

SNG-Nowlan-End corporate tax-12-24-12

Eliminate state corporate income tax

By Jim Nowlan

In a fit of petulance, Illinois Senate president John Cullerton has proposed that corporations reveal to the public—and competitors—how much state tax they pay. Better simply to eliminate the ineffective tax altogether and make a dramatic statement to the world that Illinois is open for business.

The revenue lost can be made up without increasing tax rates, though there would be some pain. Yet the long-term economic development benefits would be a plus for the whole state.

With the income tax increases of a couple of years ago, Illinois' corporate tax rate hit 9.5 percent, the fourth highest in the nation. This further battered a state business climate that even before the hike ranked us among the worst in the nation. We may now be 51st out of 50 states for business attractiveness!

The corporate tax is projected to bring in \$2.5 billion this year, or about 4 percent of total revenues. Only about one-third of corporations in Illinois even pay the tax. Most of these are quite small, with less than a million dollars in revenue. Many simply pay their owners bonuses equal to their profit, or they are legally organized so that all the profits flow through to the owners as regular income.

The corporate income tax is ultimately paid by individuals anyway, as corporations are generally able to price the tax into their products and services. And the tax will probably decrease over time, as more corporations re-organize to avoid the tax.

Nevertheless, the high corporate income tax is a red flag to outside businesses that might be interested otherwise in locating to Illinois. Claudio Agostino and a colleague at the University of Michigan concluded a study of foreign direct investment by declaring that, “for foreign investors, the corporate tax rate is the most relevant tax in their investment decisions.”

Illinois has great strengths. Our location in the center of the nation puts us within a day’s reach of most of the country’s population. And our transportation infrastructure is second to none. We have 2,300 miles of Interstate highways, more than any states but Texas and California. Our railroad hub in Chicagoland is the busiest in the nation. And we have 1,000 miles of navigable waterways.

We also have a labor force that doesn’t take off the first day of hunting season, and Illinois ranks high among the states in the percentage of our population with college degrees.

Yet business is put off by perceptions of our high taxes.

Illinois has been suffering an economic and psychological malaise for years now. Our rate of economic growth this past decade ranked us 48th in the nation, ahead of only Michigan and Ohio. And our residents are bummed out by the worldwide perception of our state as a nest of corruption, which is a column for another day.

The \$2.5 billion in revenue lost by eliminating the corporate tax can be replaced by reducing or eliminating a mix of tax exemptions. Retirement income is totally exempt in Illinois, different from most states. We could tax retirement income of those with more than \$75,000 in income and net half a billion dollars.

Non-profit organizations, which are dependent upon the economic well-being of the state, are exempt from the sales tax. Eliminating the exemption would generate nearly half a billion. Food, drugs and medical appliances were originally exempted from the state sales tax out of

concern for poor people, who spend more of their income on food than do those better off. Yet many of the poor use food stamps, which are not taxable anyway. Eliminating this exemption would generate about \$1.5 billion. There other exemptions that could be considered in place of these.

If the corporate tax were eliminated, it should be phased out over, say, five years, so that the corporations paying the tax would not receive a big windfall all at once.

I honestly don't think Illinois policymakers would have the political will to eliminate this tax, though some states such as Texas, which is booming with new business, operate without any corporate income tax.

This is an illustration of something big Illinois could do to improve its business climate. Illinois needs to do something(s) big. Otherwise, our relative decline among the states will continue.