

Illinois Approves Sharp Income Tax Increase, Fourth-Highest Corporate Tax Rate

By
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Plan Will Raise Individual Income and Corporate Income Taxes

Early on January 12, 2011, the Illinois Legislature narrowly passed a bill that significantly raises individual income and corporate income taxes.¹ Under the plan, Illinois's one-rate individual income tax will rise from 3% to 5%, a 67 percent increase. The corporate income tax will rise from 7.3%² to 9.5%, a 30 percent increase, becoming the fourth-highest state corporate income tax in the United States, and the fourth-highest combined national-local corporate income tax in the industrialized world.³ Two additional provisions include a reinstatement of the estate tax at the 2001 level and a temporary suspension of the net operating losses (NOLs) associated with the corporate tax.

The tax increases are projected to raise approximately \$6.5 billion per year, and be coupled with additional borrowing. Illinois has accumulated billions of dollars in unpaid bills and officials have made little progress compared to other states in producing a structurally balanced budget.⁴

The income tax increase will be retroactive to January 1, 2011. After four years, the individual income tax will decrease to 3.75%. Then in 2025, the individual income tax rate will drop to 3.5%. The corporate tax will follow a similar schedule of rate decreases: in four years the rate will be 7.75% and then in 2025 it will go back to the current rate of 7.3%.

Plan Drops Illinois's Rank on the State Business Tax Climate Index

Our [2011 State Business Tax Climate Index](#) ranked Illinois 23rd in the country, middle-of-the-pack compared with its immediate neighbors.⁵ Illinois's low, one-rate individual income tax offers the advantages of simplicity,

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¹ See Ray Long, "Quinn on tax hike: 'Our fiscal house was burning'" *Chicago Tribune* (Jan. 12, 2011)

http://newsblogs.chicagotribune.com/clout_st/2011/01/quinn-on-tax-hike-our-fiscal-house-was-burning.html

² Some news reports have indicated that Illinois's corporate income tax is currently 4.8%. This does not include a 2.5% property replacement tax imposed on corporate income. Reference sources that cite Illinois's corporate income tax, including the Tax Foundation and the Illinois Department of Revenue, report it as 7.3%, including this tax.

³ See, e.g., Tax Foundation, "Comparing U.S. State Corporate Taxes to the OECD, 2009,"

<http://www.taxfoundation.org/taxdata/show/23034.html>. Illinois's new top rate would be exceeded only by Pennsylvania (9.99%), Minnesota (9.8%), and Iowa. Iowa has a 12% top rate but its effective rate is lower after accounting for federal deductibility.

⁴ See Joseph Henchman, "60 Minutes on State Budget Woes," *Tax Foundation Tax Policy Blog* (Dec. 21, 2010),

<http://www.taxfoundation.org/blog/show/26917.html>; Joseph Henchman, "Illinois Governor Quinn Proposes Income Tax Increase, Borrowing, Not Paying Bills," *Tax Foundation Tax Policy Blog* (Mar. 10, 2010), <http://www.taxfoundation.org/blog/show/25963.html>.

⁵ Kail Padgitt, "2011 State Business Tax Climate Index," *Tax Foundation* (Oct. 2010),

<http://www.taxfoundation.org/news/show/22658.html>.

stability, and a competitive rate relative to other states, outweighing more negative elements of the state’s tax system. (See Table 1.)

Table 1: Illinois and Neighbors’ *State Business Tax Climate Index* Ranks

State	2011 <i>Index</i> Overall Rank	2011 Individual Income Tax Sub- Index Rank	2011 Corporate Income Tax Sub- Index Rank
Illinois	23rd	9th	27th
Indiana	10th	11th	21st
Iowa	45th	42nd	47th
Kentucky	19th	32nd	42nd
Minnesota	43rd	38th	44th
Missouri	16th	25th	5th
Wisconsin	40th	43rd	29th

Source: Tax Foundation *2011 State Business Tax Climate Index*.

If this legislation enacted on January 12, 2011 had been in place on July 1, 2010 (the snapshot date for the *2011 State Business Tax Climate Index*), Illinois would have ranked 36th instead of 23rd. This is a fall of thirteen places, past South Carolina, Georgia, Pennsylvania, Tennessee, Alabama, Nebraska, Oklahoma, Maine, Massachusetts, New Mexico, Arizona, and Kansas.

On the individual income tax sub-index, Illinois would have ranked 14th instead of 9th, a drop of five places. On the corporate income tax sub-index, Illinois would have ranked 45th instead of 27th, a drop of 18 places. (See Table 2.)

**Table 2: Illinois and Neighbors’ *State Business Tax Climate Index* Ranks with Changes
(If New Legislation Had Been in Effect on July 1, 2010)**

State	2011 <i>Index</i> Overall Rank	2011 Individual Income Tax Sub- Index Rank	2011 Corporate Income Tax Sub- Index Rank
Illinois	36th	14th	45th
Indiana	10th	10th	21st
Iowa	45th	42nd	47th
Kentucky	19th	32nd	41st
Minnesota	43rd	38th	43rd
Missouri	16th	25th	5th
Wisconsin	40th	43rd	28th

Conclusion

The enacted tax increases will severely impact Illinois’s attractiveness to business and individuals. The state’s individual income tax, in particular, has been one of the best features of Illinois’s tax system, helping mitigate a high sales tax and burdensome property tax. It remains to be seen whether the weak spending cap and other changes will resolve the state’s long-term structural budget gap. The tax changes, however, have great potential for undermining Illinois’s ability to attract and cultivate business activity as the economy recovers.

Note: This report was revised on January 18, 2011 to account for a correction to the method of calculating Iowa’s effective corporate income tax rate. Iowa’s statutory rate is 12%, but lower due to partial federal deductibility. After accounting for the correction, Iowa’s effective rate is higher than Illinois’s new rate, meaning that Illinois will have the fourth-highest corporate income tax, instead of third-highest as previously reported.

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