

Comments on Proposed Illinois Gross Revenue Tax

From: **RSM McGladrey**

As many of you are already aware, Illinois Governor Rod Blagojevich proposed a gross receipts tax in his March 7th Budget Address. Under the governor's plan, the gross receipt tax would replace the corporate income tax and help fund a universal health insurance plan, education, and pensions. The proposed tax rate is 0.85% on transfer of personal property including construction and 1.95% on services.

The implication of the tax can be demonstrated in the following example: Corporation A does 100% of its business in Illinois and has \$100 million in sales of tangible personal property and taxable income of \$5 million. Under the proposed gross receipts tax Corporation A would have a \$500,000 Illinois tax liability compared to \$240,000 corporate income tax liability under the current structure.

The gross receipts tax would become effective January 1, 2008 and eventually replace the corporate income tax. Companies will receive a credit for any corporate income taxes paid during tax/calendar year 2008. However, the future of research and development, EDGE, and other credits is uncertain. These credits may not be available after 2007. Legislation for this major tax change is currently being drafted and should be available for public distribution in the near future.

Effects of the Gross Receipts Tax:

According to the governor's estimate, the proposed gross receipts tax would raise an additional \$3 billion to \$6 billion a year for Illinois. This would potentially triple the taxes currently paid under the corporate income tax. For many industries, including manufacturers and retailers that operate on low profit margins and high volume, the consequences of a gross receipts tax could be significant. One potentially undesirable effect of a gross receipts tax is the pyramid of taxes applied on the cost of goods at each stage of production. Such broad and multiple taxation will result in a higher cost of goods and services for consumers and businesses. Additionally, partnerships, S corporations and other "pass-through entities" that currently pay no Illinois income tax will also notice a difference.

The gross receipts tax would apply to all businesses with the following exemptions:

- Businesses with sales less than \$1 million
- Export sales
- Sales of food for other than immediate consumption
- Drugs
- Sales of services to Medicaid patients
- Gaming and insurance receipts
- Transactions between related companies
- Non-profit organizations

Additionally, only gains on sales of securities and traded commodities will be subject to the tax.

We encourage businesses to voice their opinions of Illinois' proposed gross receipts tax and potential payroll tax to state lawmakers.

The following is excerpted from 3 emails from Doug Whitley, President Illinois Chamber of Commerce

The gross receipts tax concept captured attention because, despite disfavor among tax policy experts, four states — New Jersey (2002), Kentucky (2005), Ohio (2005), and Texas (2006) — recently adopted gross receipts tax laws.

Contrary to Governor Blagojevich's objective to increase the tax burden of employers, three of the four states chose to pursue a gross receipts tax as part of an overall strategy to reduce business taxes. While there was support for a gross receipts tax among some quarters of the business community in these states, it was because they expected to enjoy tax savings.

New Jersey adopted the gross receipts tax to generate more revenue from businesses. This took the form of an alternative minimum assessment so that even businesses experiencing losses would be required to pay. Democratic Governor Jon Corzine allowed the tax to expire in 2006 because, according to the state treasurer, the gross receipts tax was not "consistent with the Governor's desire to stimulate economic growth."

New Jersey is the only one of the four states with enough experience to evaluate its impact on the economy. A study by Rutgers University on the New Jersey economy found "in the 2000-2005 period, the state lost 117,600 high-paying advanced services and manufacturing jobs." While not directly or exclusively attributable to the New Jersey gross receipts tax, the parallel is conspicuous.

Kentucky's decision to impose a gross receipts tax in 2005 was part of a tax restructuring that included reduction of the corporate income tax from 8 1/4% to 6%, repeal of the corporate license tax, reduction of the personal income tax rate and raising the individual exemption to exclude thousands of low income taxpayers from liability. It was presented as a revenue neutral program. A \$1 million dollar GRT exemption was established in 2006. During a subsequent special session called by Republican Governor Ernie Fletcher the exemption increased to \$3 million and a graduated rate was created for business with gross receipts between \$3 and

\$6 million. The Kentucky Association of Manufacturers opposed the tax and is committed to its repeal.

Ohio's change eliminated the corporate income tax, personal property tax on business equipment (a tax Illinois repealed in 1980) and reduced the individual income tax rate 21% from 7.5% to 5.9%. The only partially phased in gross receipts tax rate of 0.1% has already exceeded projected revenue by more than \$500 million. After one year's experience, there are already suggestions the Ohio rate should be reduced because it is bringing in so much more revenue than was anticipated.

The rate proposed by Governor Blagojevich is 500% higher for manufacturers and 1800% higher for services than the current rate in Ohio. When the Ohio rate of .26 is fully-implemented in spring 2009, after elimination of the corporate income and personal property taxes, the proposed Illinois rates will still be double for manufacturers and more than seven times higher for services. The Ohio experience offers reason to believe Governor Blagojevich has greatly understated likely revenue projections that would generate from his tax rates.

Texas has not yet implemented their new alternative margins tax. Unlike Governor Blagojevich's approach Texas' version of a gross receipts tax incorporates significant cost of doing business deductions. Texas also chose lower tax rates. Texas repealed the corporate franchise tax that was the major business tax in the state and reduced the real estate tax for schools by 1/3 thus saving taxes for individuals and business alike. The new law does not become effective until 2008. Governor Perry, a Republican who supported the new tax, called for cutting the rate in half within months of putting his signature on the bill.

Washington is the only state with a long history of relying on a gross receipts tax as a major revenue source. Like Texas, the Washington state constitution prohibits a personal or corporate income tax. The business and occupations tax (as it is called) has been subject to constant amendment since introduced in 1933. There are 34 separate classifications funneling businesses into one of six different tax rates.

Indiana abolished their gross receipts tax in 2002, seventy years after it's 1933 introduction as a temporary measure to help finance government during the Depression. There were previous efforts to phase out the tax during the 1970s and 1980s, but during economic downturns, tax reform plans were superseded by the state's revenue needs.

The long despised tax was finally eliminated as part of a much larger tax restructuring plan. Democratic Former Governor Joe Kernan pushed for repeal to make Indiana a more business friendly state. Indiana Chamber President Kevin Brinegar called the gross receipts tax particularly onerous:

"In Indiana we fought long and hard to repeal the corporate gross income (receipts) tax. A corporate gross income tax is bad tax policy because it makes businesses pay even in years in which they are not profitable. Gross income taxes are a huge "red flag" to site selection consultants who will steer clients away from states that impose these taxes. It is a major reason why we fought so hard to repeal the tax in Indiana.

Eliminating Indiana's corporate gross income tax (as well as the inventory tax) in 2002 has dramatically improved Indiana's national business tax climate ranking to 11th best according to the Tax Foundation. Reducing business taxes has directly contributed to significant new business investments in our state, including the Honda plant in Greensburg, the \$3 billion expansion and renovation of the BP refinery in Whiting and major investments by the steel companies in northwest Indiana."

Recent tax burden studies compiled by Ernst & Young revealed employers pay 49.8% of all state and local taxes in Illinois, a higher percentage than employers in other regional states and far above the national average of 44.9%.

In 2006, Illinois employers paid \$29.1 billion in state and local taxes. Illinois corporations paid \$2.4 billion in corporate income taxes last year. This includes the personal property replacement income tax (PPRT) paid by corporations, but distributed to local governments. Whether counted as state or local revenue, corporations paid it.

Thanks to the nation's economic recovery from the last recession, corporate income tax payments increased in Illinois by 45% since 2002, a growth rate that exceeds the 17.6% growth from individual income tax payers during the same period. Yet Governor Blagojevich is not satisfied with one of the ten most productive and efficient corporate income tax laws in the country.

The cost of doing business in Illinois continues to rise as a direct result of policies implemented since Governor Blagojevich assumed office. Taxes and fees paid exclusively by business were introduced and raised in 2003, boosting state receipts by \$319 million annually. Since 2003 a new worker's compensation tax has cost Illinois employers over \$100 million. Workers' compensation benefit increases established in 2005 have cost employers approximately \$75 million. Unemployment insurance tax increases imposed in 2003 have drawn \$700 million from Illinois employers. Total estimated Workers' Comp cost increases in 2006 approach \$150 million. The state's minimum wage increased twice in the last five years and will continue to increase for the next three.

The Governor's latest demand of Illinois business is \$6 billion in revenue from a new gross receipts tax on practically every transaction. He also seeks a new 3% payroll tax to generate over \$1.1 billion, which can be characterized as a no-interest loan to the state from employers who may receive the benefit of a future credit or refund.

The Governor's claim that small businesses under \$1 million in gross receipts will be exempt is misleading. A small company may be exempt from collecting and remitting the tax, but it will pay higher prices to suppliers and service providers who are not exempt and must hike prices to compensate. Exempt or not, the small business will continue to pay income and CPPRT tax.

ACTION MEMORANDUM

SUGGESTED ACTION AGENDA TO HALT GOVERNOR BLAGOJEVICH'S PLANS FOR HUGE SPENDING AND TAX INCREASES, IN PARTICULAR A NEW GROSS RECEIPTS TAX AND A NEW PAYROLL TAX.

Although Governor Blagojevich has proposed the largest increase in taxes and spending in the history of Illinois, focus your attention and opposition on the members of the General Assembly. The Governor has proposed actions that are undoubtedly detrimental to employers and the state's economy, but only the members of the General Assembly can vote to impose new taxes and hike state spending. The members of the legislature must be convinced these proposals are not in their best interest or in the best interest of the people of Illinois.

Be reminded the Governor's tax scheme is not limited to the Gross Receipts Tax. The Governor also seeks a 3% payroll tax on all employers with ten or more employees. The payroll tax will be required whether or not the company currently provides healthcare benefits. The new tax is anticipated to contain a refund or credit mechanism, but to qualify for a full refund of the payroll tax the company's healthcare benefit plan must be equivalent to at least 4% of payroll.

A. Use your influence and contacts to help build statewide opposition to the Governor's gross receipts tax proposal among all the state's employers.

1. Encourage your local chamber of commerce as well as other professional, industry and trade associations that you or your company finances to adopt a resolution or policy statement objecting to the imposition of a gross receipts tax in Illinois. The Illinois Chamber Board of Directors adopted a policy statement in opposition to the gross receipts tax at its December 2006 meeting. A copy of the policy statement is available on our web site. You may find it a useful reference to share with others. The Illinois Chamber has already made this request via email to every local chamber in Illinois.
2. If adopted, make sure the local chamber, pro-

fessional or trade association sends a copy of their policy statement or resolution to the senator(s) and representative(s) elected to represent your community or region. If a resolution or policy statement is adopted by statewide association action ask the association to communicate its action to ALL members of the Illinois General Assembly on the association's letterhead.

3. If adopted, make sure the local chamber, professional or trade association sends a notice to EVERY member of the organization and encourages EVERY member of the organization to communicate their opposition and disapproval of the Governor's gross receipts tax plan to their elected members of the General Assembly.

B. Take action now.

1. Communicate with your legislators about your individual experience, perspective or opposition to imposing a gross receipts tax on all business transactions in Illinois. Do this by phone, personal visit, letter, email or whatever method might be most appropriate and available to you. If your business has multiple locations it is appropriate to communicate with every legislator who has one of your facilities in his or her district.
2. In addition to official communications on your business letterhead it is also appropriate to write personal letters and to encourage all managers and employees of your company to do like wise. Keep in mind that if you work and live in two or more different communities it is appropriate to reach out to legislators who represent your residence and your business locations.
3. The Illinois Chamber web site has an easy way for you and your employees to communicate your opinions and concerns to legislators about the gross receipts tax and the proposed new employee withholding tax. Direct your employees and others to the "Grassroots Action Center" <<http://www.votervoice.net/Core.aspx?AID=197>> and encourage them to use it. Contact Todd Maisch at 217-522-5512 for further assistance.
4. Make an effort to consider and calculate

what the imposition of a gross receipts tax policy in Illinois may mean to your business, industry, community and the Illinois economy. Invite legislators to visit your facility or facilities to learn first-hand what a gross receipts tax may mean to your company, your business, your employees and the community. Legislators will benefit from multiple personal encounters and gaining knowledge about the adverse impact the gross receipts tax may have upon their constituents.

If not by yourself, then consider convening a legislative briefing with your state senator(s) and representative(s) that includes other local business owners. Invite other business leaders to join with you in telling their situations, experiences and concerns.

5. The Illinois Chamber would like to collect real life examples of how individual business owners and companies think the imposition of the Governor's gross receipts tax plans will affect them or their industries. We would welcome such information by email or postal delivery. We want to build a portfolio of examples to help convince legislators that Illinois employers in their districts are informed and resolute that the GRT is a bad idea. If you provide examples be sure to tell us which community or legislative district(s) your company is located in so we may align the business with the appropriate elected officials to help us with lobbying.
6. Don't forget the objective of your contacts with legislators should be to inform them how detrimental this tax scheme may be to your business, your industry and the state's economic future and to secure a commitment to oppose the GRT. Ask legislators for a commitment to vote against the taxes the governor is seeking. If you are successful in obtaining a legislator's commitment that he or she will not vote to implement a gross receipts tax in Illinois contact Todd Maisch 217-522-5512 or tmaisch@ilchamber.org

C. Implement a media strategy.

1. If you or your company have opinions and experiences you are willing to share with local media outlets, especially with newspaper

publishers and station owners/managers, a personal story with a local angle is likely to be well received. If you know the local newspaper publisher or editor ask for an opportunity to visit with the editorial board to talk about what a new GRT in Illinois may mean to your company and the future of business in Illinois.

2. Join with other business owners, managers and community leaders to convene press conferences to let local business owners tell their stories about how the GRT threatens their business. Chambers and allied groups in Champaign, Quad Cities, Rockford, and Quincy have already done this with positive results. Illinois Chamber staff can assist with messaging, technical details and planning advice. Contact Todd Maisch at 217-522-5512 or tmaisch@ilchamber.org.
3. Invite reporters to your business and engage in personal tours or interviews to explain the cost of doing business issues you face every day and how huge new tax increases by the Illinois General Assembly would affect your operations or plans for expansion.
4. Set the record straight and confront detractors who continue to suggest employers don't pay their fair share of taxes or that there are no economic consequences to political ambitions that increase the cost of doing business in Illinois. You are encouraged to write letters to the editors of local print media publications and seek opportunities to participate in call-in radio programs. Help educate the members of the General Assembly and inform the public about what it means to operate a successful business and compete in a dynamic global marketplace. It is especially important that you respond to the challenge when you recognize misleading statements or falsehoods are being presented.

D. Help finance the campaign against higher business taxes in Illinois.

1. If you are prepared to contribute funds to help our opposition campaign to the gross receipts tax, the Illinois Chamber is leading the charge and would welcome financial support. Checks should be sent to the Illinois

Chamber, 215 East Adams, Springfield, Illinois, 62701. Including a cover note or check memo indicating a contribution is for GRT expenses will help the accounting office. Contributions to the Illinois Chamber Political Action Committee (Chamber PAC) may be submitted online by credit card.

2. The Illinois Coalition for Jobs, Growth and Prosperity is developing and funding a media outreach campaign. The Illinois Chamber is a founding member and active participant in this Coalition and would welcome financial help for the opposition media campaign. Checks for helping to finance a statewide media campaign in opposition to the gross receipts tax should be made payable to the Illinois Coalition for Jobs, Growth and Prosperity and may be sent to the Illinois Chamber at 215 East Adams, Springfield, Illinois 62701.

This tax, once implemented, will cost employers and business owners billions every year, so sending money to the Illinois Chamber to fight this irrational tax scheme should be recognized as a worthwhile short-term investment that may save a fortune in future tax liability.

E. Learn more.

The Illinois Chamber will launch a special web site dedicated to the Gross Receipts Tax campaign where you can stay informed on details of the legislative proposal, as well as, related activities and information. The web site will be launched March 14. The address is: www.largesttaxincreaseever.com