Personal Property Replacement Tax: Background on Existing Conditions

GO TO 2040's section "Reform State and Local Tax Policy" recommends that existing state and local revenue sharing arrangements should be evaluated and potentially adjusted, to support economic efficiency and fairness. Recommendations in this area should help move metropolitan Chicago toward a "21st century system" of taxation that reflects the modern economy, raises revenue sufficient for public services, and avoids creating undue burdens on taxpayers. Given this direction, one tax that should be analyzed in more depth is the Personal Property Replacement Tax, or "PPRT".

The PPRT primarily operates as an additional corporate income tax on businesses that is collected by the State and then fully disbursed to local governments. The local disbursements are based on the local entity's share of personal property tax revenues from 35 years ago, and thus have not changed in accordance with any shifts in demographics or economic activity. GO TO 2040 provides the following implementation action area, to be executed by the Regional Tax Policy Task Force:

Evaluate state and local revenue sharing criteria with particular emphasis on the sales tax Lead Implementers: Task Force, CMAP Board, State, counties, municipalities	More than $4 billion in state tax revenue, much of which is made up of sales tax, is disbursed annually to local governments in northeastern Illinois. Evaluate state/local revenue sharing criteria including the sales tax, income tax, **personal property replacement tax**, and MFT. The task force should analyze the fiscal, economic, and equity impacts of altering disbursement criteria and make appropriate recommendations to the state and/or propose regional or subregional actions. The sales tax disbursement, which is based on local retail sales, should receive particular emphasis. Prepare detailed recommendation.

The purpose of this interim report is to illustrate some of the existing conditions and policy implications regarding the PPRT and its allocation to local governments. At this time, CMAP is not providing a prototypical example of how the PPRT might be adjusted or changed, and requests specific direction from the task force in this regard.

Background

The Personal Property Replacement Tax was enacted in 1979 in response to a provision in the Illinois Constitution of 1970 that required the General Assembly to abolish ad valorem (value based) personal property taxes and replace all revenue lost by local governments. That Constitution stated that:

> *Article IX, Section 5. Personal Property Taxation*
>
> *(a) The General Assembly by law may classify personal property for purposes of taxation by valuation, abolish such taxes on any or all classes and authorize the levy of taxes in lieu of the taxation of personal property by valuation.*
>
> *(b) Any ad valorem personal property tax abolished on or before the effective date of this Constitution shall not be reinstated.*
>
> *(c) On or before January 1, 1979, the General Assembly by law shall abolish all ad valorem personal property taxes and concurrently therewith and thereafter shall replace*

all revenue lost by units of local government and school districts as a result of the abolition of ad valorem personal property taxes subsequent to January 2, 1971. Such revenue shall be replaced by imposing statewide taxes, other than ad valorem taxes on real estate, solely on those classes relieved of the burden of paying ad valorem personal property taxes because of the abolition of such taxes subsequent to January 2, 1971. If any taxes imposed for such replacement purposes are taxes on or measured by income, such replacement taxes shall not be considered for purposes of the limitations of one tax and the ratio of 8 to 5 set forth in Section 3(a) of this Article.

Pursuant to this constitutional provision, the statute replaced personal property taxes on businesses with an income tax on businesses and an invested capital tax on public utilities. The PPRT has since been amended and is currently imposed as follows:

Personal Property Replacement Tax Rates

Taxpayer	Tax Imposed
Corporations	2.5% of taxable income
Partnerships, trusts, and S corporations	1.5% of taxable income
Public utilities (gas, electric, water)	0.8% of invested capital
Electricity distributors	Based on amount of kilowatt-hours distributed. The rate increases as the amount distributed per month increases.
Telecommunications services	0.5% of all gross charges charged by the telecommunications retailer

Source: 35 ILCS 5/201(d), 35 ILCS 615/2a.1, 35 ILCS 620/2a.1(b), 35 ILCS 625/3, 35 ILCS 620/2a.1(a), 35 ILCS 635/15. See Appendix A for an overview of how these types of businesses are defined.

Implications of the PPRT on Taxpayers

Partnerships and S corporations pay a PPRT rate, but income tax is paid by the partners or shareholders of the partnership or S corporation. Trusts pay a 5 percent individual income tax rate in addition to the PPRT rate, for a total rate of 6.5 percent. In addition to the PPRT rate on taxable income, corporations currently pay a 7 percent corporate income tax rate.[1] The total rate for corporations of 9.5 percent is one of the highest flat corporate income tax rates in the country. After the corporate income tax rate drops in 2015 to 5.25 percent, the combined rate will be 7.75 percent. The following table compares the income and PPRT tax rates paid by corporations in Illinois with the rates corporations pay in other states with flat rates.

[1] Until January 1, 2011, the corporate income tax rate was 4.8 percent. On January 1, 2015, it will drop to 5.25 percent.

Corporate Income Tax Rates in States with Flat Rates

	State	Flat Rate
1	Pennsylvania	9.9%
2	Minnesota	9.8%
3	**Illinois**	**9.5%**
4	Rhode Island	9.0%
5	Delaware	8.7%
6	Indiana	8.5%
7	New Hampshire	8.5%
8	West Virginia	8.5%
9	California	8.4%
10	Maryland	8.25%
11	Wisconsin	7.9%
12	Oregon	7.6%
13	Idaho	7.6%
14	Connecticut[1]	7.5%
15	Kansas[2]	7.0%
16	Arizona	6.968%
17	North Carolina	6.9%
18	Montana	6.75%
19	Alabama	6.5%
20	Tennessee	6.5%
21	Missouri	6.25%
22	Georgia	6.0%
23	Oklahoma	6.0%
24	Virginia	6.0%
25	Michigan[3]	6.0%
26	Florida	5.5%
27	South Carolina	5.0%
28	Utah	5.0%
29	Colorado	4.63%

[1]Plus a 10% surcharge from 2009 through 2011 on companies with at least $100 million in gross revenue.
[2]Plus a surtax of 3.35% of taxable income over $50,000.
[3]Beginning on January 1, 2012
Source: "Top State Corporate Income Tax Rates, as of January 1st, 2011", The Tax Foundation; Michigan Public Act 38 of 2011; "Illinois Tax Handbook for Legislators 26th Edition", Legislative Research Unit, March 2010.

Disbursement

All taxing districts that collected personal property taxes in 1977, or in 1976 for taxing districts in Cook County, receive PPRT disbursements from the State. Total collections are divided into two portions. One portion (51.65%) goes to taxing districts in Cook County. This portion is distributed to taxing districts in Cook County on the basis of each district's share of total personal property tax collections in Cook County for the 1976 tax year. The other portion (48.35%) is disbursed to taxing districts in the remaining counties based on each district's share of total personal property tax collections in the rest of the State for the 1977 tax year.

The City of Chicago receives 17.9 percent of the PPRT revenues in the region, while suburban municipalities receive 5.5 percent. Park districts receive 6.9 percent, with about three-quarters of the park district funds in the region going to the Chicago Park District. Of the 5 percent of revenues that go to sanitary and water districts, about 90 percent go to the Metropolitan Water Reclamation District. 1,243 taxing districts receive PPRT revenues in the region, while approximately 70 districts, including 21 municipalities, do not receive revenue. Districts that do not receive revenue either were created after 1977 or did not collect personal property taxes. The following chart provides a summary of PPRT allocations in northeastern Illinois by type of district.

Personal Property Replacement Tax Allocations to Taxing Districts in Northeastern Illinois

Type of Taxing District	Percent of PPRT Revenues to the Region	Number of Districts Receiving Revenues in the Region
Elementary, High, and Unit School Districts	49.5%	298
City of Chicago	17.9%	1
Counties	7.6%	7
Park Districts	6.9%	163
Suburban Municipalities	5.5%	262
Sanitary and Water Districts	5.0%	38
Community College Districts	3.2%	14
Townships and Road and Bridge Districts	2.0%	236
Conservation, Forest Preserve, and Street Lighting Districts	1.3%	14
Library and Fire Districts	1.0%	210
Total	**100.0%**	**1,243**

Source: Illinois Department of Revenue

Since the replacement tax was enacted in 1979, local governments have received the same proportion of the total revenue generated every year. However, the demographics and economy of northeastern Illinois have changed fairly extensively during that time. The following chart provides PPRT allocations by the primary county of the taxing district. For comparison, personal property tax collections from 1977 and county populations for 1970 and 2010 are also included.

PPRT Allocations and Personal Property Tax Collections Compared with Population

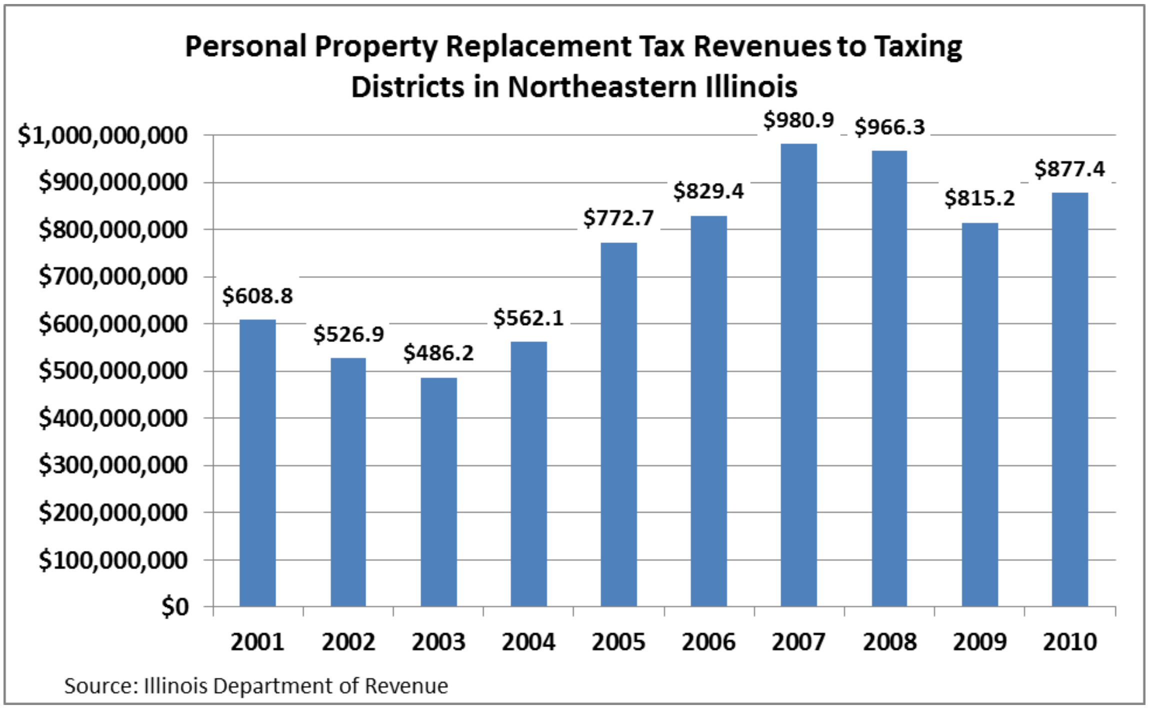
Taxing District County	Percent of Total PPRT Disbursed Statewide to Taxing Districts within County	1977 Personal Property Tax Collections for Taxing Districts within County as a Percent of State Total	1970 County Population as a Percent of State Population	2010 County Population as a Percent of State Population
Cook	51.7%	48.6%	49.4%	40.5%
DuPage	3.4%	3.7%	4.4%	7.1%
Kane	1.7%	1.9%	2.3%	4.0%
Kendall	0.4%	0.4%	0.2%	0.9%
Lake	3.0%	3.2%	3.4%	5.5%
McHenry	0.8%	0.9%	1.0%	2.4%
Will	3.4%	3.6%	2.2%	5.3%
Total	64.4%	62.3%	63.0%	65.7%

Source: Illinois Department of Revenue; U.S. Census Bureau

When examined by county, PPRT allocations to taxing districts are somewhat close to actual personal property tax collections in 1977. However, because Cook County taxing districts receive a set 51.65 percent of PPRT allocations, their allocation does not correspond as well to collections, which accounted for 48.6 percent of the total in 1977 and 48.0 percent in 1976. PPRT allocations were also close to each county's population relative to the state population. However, as the collar counties grew relative to Cook County, Cook County still receives 51.65 percent of PPRT revenues while its population accounts for 40.5 percent of the state population. At the same time, collar counties receive 12.7 percent of the PPRT revenue. This allocation is close to their proportion of the population in 1970 of 13.6 percent. However, in 2010, the collar counties' population accounted for 25.2 percent of the state population.

Revenues

In 2010, taxing districts in northeastern Illinois received $877.4 million in PPRT disbursements. Statewide, taxing districts received $1.4 billion. Statewide revenues were 8.2 percent less than personal property tax collections in 1977 (after adjusting for inflation), which totaled $256.9 million for the 7-county region and $412.1 million statewide. Since 2007 PPRT revenues were actually higher than inflation-adjusted personal property tax collections in 1977, the 2010 drop may be due to the economy. Since the primary revenue source for the PPRT is the income tax on corporations, partnerships, trusts, and S corporations, revenues typically follow economic cycles. Aside from experiencing drops in revenue in 2002 and 2003 and then in 2008 and 2009, PPRT revenue has generally increased between 2001 and 2010. The following chart shows PPRT revenues to the CMAP region for the past ten years.



Even with hundreds of millions of dollars going to local governments in the region from the PPRT, the funds do not make up a large portion of most local governments' budgets. The following chart provides an overview of how much PPRT contributes to local government budgets in the region.

Proportion of Revenue from Personal Property Replacement Tax Revenues

Type of Taxing District	Average PPRT as a % of Total Revenue	Number of Districts with PPRT more than 5% of Total Revenue	Number of Districts with Budget Data Available	Total Number of Districts in the Region Receiving PPRT Revenue
Elementary, High, and Unit School Districts	2.3%	22	297	298
City of Chicago	2.8%	0	1	1
Counties	1.1%	0	7	7
Park Districts	2.8%	21	139	163
Suburban Municipalities	0.7%	2	255	262
Sanitary and Water Districts	6.2%	5	20	38
Community College Districts	n/a	0	0	14
Townships and Road and Bridge Districts	5.0%	42	117	236
Conservation, Forest Preserve, and Street Lighting Districts	3.8%	2	9	14
Library and Fire Districts	2.4%	17	207	210
Total	**2.3%**	**111**	**1,052**	**1,243**

Source: Illinois Office of the Comptroller
Note: Total revenues exclude enterprise, fiduciary, and internal service funds.

Sanitary and water districts have the highest average reliance on PPRT revenue, with an average of 6.2 percent of revenues coming from PPRT. Townships rely on PPRT revenue for 5.0 percent of their revenues, on average. Of the 117 townships for which budget data was available, 42 rely on PPRT for more than 5 percent of total revenues and 15 rely on PPRT for more than 10 percent of total revenues. In total, 111 taxing districts in the region rely on PPRT for more than 5 percent of their revenues, while 39 taxing districts rely on PPRT for more than 10 percent of their revenues. The following table lists taxing districts in the region that rely on PPRT for more than 10 percent of total revenues.

Taxing Districts with more than 10 Percent of Revenues from PPRT

Taxing District	PPRT	Total Revenue	PPRT as a Percent of Total Revenue
Round Lake Sanitary District	$22,396	$37,498	59.7%
West Dundee Fire Protection District	$8,486	$16,303	52.1%
Rockdale Elementary School District 84	$1,161,090	$2,506,235	46.3%
Phoenix Park District	$10,664	$24,899	42.8%
Romeoville Mosquito Abatement District	$28,333	$76,350	37.1%
Forest View Park District	$58,355	$166,010	35.2%
Jackson Township	$168,623	$493,895	34.1%
Laraway Community Consolidated School District 70-C	$1,826,954	$7,107,686	25.7%
Central Stickney Sanitary District	$11,437	$48,129	23.8%
Lockport Township	$756,546	$3,360,723	22.5%
Stickney Township	$1,551,311	$7,086,994	21.9%
Hodgkins Park District	$186,878	$1,012,661	18.5%
South Cook Mosquito Abatement District	$248,769	$1,414,799	17.6%
Village of Forest View	$552,292	$3,235,543	17.1%
Bedford Park Library District	$188,862	$1,110,358	17.0%
Bedford Park District	$283,697	$1,694,245	16.7%
Addison Creek River Conservancy District	$24,937	$150,744	16.5%
Joliet Township	$706,727	$4,414,677	16.0%
Stickney-Forest View Library District	$179,684	$1,131,940	15.9%
Central Stickney Elementary School District 110	$763,559	$4,829,822	15.8%
Dunham Township	$83,020	$551,952	15.0%
Waukegan Township	$691,831	$4,885,836	14.2%
Broadview Park District	$163,032	$1,159,294	14.1%
Little Rock Township	$132,564	$960,814	13.8%
Wilmington Township	$50,862	$393,527	12.9%
Veterans Park District	$734,955	$5,732,657	12.8%
Marengo Township	$106,923	$838,699	12.7%
Reavis High School District 220	$3,270,492	$27,043,856	12.1%
Komarek Elementary School District 94	$644,980	$5,334,414	12.1%
Ford Heights Elementary School District 169	$1,357,575	$11,925,506	11.4%
Niles Township	$228,503	$2,015,028	11.3%

Taxing District	PPRT	Total Revenue	PPRT as a Percent of Total Revenue
Berkeley Park District	$23,687	$208,943	11.3%
Manhattan Township	$78,144	$691,315	11.3%
Leyden Township	$606,776	$5,519,816	11.0%
Leyden Fire Protection District	$240,746	$2,206,209	10.9%
Naperville Township	$369,186	$3,517,657	10.5%
Chicago Park District	$42,150,000	$409,497,168	10.3%
Bloom Township	$349,751	$3,445,883	10.1%
Florence Township	$16,932	$168,920	10.0%

Source: Illinois Office of the Comptroller

Note: Total revenues exclude enterprise, fiduciary, and internal service funds.

Most districts that rely heavily on PPRT revenue are also relatively small. Fifteen of the districts have total revenues of less than $1 million, and five districts have total revenues of less than $100,000. However, a handful of school districts and larger townships also rely on PPRT for more than 10 percent of their budget. Of the 39 districts, nine are fully or partially located within the boundaries of Stickney Township. Stickney Township is located in west Cook County and includes the villages of Bedford Park (portion), Bridgeview (portion), Burbank, Forest View, and Stickney and related taxing districts.

Policy Implications

The PPRT was enacted in order to abolish and replace an unpopular personal property tax. However, the PPRT distribution structure that holds local governments harmless by maintaining 35-year-old allocations has resulted in a system that no longer has a relationship to the region and its economy. In addition, the combined income and PPRT tax rate imposed on corporations (while the 7.0 percent corporate income tax is in effect) of 9.5 percent is one of the highest rates in the country and may negatively affect the region's economic competitiveness.

Appendix A: Definitions of Business Types

Corporations

In forming a corporation, prospective shareholders exchange money, property, or both, for the corporation's capital stock. A corporation generally takes the same deductions as a sole proprietorship to figure its taxable income. A corporation can also take special deductions. For federal income tax purposes, a C corporation is recognized as a separate taxpaying entity. A corporation conducts business, realizes net income or loss, pays taxes and distributes profits to shareholders.

S Corporations

S corporations are corporations that elect to pass corporate income, losses, deductions and credit through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. S corporations are responsible for tax on certain built-in gains and passive income.

Partnerships

A partnership is the relationship existing between two or more persons who join to carry on a trade or business. Each person contributes money, property, labor or skill, and expects to share in the profits and losses of the business. A partnership must file an annual information return to report the income, deductions, gains, losses, etc., from its operations, but it does not pay income tax. Instead, it "passes through" any profits or losses to its partners. Each partner includes his or her share of the partnership's income or loss on his or her tax return.

Source: Language taken directly from the Internal Revenue Service, http://www.irs.gov/businesses