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Ten Revenue Options for School Construction And Other Urgent State Priorities

Current state revenue projections show that without substantial new revenue sources, there will **not** be sufficient funds next fiscal year to support a capital development program, sustain the current level of health and human services, and meet the FY2007 pension obligation, let alone help cover the many unmet needs of children, families, and communities. By FY2008, when the payment due to the pension funds will require an additional \$600 million, the budget will be stretched to the breaking point. At the same time, additional funds are urgently needed to fully fund the state school aid formula.

Also receiving increasing attention this legislative session is the need for state funding for school construction and repairs. Between FY1997 and FY2004, about \$3.1 billion in state-funded grants helped to build new schools and renovated buildings throughout the state, but no grants have been issued since 2003. According to a survey by the Illinois State Board of Education and the Capital Development Board, today the cost of needed repairs and additional schools totals \$6.7 billion. We urge serious consideration of the following 10 options for new state revenues to support capital development bonds for school construction and repairs and to ease current budget pressures.

1 State fees for new construction

New housing construction attracts families and adds students to local schools, creating a need for more classrooms. Over the past 12 months almost 50,000 single family housing construction permits were issued in Illinois. A state-assessed fee of \$1,000 per new unit could provide over \$50 million each year. The potentially harmful impact of this fee on the supply of affordable housing could be lessened by structuring the fee as a percentage of the home's value. Assessing state impact fees for commercial development and housing rehabilitation could be an additional source of revenue. State construction fees would provide an ongoing, common-sense source of funding for state bonds and Capital Development Board grants.

2 State entertainment sales tax

If the state sales tax rate of 5% were applied to arts, entertainment and recreation, the state could raise an additional \$100 million each year.

3 Means-test the education expense credit

There currently is no income limit on this credit, which is used to offset expenses for K-12 education. As a result, relatively affluent taxpayers receive most of the benefits from this tax break. Taxpayers with incomes of \$60,000 or more account for 65 percent of the tax relief. Allowing the expense only for taxpayers with incomes below \$60,000 would recoup an estimated \$40 million for the state.

4 Means-test or cap the property tax credit

Currently, state taxpayers may claim a tax credit of 5% of their property taxes. This credit cost Illinois more than \$380 million in FY2004. Creating a means-test would preserve the benefit for low- and middle-income families, while reducing the benefits to wealthy homeowners. Alternatively, capping the credit at \$300 would accomplish the same goal.

5 Cap the retailer's discount

This tax break was enacted in 1959 to off-set retailers' expenses for computing and collecting the state sales tax. Today, the burden is largely eliminated by computerized collection and accounting systems. The retailer's discount cost the state more than \$113 million in FY2004. Capping the discount at the first \$1 million of sales taxes collected could provide appropriate protection for small businesses.

6 Reduce the amount of the retailer's discount

The retailer's discount currently is set at 1.75% of their sales tax collections. Reducing the amount retailers receive for administrative costs to 1% of their collections would save the state an estimated \$50 million.

7 Phase out the income tax exemption for retirement income over \$75,000

Illinois is one of only three states that exempt all retirement income from taxation regardless of the wealth of the taxpayer. The exemption applies to income from a CEO's 401(k) as well as a state retiree's pension. Currently this exemption costs the state \$763 million annually. Taxing some retirement income for high-income retirees could generate hundred of millions of dollars of revenue annually.

8 Collect sales and use taxes from remote vendors (long-term alternative)

Last year, Illinois lost an estimated \$180 million in use taxes on internet purchases, and stands to lose more in the future as e-commerce increases. Illinois law requires that consumers report purchases from out-of-state vendors on their state tax returns and pay a use tax, but few taxpayers actually do so. The U.S. Supreme Court's 1992 *Quill* decision prevents the state from requiring remote merchants to collect use taxes, but also indicates that Congress is free to change that rule. The Streamlined Sales Tax Project is a national effort to encourage Congress to authorize states to require collection of taxes from out of state purchasers. It currently has 13 member states and six associate member states, but Illinois is not yet a member. We should join this important effort. In the meantime, voluntary use tax collection from retailers without a physical presence in Illinois can be encouraged through an amnesty program for accounting errors.

9 Expand the sales tax base to more services purchased by households

Services are the largest and fastest growing sector of the Illinois economy, yet the state exempts most services from sales tax. Illinois taxes fewer services than all but six other states. Taxing services purchased by households could generate an estimated \$1.8 billion in new revenue.

10 Increase the personal income tax rate

Illinois' maximum personal income tax rate is the lowest in the country, of the 41 states that impose an income tax. Moreover, state income taxes can be deducted from federal income tax obligations, lowering the effective rate of any increase. The increased burden on low- and moderate-income families resulting from an income tax increase can be offset by expanding the Illinois Earned Income Tax Credit to 20 percent of the federal credit. Increasing the personal income tax rate from the current 3% to 4% would generate \$2.7 billion, and increasing it to 5% would generate \$5.4 billion in new revenue. In addition, the corporate income tax rate could be increased, although Illinois' existing corporate tax rates are already high when compared with those of other states.

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