Agenda Item No. 6.0

Chicago Metropolitan Agency for Planning

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MEMORANDUM

To: Regional Tax Policy Task Force

From: Lindsay Hollander, Associate Policy Analyst

Date: April 1, 2011

Re: State and Local Finance Overview

The Regional Tax Policy Task Force is charged with making recommendations on state and local tax policy matters addressed in GO TO 2040. For this item, CMAP staff will present a brief overview of state and local finances in order to provide the Task Force with general background information prior to evaluating the issues in greater depth. The accompanying staff report, "Overview of State and Local Revenues and Expenditures," also provides background on state and local finance topics.

The Task Force will be presented with more comprehensive information about these topics at future meetings. Please see the included Scope of Work for more information on the anticipated scheduling of meeting topics.

ACTION REQUESTED: Information and Discussion

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Overview of State and Local Revenues & Expenditures

In the seven-county region of northeastern Illinois, 1,230 different units of government collect revenues and provide services to residents, businesses, and visitors. No metropolitan area in the United States has more units of government than Chicago. Illinois has always had permissive incorporation laws for municipalities. By the late 1800's, any community of at least 300 residents could acquire a municipal charter. Many of these municipal governments were transitional in nature, however, and eventually consolidated with the City of Chicago in order to receive services like water, fire, and police protection. Yet, even with these incentives to join up with the City, suburban growth still grew at a faster rate than annexation. By 1910, suburban Cook County already contained 66 municipalities, 30 townships and more than 20 park districts. By 1930, it had 89 municipalities, and by the 1980s, it had 119.[1]

The reason for the proliferation of special district governments has its genesis in the Illinois State Constitution, which from 1870 to 1970 limited the debt municipalities could acquire to 5 percent of assessed valuation.[2] Special districts emerged as a mechanism to work around the constitution, since these districts could borrow an additional 5 percent of assessed value, levy taxes, and provide independent services. The constitution adopted in 1970 removed these limitations.

Units of Government in Northeastern Illinois, 2008

Counties	7
Township or road	123
Municipalities	284
Elementary school	203
Unit school district	38
High school	52
Community college	14
Fire protection	133
Park	170
Sanitary	49
Library	108
Mosquito abatement	13
Other	36
Total	**1,230**
Source: Illinois Department of Revenue	

State Revenues

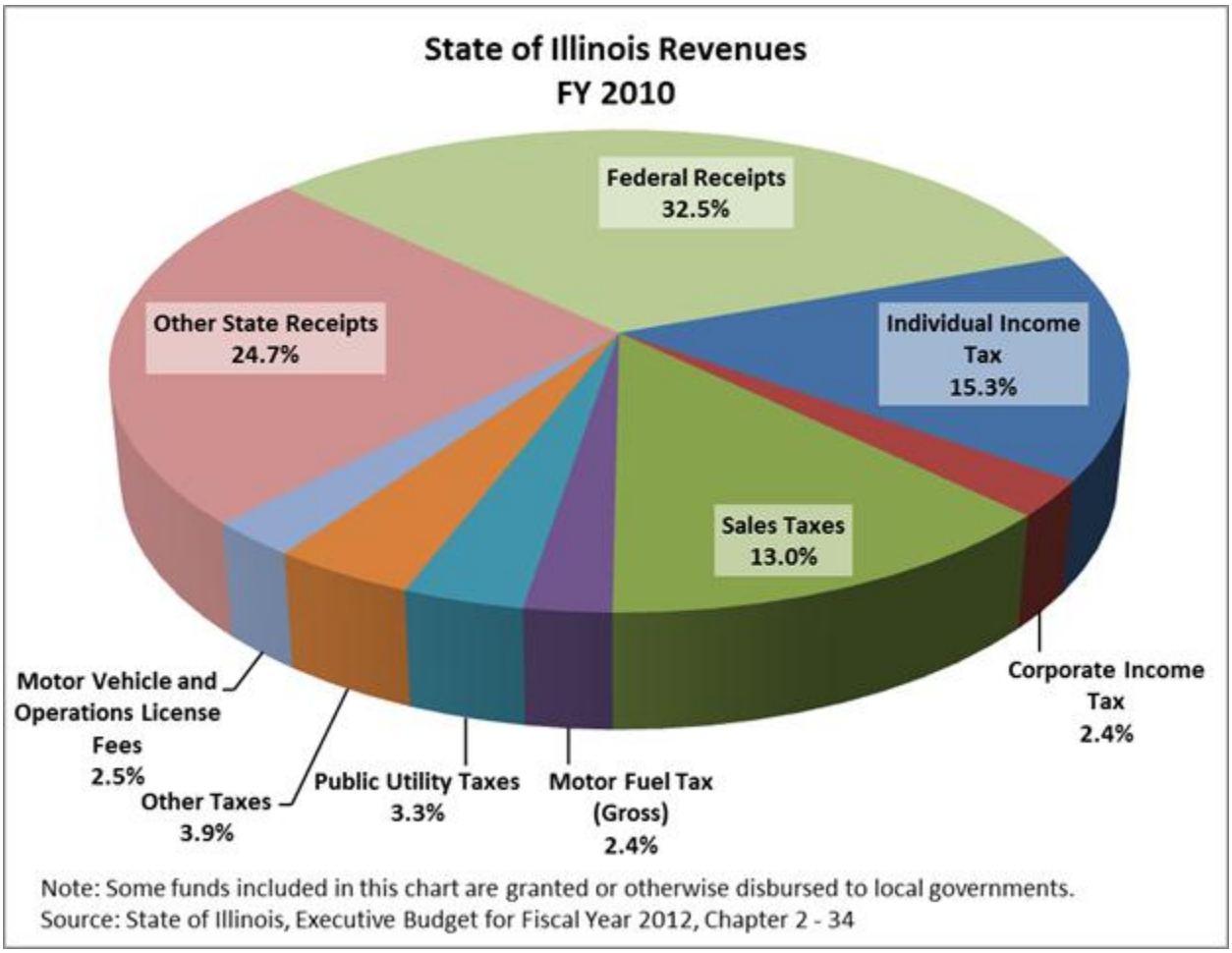
The State's budget consists of revenues from state taxes, receipts arising from the provision of specific services, and receipts from the federal government. The State's FY (fiscal year) 2010 budget[3] consisted

[1] Teaford, John C. 2004. Government, Suburban. The Encyclopedia of Chicago. Chicago: The Newberry Library.
[2] Illinois Office of the Comptroller, "A Brief History of Local Governments in Illinois," *Fiscal Focus*, July 2006
[3] The State of Illinois' fiscal year runs July 1 to June 30.

of $22.5 billion in tax revenue, or 40.4 percent of the total. Primary tax revenue sources for the State include income and state sales tax revenues, which make up over 30 percent of the revenues in the State's budget.

State receipts such as motor vehicle license fees and lottery receipts accounted for $15.1 billion or 27.1 percent of the total. Federal receipts like grants and reimbursements for public assistance, social services, and other programs were $18.1 billion or 32.5 percent of the total. Roughly half of the total $55.7 billion revenues were deposited into the State's General Funds, which support public services such as education, health care, and human services.

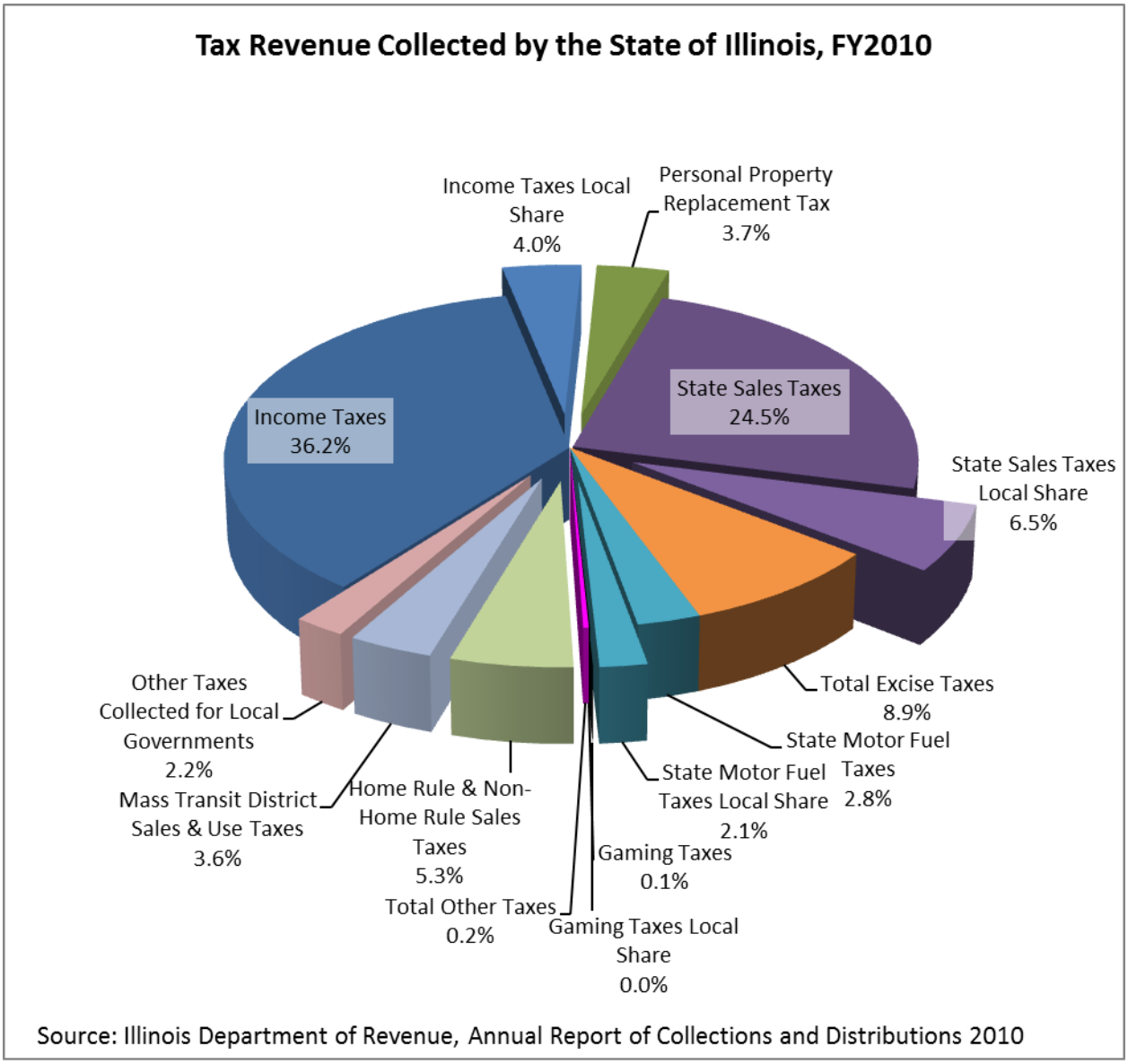
Not all state revenues are used to fund state government. State statute requires that a portion of income and motor fuel taxes be transferred to local governments. In addition, the State passes revenues, including some federal receipts, to local governments and school districts to fund services like education and law enforcement programs. The following chart provides an overview of the revenue sources that fund the State's budget.



State Revenue Disbursements to Local Governments

Included in the State's budgeted funds are revenues that the State disburses to local governments, such as portions of the motor fuel tax. The state budget also includes funds that are appropriated for general state aid to school districts, which are funds granted to school districts to ensure a minimum or "foundation" level of funding for each student.

In addition to the State's budgeted revenues, the State sends 20 percent of state sales tax collections to local governments and collects local sales tax revenues on behalf of local governments. The following chart shows all tax revenues collected by the State of Illinois, which totaled $27.6 billion in FY2010. This chart excludes revenues that are not from tax collections, such as federal receipts or fee revenue.



Approximately three-quarters of the tax revenues, $20.1 billion, were retained by the State, while tax revenues disbursed to local governments, shown in the chart as separated pieces, totaled $7.6 billion. Collections disbursed to local governments primarily consist of revenues from statewide taxes shared with local governments, including income, personal property replacement, sales, motor fuel, and gaming taxes. The revenues disbursed to local governments also include mass transit district sales taxes imposed for the Regional Transportation Authority[4] and the Metro East Transit District,[5] home rule and

[4] See 70 ILCS 3615/4.03. The rate of tax in Cook County is 1 percent (1.25 percent for qualifying food, drugs, and medical appliances) and 0.75 percent in DuPage, Kane, Lake, McHenry, and Will counties.

[5] See 70 ILCS 3610/5.01. General merchandise and qualifying food, drugs, and medical appliances are taxed at a rate of 0.25 percent in Madison County and 0.75 percent in St. Clair County. Titled or registered sales are taxed at a rate of 0.25 percent in St. Clair County and Madison counties.

non-home rule sales taxes imposed by municipalities and counties, and other taxes collected for local governments such as telecommunications taxes.

The formulas used to calculate the disbursement of state tax revenues to local governments vary for each tax type. The following table briefly explains some of these state-local revenue sharing arrangements:

Examples of State/Local Revenue Sharing Arrangements in the State of Illinois

State Tax Source	How Imposed	Local Governments Receiving Disbursement	Disbursement Formula
Sales Tax	6.25% state rate for retail sales of general merchandise and 1 percent state rate for sales of qualifying food, drugs, and medical appliances	Counties, municipalities, and the Regional Transportation Authority	16% of the state collections from retail sales of general merchandise and 100% of the collections from sales of qualifying food, drugs, and medical appliances are returned to the municipal or county government (if unincorporated) where the sale took place. 4% of the tax collected from general merchandise sales is disbursed to county governments (except Cook County) for sales that occurred anywhere within their county boundaries. For sales made in Cook County, this 4% share is allocated to the RTA.
Income Tax	Individuals, trusts, and estates: 5% of net income. Corporations: 7% of net income	Counties and municipalities	One tenth of total collections minus the amount deposited in the refund fund. The amount that each municipality or county receives is based on its population in proportion to the total state population.
Personal Property Replacement Tax	Corporations: 2.5% tax on income Partnerships, trusts, and S-corporations: 1.5% tax on income Public utilities: 0.8% tax on invested capital	All taxing units of government that collected personal property taxes before they were abolished	The total collections are divided into two portions. One portion (51.65%) goes to Cook County. The other portion (48.35%) goes to other counties. The Cook County portion is then distributed to the taxing districts in Cook County based on each district's share of personal property tax collections for the 1976 tax year. (For example, if total taxes collected by all districts were $1 million and District A collected $35,000 of that total, District A's share of any future distributions would be 3.5%.) The downstate portion is distributed similarly, except that the collections from the 1977 tax year are used to calculate each district's share of the distribution.

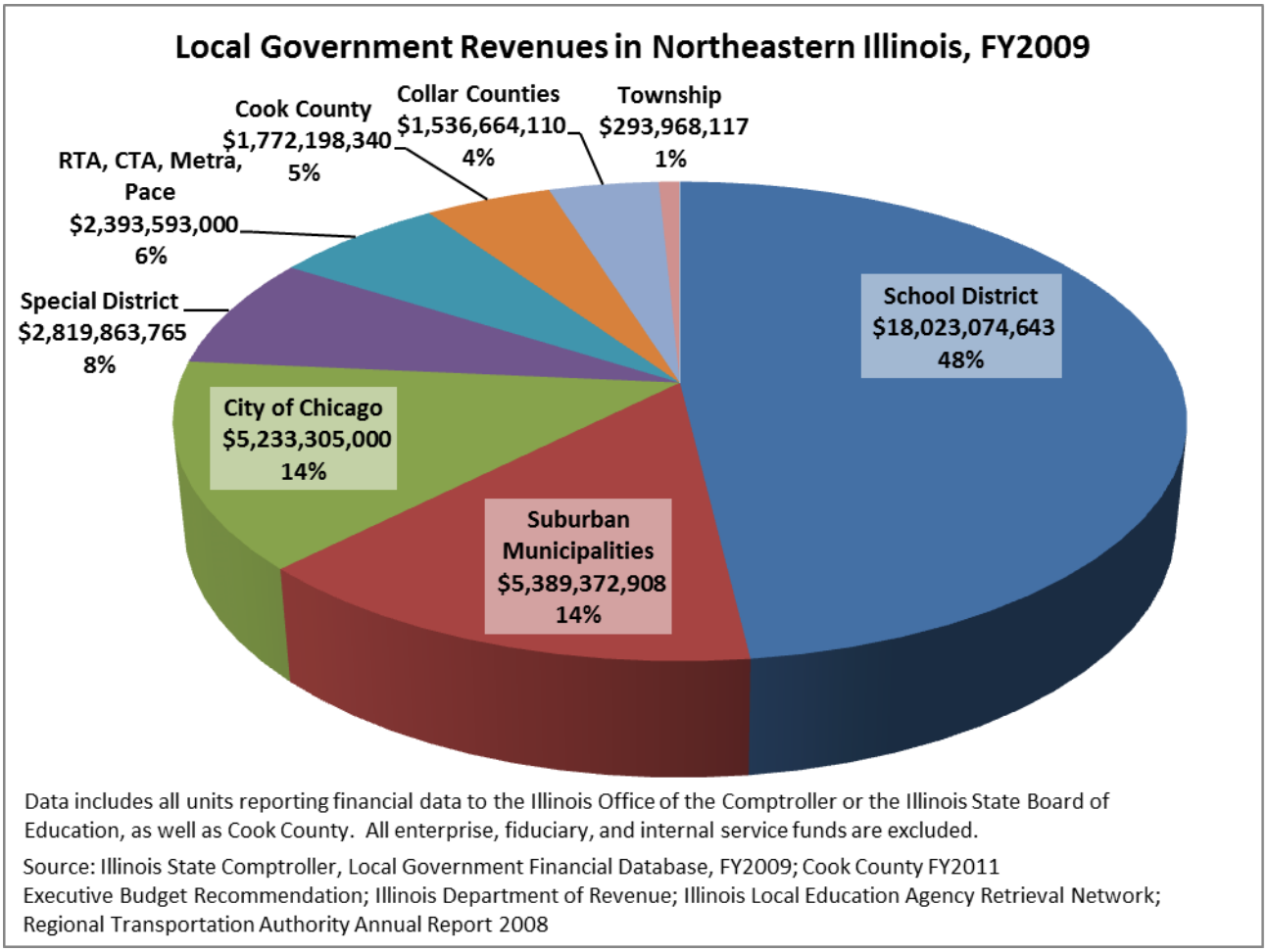
Motor Fuel Tax	$0.19/gallon for gasoline and gasohol, $0.215/gallon for diesel, and $.215/gallon for combustible gases	Counties, municipalities, townships	After a variety of deductions, 54.4% of the balance is allocated to local governments. Of this portion, 49.1% is distributed to municipalities, 16.74% to counties over 1,000,000 in population, 18.27% to counties under 1,000,000 in population, and 15.89% to townships. The municipality's share of the total MFT allocation is based on population. The county share is based on the amount of motor vehicle license fees received. The road district/township share is based on mileage of township roads. MFT funds must be used for transportation purposes.
Gaming Taxes	The charitable games tax and license fee is a 3% tax on the gross proceeds of charitable games. The pull tabs and jar games tax and license fee is a 5% tax on the gross proceeds of pull tabs and jar games.	Counties and municipalities	One-third of each of these revenue sources is distributed for law-enforcement purposes to municipalities and counties in proportion to the number of licenses issued in each municipality or county.
Source: Information and language directly from the Illinois Department of Revenue was used for this table.			

Local Government Revenues in Northeastern Illinois

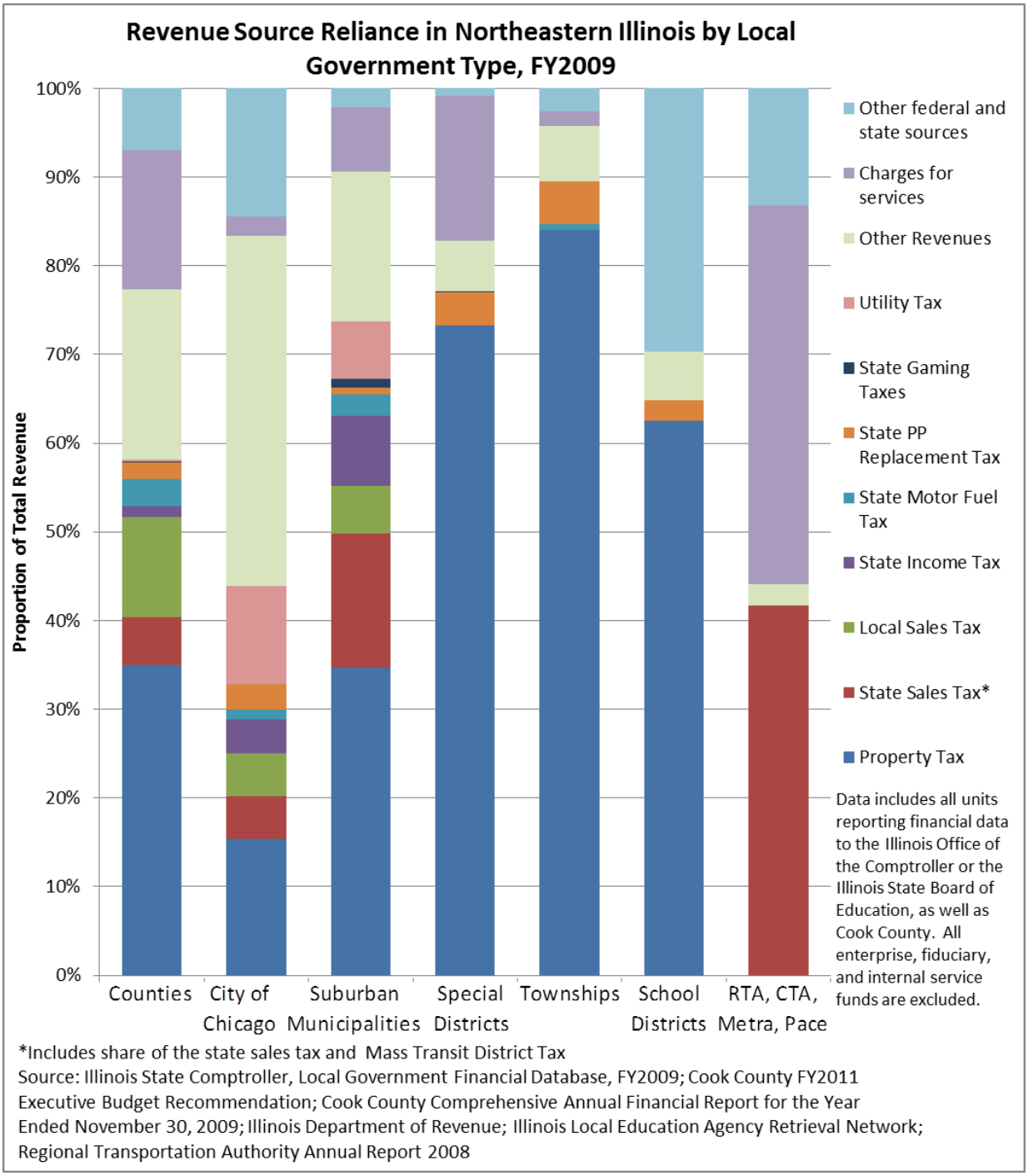
Local governments in northeastern Illinois collected nearly $40 billion in total revenues during FY2009, including tax revenues discussed in the preceding section as well as other receipts.[6] Municipalities collected $10.6 billion in FY2009. About half of those revenues were collected by the City of Chicago. The region's school districts received $18.0 billion in revenues in FY2009. The seven counties in the region accounted for about 10 percent of the local government revenues, with Cook County receiving $1.8 billion in revenue and the collar counties receiving $1.5 billion. Special districts and mass transit districts received $2.8 billion and $2.4 billion, respectively, while townships took in about $294.0 million or 1 percent of local government revenues. The following chart provides an overview of local government revenues in northeastern Illinois. Only revenues for governmental funds are included.[7]

[6] Local governments' fiscal years may start on different dates, although many start on January 1.

[7] Excluded funds: Enterprise Funds for accounting for services where the costs of providing services to the public be recovered through user charges such as parking garages or water utilities; Fiduciary Funds that are held by a government but belong to another entity and account for revenues like pension fund interest income; and Internal Service Funds to account for services provided within a unit of government.



Revenue sources among these local governments vary considerably. Property tax revenues make up 46.5 percent of all local government revenues in the region. In the aggregate, property tax revenues are the largest single funding source for local governments' general funds, out of which expenditures for general government operations such as public safety services are made. Charges for services also make up a large portion of the budgets for municipalities and counties. Local governments typically use these charges to recover the cost of providing the service, such as transit services or recreation programs. Cook County and the city of Chicago both have a very diverse stream of revenues, owing in large part to a variety of local option taxes, licenses, and fees imposed specifically by the City or the County for various purposes. The following chart shows how much various revenue sources contribute to local governments' funding resources.



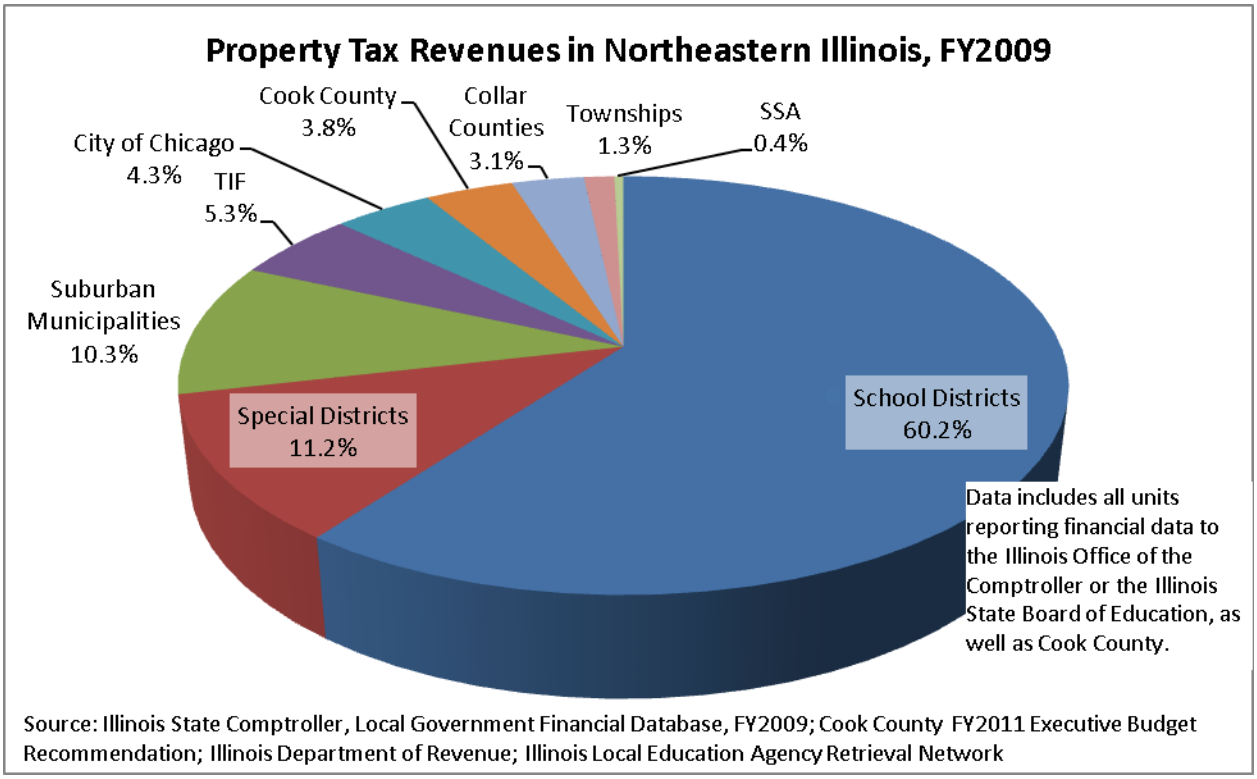
Property Taxes

The vast majority of local governments in the region impose a property tax. As the largest revenue source, the property tax makes up 84 percent of township revenue, 73.3 percent of special district revenue, and 62.6 percent of school district revenue. It also remains a very important revenue source for counties (35 percent) and suburban municipalities (34.6 percent). In addition, property tax revenues fund Tax Increment Financing (TIF) districts[8] and Special Service Areas (SSA)[9]. The following chart

[8] TIF districts are created to fund economic development projects in blighted areas where development would not otherwise occur. Property tax extensions on increases in property value that occur after the district is established, or the tax increment, flow to the TIF district.

[9] Special Service Area districts are funded with an additional property tax levy on properties in the district. Revenue is used for special projects or services that benefit the district area. See 35 ILCS 200/27.

provides an overview of how property tax revenues in the region are distributed among local governments.



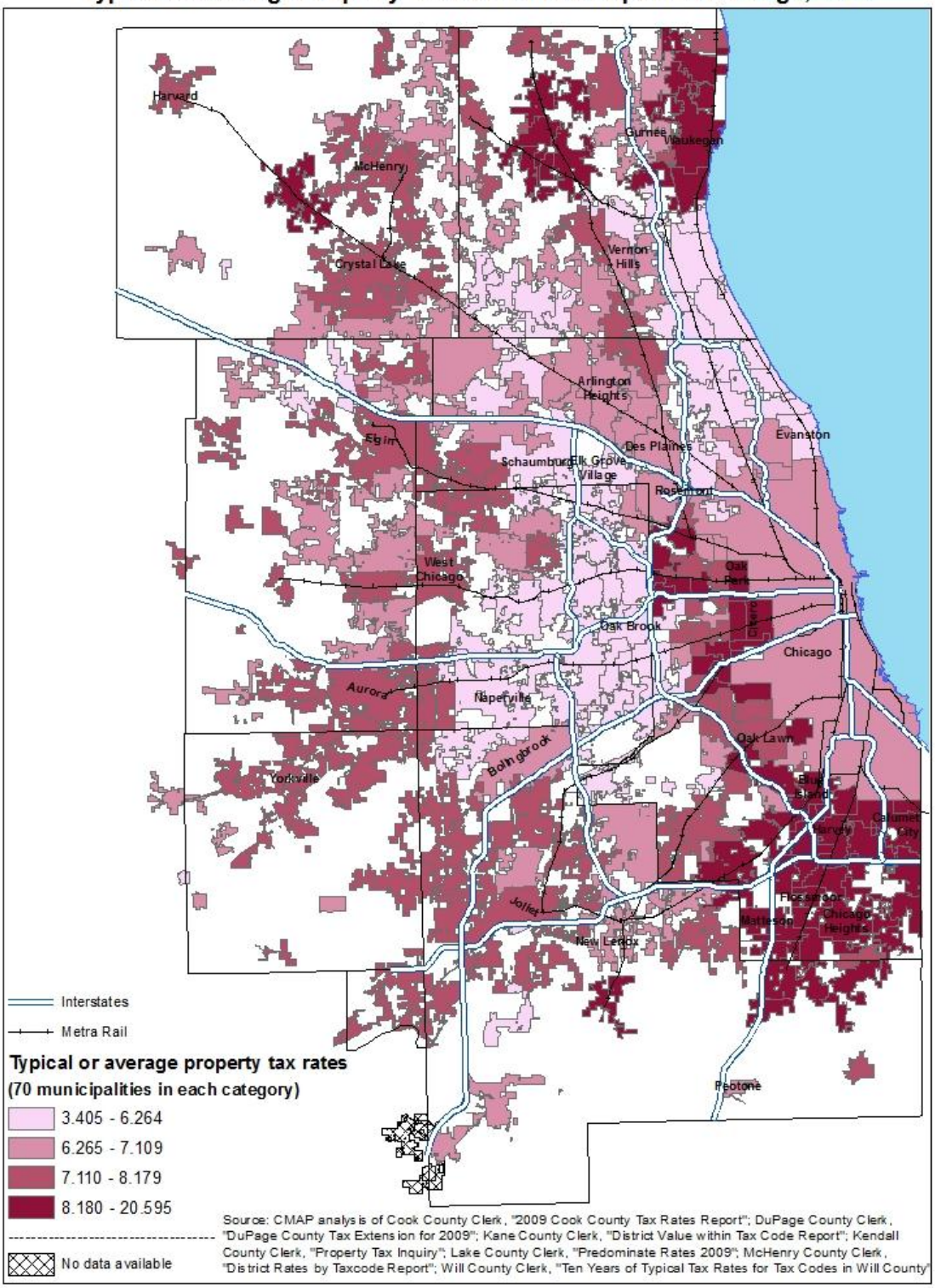
Individual taxing bodies have their own levy rates that are individually determined by the relationship between their annual financial requests and the assessed value of property within their geographical boundaries. Rates can be understood as a function of service provision needs, the value of real property, and other revenue sources. The rates are generally determined according to a simple formula, $\frac{Tax\ levy}{EAV} = Tax\ rate$, where "Tax Levy" refers to the funds requested by taxing bodies and "EAV" refers to the equalized assessed value of all properties within a taxing district.

In Cook County, the county Assessor initially assesses properties. In the collar counties, township assessors submit initial assessments to the county assessors. The resulting market value is then converted to an assessed value by applying assessment ratios (generally 33 1/3 percent for all properties except in Cook County, which uses 10 percent or 25 percent depending on the property classification). Equalization multipliers, calculated by the Illinois Department of Revenue, help ensure that localities assess their properties fairly and uniformly. Local government units set their own tax levies and the County Clerk is responsible for "backing out" the tax rate for each jurisdiction.

In Illinois, property tax rates are set by local governments and vary from place to place. The composite rate extended to each taxpayer depends on the set of taxing districts that encompass the property. As a result, two properties located in the same city may be extended different levy rates. Tax rates in the region vary widely, from less than 4 percent of EAV in Oak Brook, to 20.6 percent in south suburban Ford Heights. The following map illustrates average or typical property tax rates for each municipality in the region. The rates included on the map are inclusive of rates levied by counties, municipalities, school districts, and special districts, but exclude rates levied by Special Service Areas. Where available,

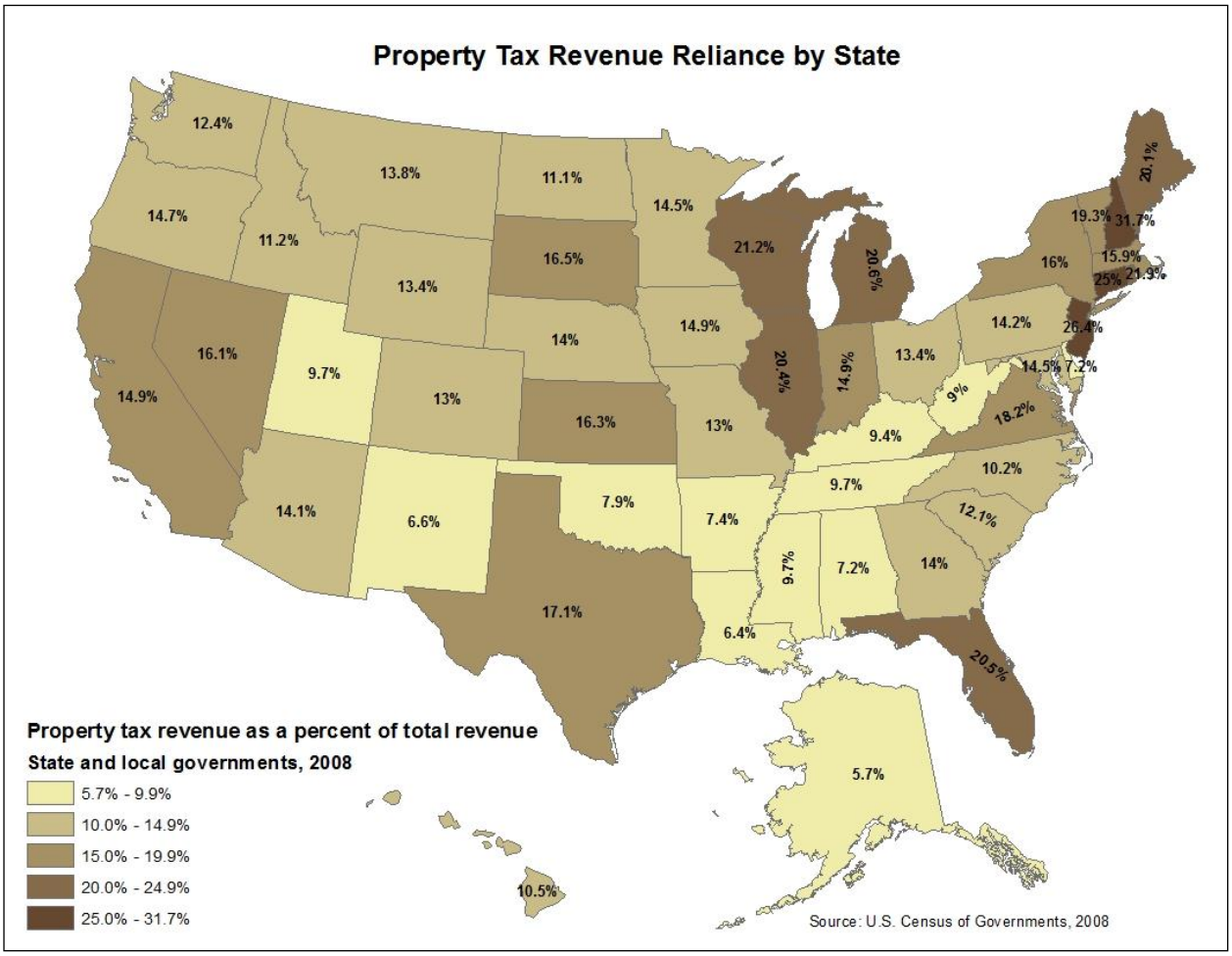
the rate paid by a "typical" taxpayer in a municipality is shown. Otherwise, the rate shown is the unweighted-average of the composite rates of each tax code[10] located in the municipality.

Typical or Average Property Tax Rates in Metropolitan Chicago, 2009



[10] The Civic Federation report, *The Cook County Property Tax Extension Process: A Primer on Levies, Tax Caps, and the Effect of Tax Increment Financing Districts,* provides the following description of tax codes: "Parcels in the same tax code all owe taxes to the same array of taxing districts and are taxed at the same composite tax rate, which is the sum of the rates of the individual taxing districts." (October 5, 2010, p. 5)

Property tax revenues accounted for 20.4 percent of all state and local government revenues in Illinois in 2008, according to the U.S. Census of Governments. In comparison to other states, property taxes revenues in Illinois make up a large proportion of government revenues. Just eight states relied on property tax revenues more than Illinois. Most of these states were located in the northeastern or Midwestern parts of the United States. Most of the states with lower proportions of property tax revenues were located in the South. On average, property tax revenues accounted for 14.4 percent of state and local revenues. The following map illustrates how much property tax revenues contributed to total state and local revenues, by state.

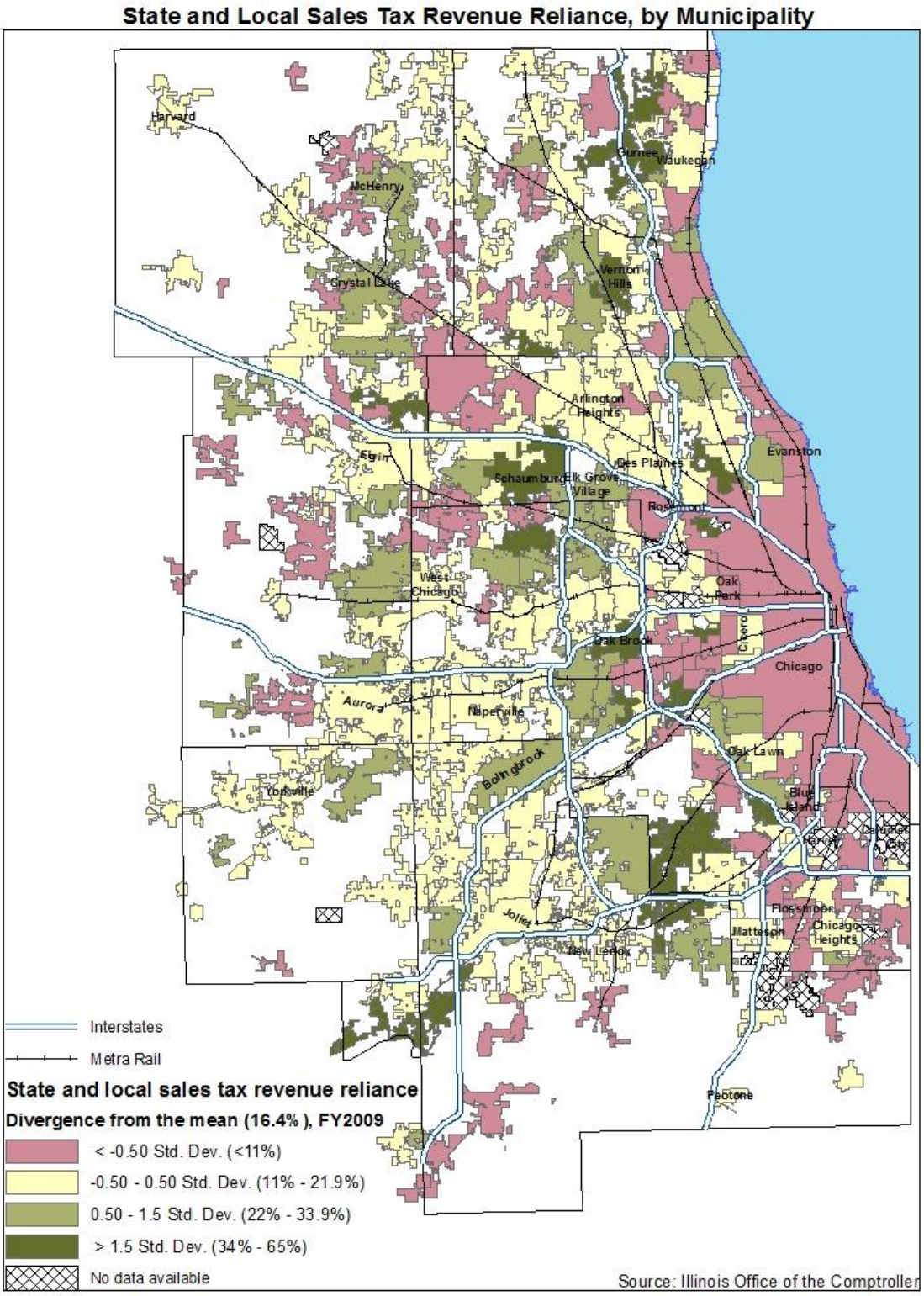


Sales Taxes

State and local sales taxes are a major revenue source for the RTA system (41.7 percent), suburban municipalities (20.6 percent), and the counties (16.7 percent). Most state and local sales tax revenues in the region accrue to municipalities' and counties' general funds. Approximately 5 percent of municipal revenues come from home rule and non-home rule sales taxes, while nearly a quarter of Cook County's revenues came from its 1.75 percent home rule sales tax during FY 2009.[11] State and local sales tax revenues account for 16.4 percent of total revenues for a municipality, on average.[12] However, municipalities' reliance on this revenue source varies widely throughout the region, from 0.2 percent to 65 percent of municipal revenues. The following map shows the extent that municipalities deviate from the average sales tax revenue proportion in the region.

[11] Cook County's home rule sales tax rate was 1.75 percent between July 1, 2008 and June 30, 2010. The rate is currently 1.25 percent.

[12] As explained in footnote 7, totals exclude Enterprise, Fiduciary, and Internal Service funds.



For 103 of the 266 of the municipalities for which data was available, sales tax revenue as a proportion of total revenue was within a half of a standard deviation of the mean, or between 11 and 21.9 percent of total revenue. Municipalities falling more than a half of a standard deviation below the mean included Chicago as well as 94 other municipalities distributed throughout the region. The remaining 68 municipalities, shown in progressing shades of green on the map, had sales tax revenue proportions

greater than 22 percent. Reliance on state and local sales tax revenues varies throughout the region depending on factors like the retail sales tax base and the existence of a local sales tax. In northeastern Illinois, 112 home rule municipalities as well as 33 non-home rule municipalities impose a local sales tax.

Home rule authority for some Illinois local governments was implemented when the current state constitution was adopted in 1970. All municipalities with populations greater than 25,000 are automatically granted home rule status.[13] If a municipality's population drops below that threshold, a referendum must be held to determine whether to maintain home rule status. Municipalities with smaller populations may adopt home rule status by referendum, and large municipalities may choose to reject home rule status by referendum. Cook County has also been granted home rule status through the state constitution, and is currently the only home rule county in the State. Other Illinois counties can become home rule if they adopt, by referendum, a county executive form of government with home rule.[14] School districts, townships, and special districts do not have home rule powers.

Home rule grants local governments authority to expand taxation in ways that would be otherwise unavailable. For example, home rule units may implement local option retail sales taxes, while non-home rule municipalities require a referendum to implement retail sales taxes of up to 1 percent for expenditure on public infrastructure or for property tax relief.[15] Non-home rule counties also require a referendum to implement local sales taxes, and revenues may only be used for public safety, public facilities, or transportation.[16] In the Chicago metropolitan region, only Kendall County has a non-home rule sales tax, for public safety.[17]

In addition, home rule units may exceed statutory caps on property tax levies,[18] and may access a wide variety of other tax bases including the real estate transfer tax and the hotel/motel tax. Home rule units may not tax income. The following map provides an illustration of which home rule and non-home rule municipalities in northeastern Illinois have a local sales tax.

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[13] Illinois Legislative Research Unit, *1970 Illinois Constitution Annotated for Legislators, Fourth Edition*, updated 2005.

[14] Ibid.

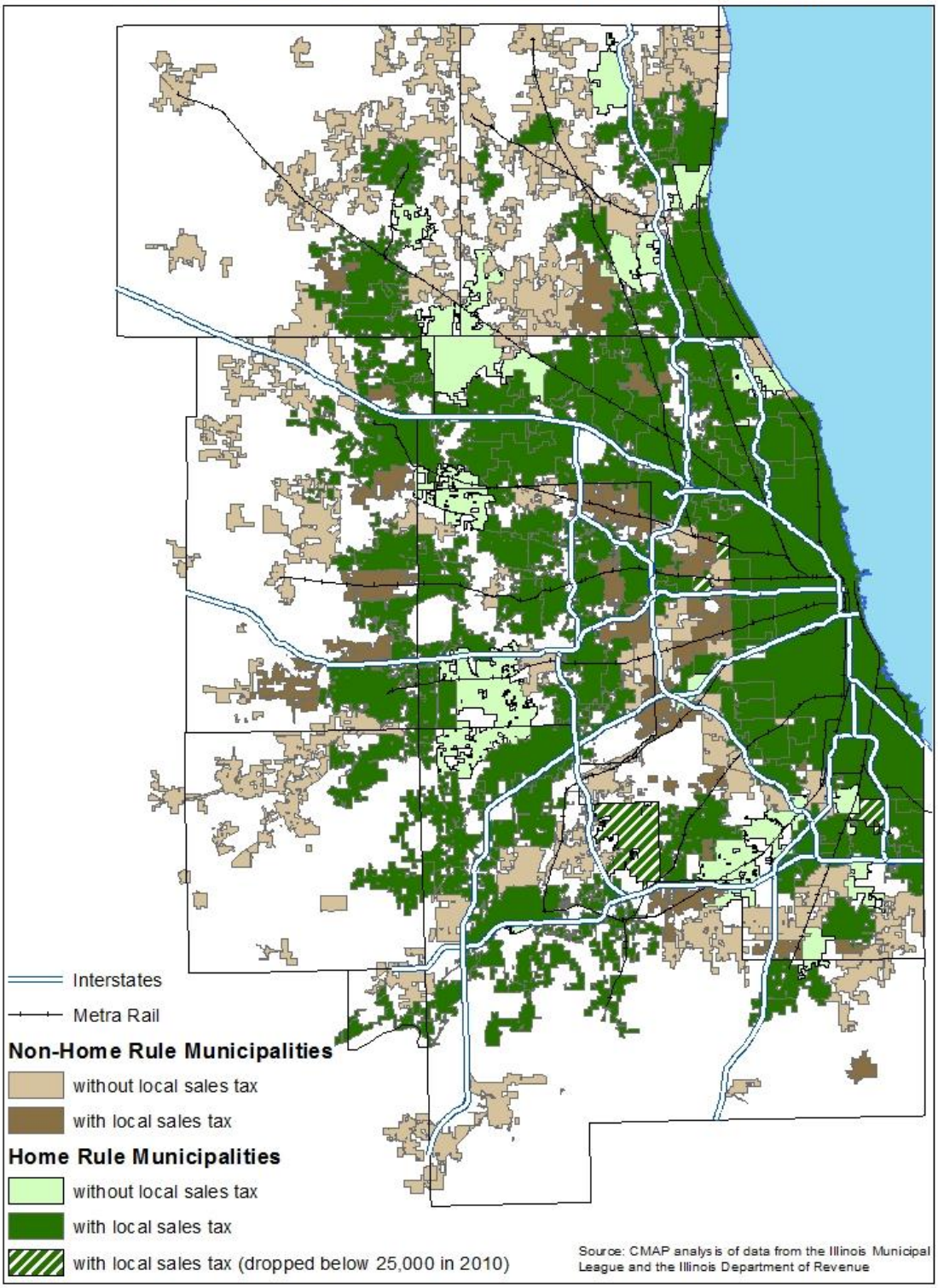
[15] Both home rule and non-home rule taxes must be imposed in 0.25% increments. See 65 ILCS 5/8-11-1, 65 ILCS 5/8-11-1.3 and 55 ILCS 5/5-1006.

[16] The tax must be imposed in 0.25% increments. See 55 ILCS 5/5-1006.5.

[17] Kendall County implemented a 0.5 percent sales tax rate on January 1, 2002 and increased the rate to 1 percent on July 1, 2007.

[18] The Property Tax Extension Limitation Law, PTELL, limits increases in property tax extensions to the smaller of either inflation (as measured by the CPI) or 5%. See 35 ILCS 200/18.

Home Rule Status and Local Sales Taxes in Northeastern Illinois

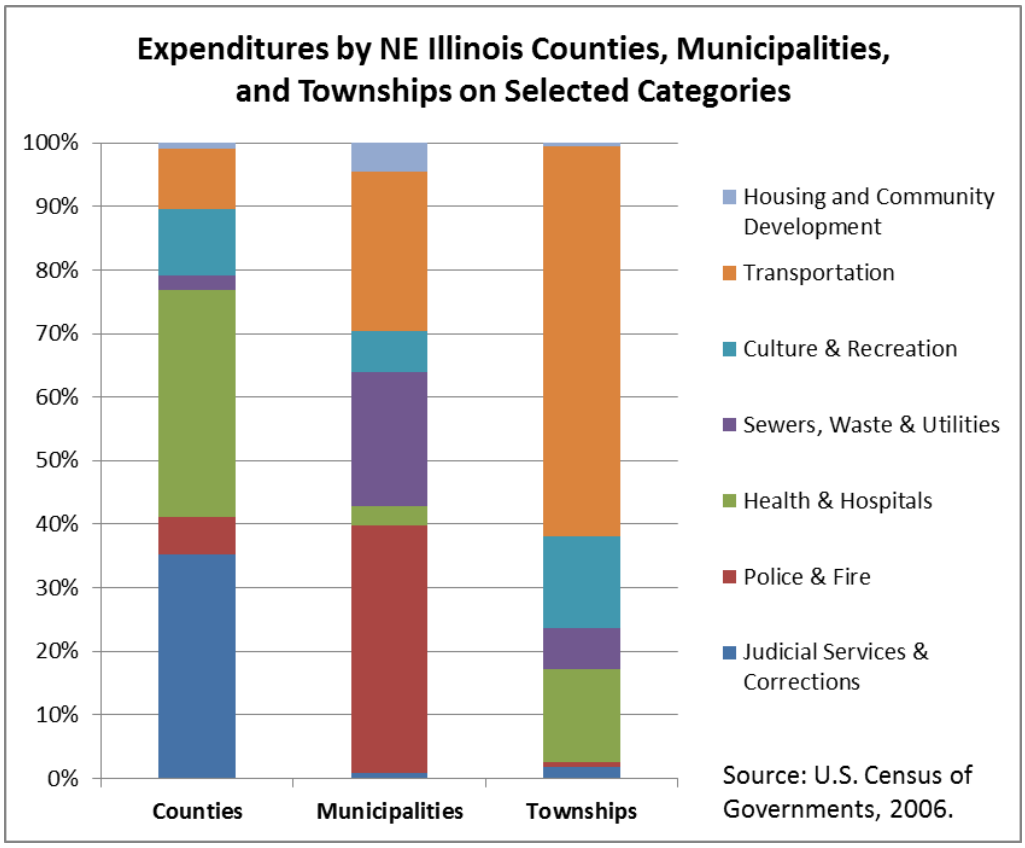


Nearly all areas of the region are subject to a sales tax rate above the 6.25 percent state rate due to both home rule and non-home rule sales taxes, as well as the Regional Transportation Authority sales tax. Most of Kane, Lake, McHenry, and Will counties have a sales tax rate of 7 percent on general merchandise. However, municipalities in these counties that impose local sales taxes, as well as most of DuPage and Kendall counties impose rates between 7.25 and 8 percent, which are 1 to 1.75 percentage points above the state rate.

Large portions of Cook County, as well as some areas of the collar counties, impose rates between 8.25 percent and 9 percent. The highest sales tax rates on general merchandise in the region are imposed in Cook County, where sales in 73 municipalities are subject to sales tax rates between 9.25 percent and 10 percent.[19] This includes Chicago, where the sales tax rate on general merchandise is 9.75 percent.[20]

Local Government Expenditures in Northeastern Illinois

Local government expenditures in northeastern Illinois vary depending on the form and purpose of the unit of government. Special districts have specific purposes which dictate expenditures, such as parks or fire protection. The region's counties expended approximately 35 percent for corrections and courts and then another 35 percent for health and hospital services. Townships, having motor fuel tax disbursements as a primary revenue source, spent 60 percent of their funds for transportation. Municipalities spent 39 percent of their budgets for police and fire, as well as 21 percent on sewers, waste, and utilities. The following chart provides an overview of how counties, townships, and municipalities allocate expenditures.



Stability of Main Tax Revenue Sources

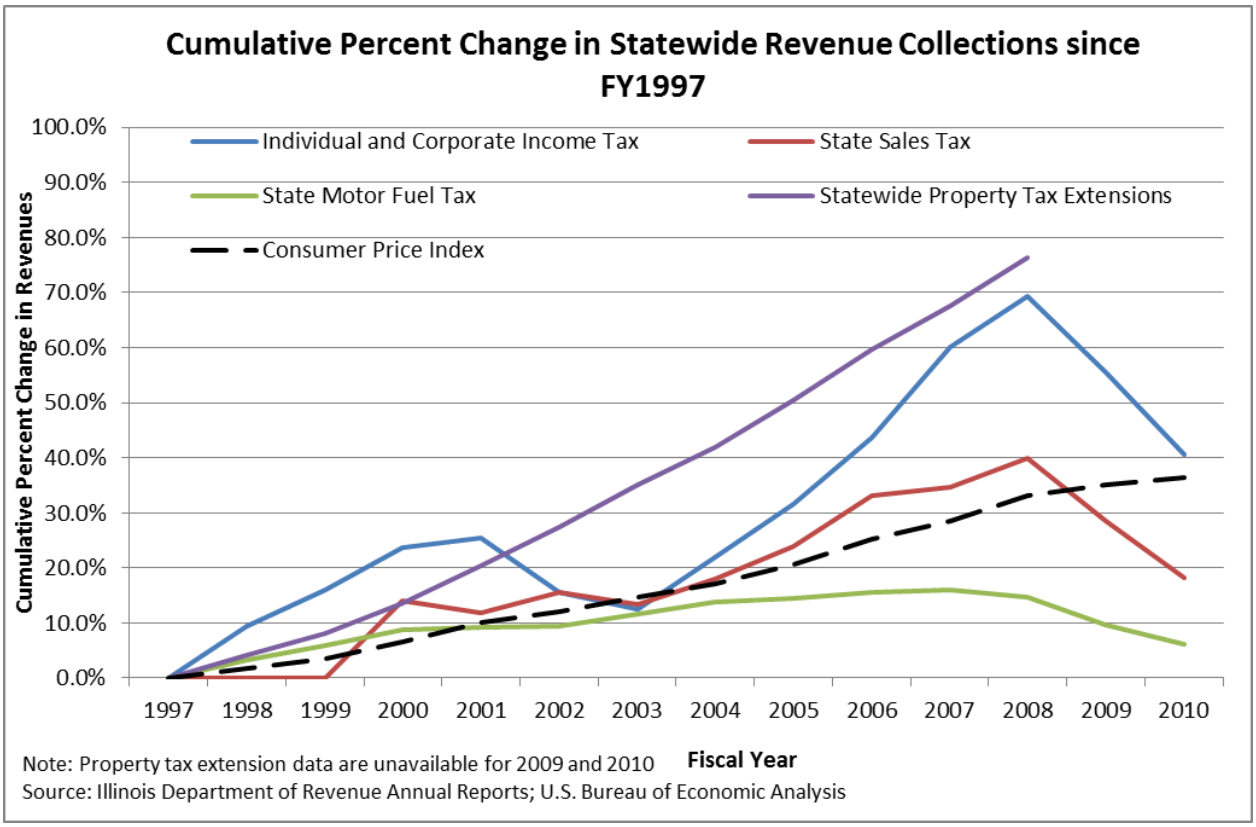
Tax revenues are the primary source of state and local government general revenues, which are funds over which governments typically have more discretion, in comparison to federal receipts, user fees, or other receipts that must be used for a specific program or purpose. Fluctuations in tax revenue can

[19] The sales tax rate in most municipalities in Cook County is 9.5 percent. Only East Dundee (Cook County portion only), Bellwood, Cicero, and Stone Park have a sales tax rate of 10 percent.

[20] The City of Chicago imposes additional home rule taxes on certain general merchandise purchases, such as food and drink from restaurants, and bottled water. Additionally, certain areas as also subject to Metropolitan and Pier Exposition Authority taxes.

affect the ability of state and local governments to budget for public services that do not typically receive dedicated revenue sources, such as public safety services or general government administration.

The tax revenue sources that governments depend on vary in terms of stability. Property taxes yielded $24.8 billion statewide during 2008, and are a fairly stable funding source for local governments. State income, sales, and motor fuel taxes have exhibited more volatility. Local units can maintain stability in property tax revenues by adjusting the rate, while income and sales tax revenues, with set rates, vary based on fluctuations in the amount income and retail sales generated. The following graph illustrates the cumulative percent change for the income tax, the state sales tax, the state motor fuel tax, and statewide property tax collections. Statewide property tax data are unavailable for 2009 and 2010.

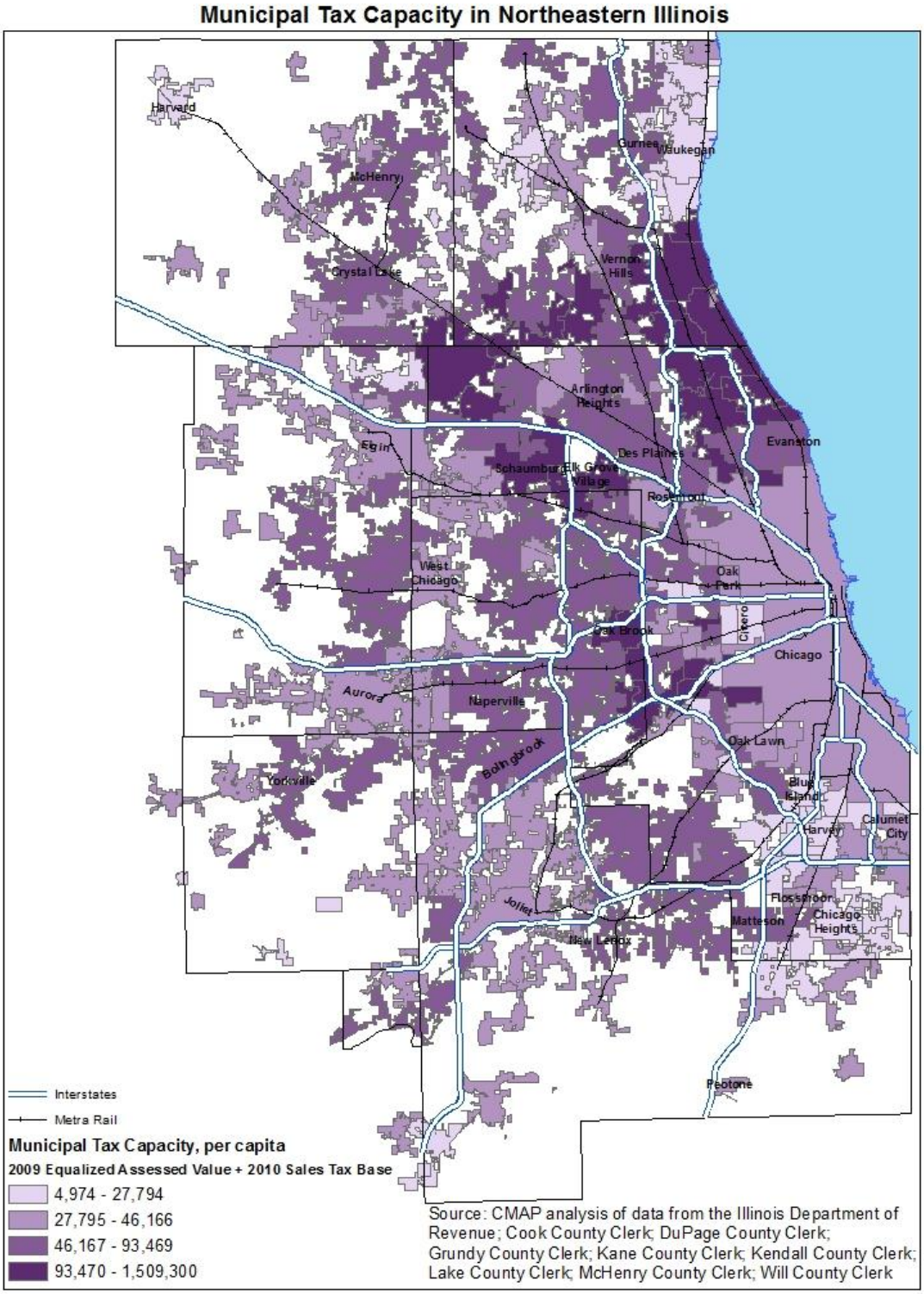


The state individual and corporate income tax exhibited some of the highest year-to-year volatility, decreasing during the early part of the 2000s, rising annually during the next few years, and then dropping again during 2009 and 2010 as a result of the economic recession. Overall, income tax revenues have increased 40.7 percent between 1997 and 2010. The state sales tax revenue followed similar trends as the state income tax, and has experienced an 18.3 percent increase since 1997, which translates to an increase of $1.3 billion. Motor fuel tax revenue increased just 6.1 percent since 1997. Meanwhile, property tax extensions rose steadily every year, increasing 76.3 percent between 1997 and 2008. Income tax collections and property tax extensions were the only revenue sources to keep pace with inflation, which rose 36.4 percent between 1997 and 2010.

Local Tax Capacity

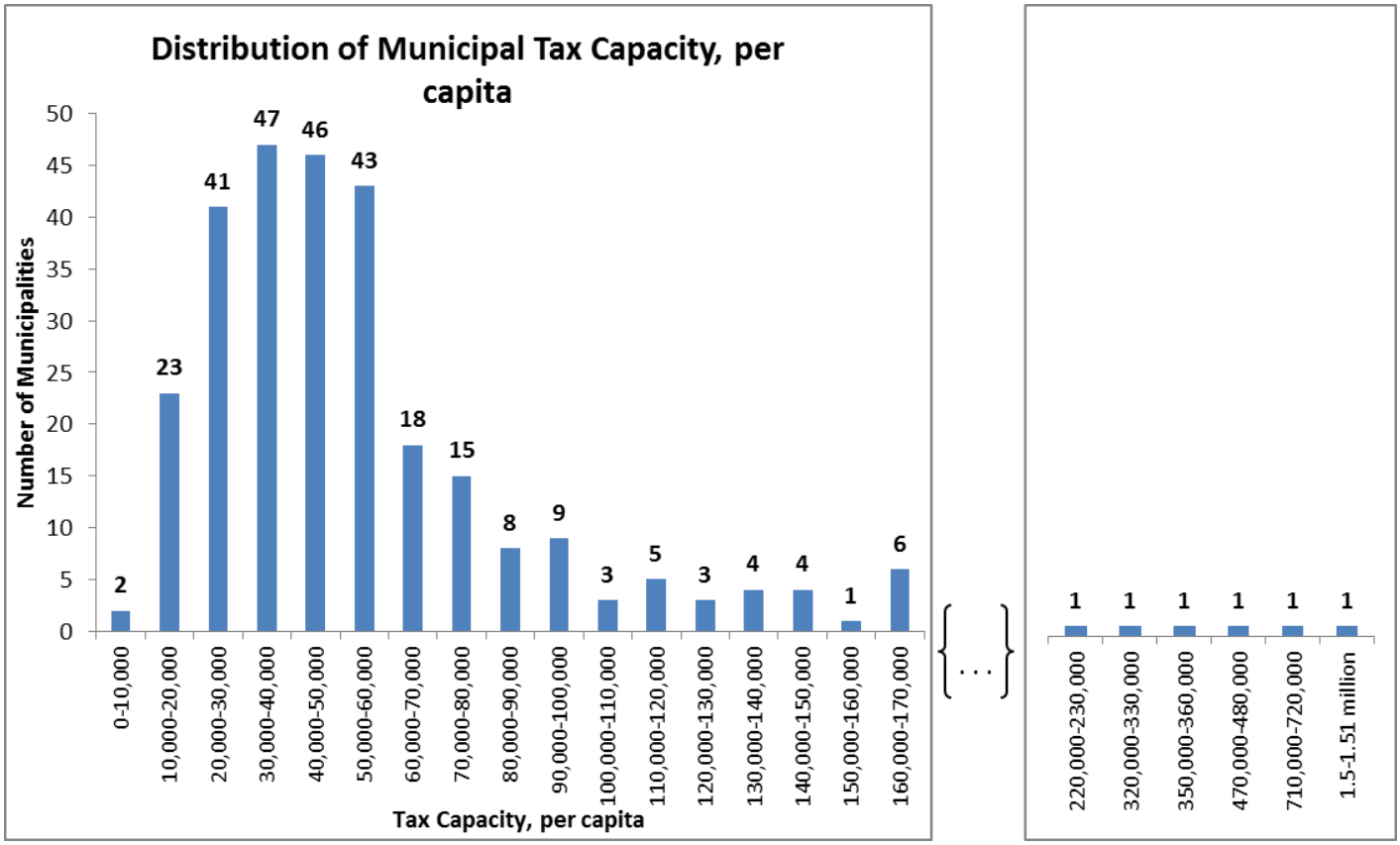
Some areas within the region have a much greater economic base than others, hence a greater "tax capacity." Since most local governments depend on general revenues like property and state and local sales tax revenues to fund basic services, tax capacity will be defined as the sum of a municipality's

equalized assessed value and sales tax base for this analysis. The following map illustrates the per capita tax capacity of the region's 284 municipalities.



Median per capita tax capacity among the region's municipalities was $46,174 and ranged from $4,974 to $1.5 million. Municipalities in the high tax capacity range were mostly located in Chicago's northern suburbs. Low tax capacity municipalities were mostly located in suburbs south of Chicago, as well as in Lake County. Relatively high sales tax revenues or greater property valuations allow local governments

to maintain lower property tax rates than local governments with minimal tax bases. While this should be expected to some extent in any metropolitan area, extreme divergences render many local governments helpless in terms of providing essential services and attracting new residents and businesses. The following chart illustrates the tax capacity frequency distribution among municipalities.



Of the 284 municipalities, 136 had per capita tax capacity between 30,000 and 60,000. A handful of municipalities were found to have per capita tax capacities far from the region's median. Three outliers with high per capita tax capacity of more than ten times the median had low populations (<600). Two municipalities with tax capacity of less than $10,000 per capita were both located in southern Cook County.

While state sales tax revenue disbursements are simply a function of a municipality's sales tax base, home rule municipalities have greater ability to derive additional revenue from their base with a local-imposed sales tax. At the same time, non-home rule taxing districts, such as special districts, school districts, and non-home rule counties and municipalities, are limited in their ability to increase their property tax extension. As a result, these districts are limited in their ability to turn an increase in property valuation into an increase in property tax revenue.