Chicago Teachers Union
Comprehensive Tax Program

Newspaper editorials informed by constant stories of government profligacy and corruption would suggest that Chicago government's fiscal health could be easily repaired with a stronger commitment to good government principles. However, despite deep staffing cuts (or hiring freezes) in the Chicago Public Schools, Chicago Police Department, libraries, and mental health clinics, and legislation to dramatically reduce pension benefits for those public employees fortunate enough to still have a job, major budget deficits remain. While the true scope of those deficits is up for debate, one fact has become abundantly clear: local government agencies are suffering from a serious revenue shortfall. Neither the federal government (since fiscal stimulus expired) nor the state of Illinois (since an income tax hike failed to provide sufficient additional revenue) have taken any further steps to support core functions of government. The absurd platitude of "doing more with less" has become conventional wisdom. This report attempts to address Chicago's revenue crisis at a local level. Several key assumptions underlie the recommendations herein:

1. Taxation should be fair and thus progressive. Such a system is only fair in an economy in which the largest income gains have gone to those at the top of the income pyramid.

2. Public service cuts hurt those who are the most vulnerable, including people with disabilities, young children, and senior citizens.

3. Taxes should be directed toward those sectors of the economy that are most robust and provide the strongest growth opportunities.

4. Added tax revenues should go toward improving public services and upholding commitments made to those providing the services. People who have played by the established rules should not be punished for the crimes of policymakers who have not upheld their end of the bargain.

With these assumptions in mind, we endorse the following proposals.

1. Institute a Chicago City Income Tax

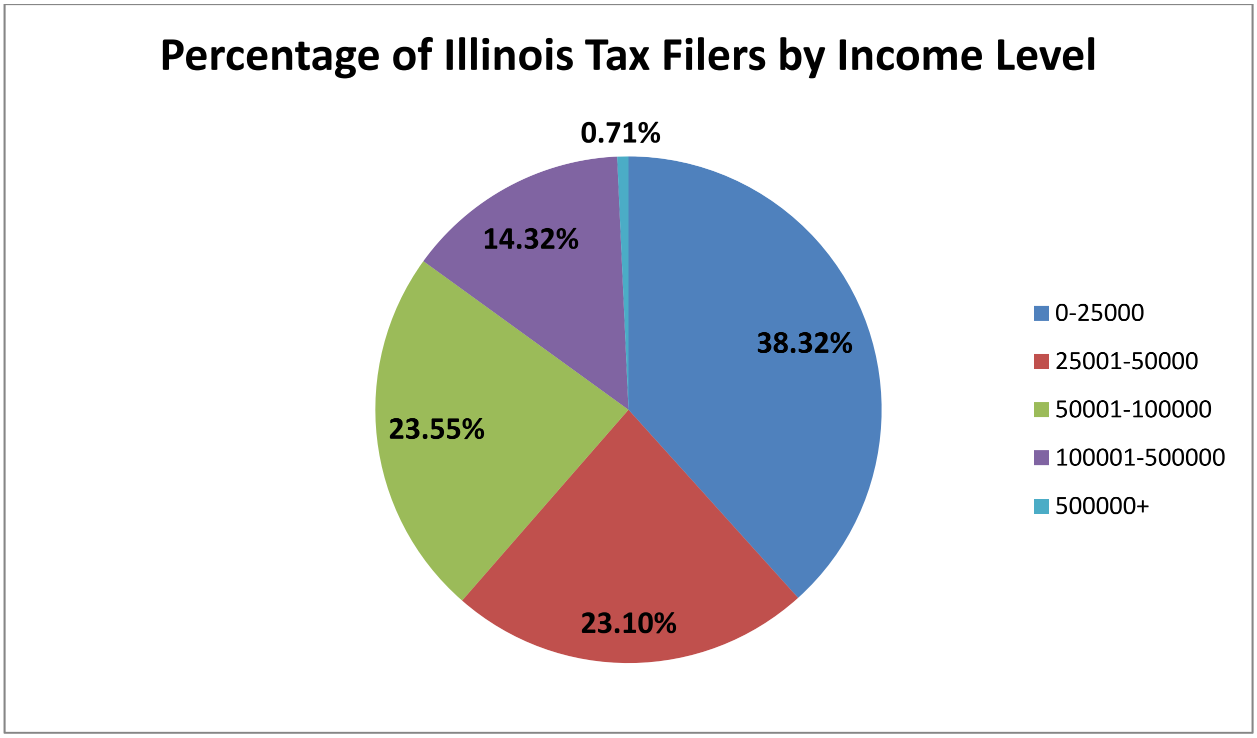
City income taxes are not new. New York, St. Louis, Detroit, Pittsburgh, Birmingham, Denver, Louisville, KY, Portland, OR, Columbus, OH, and Philadelphia, as well as every county in Indiana and 666 school districts in Iowa all charge varying levels income tax. Some are flat rates and some have a graduated structure. The money collected through this tax could be significant. New York City reaped $8.116 billion in FY2011 from its personal income tax.[1] New York has a graduated income tax structure with rates ranging from 2.907% to 3.648% depending on income level.[2]

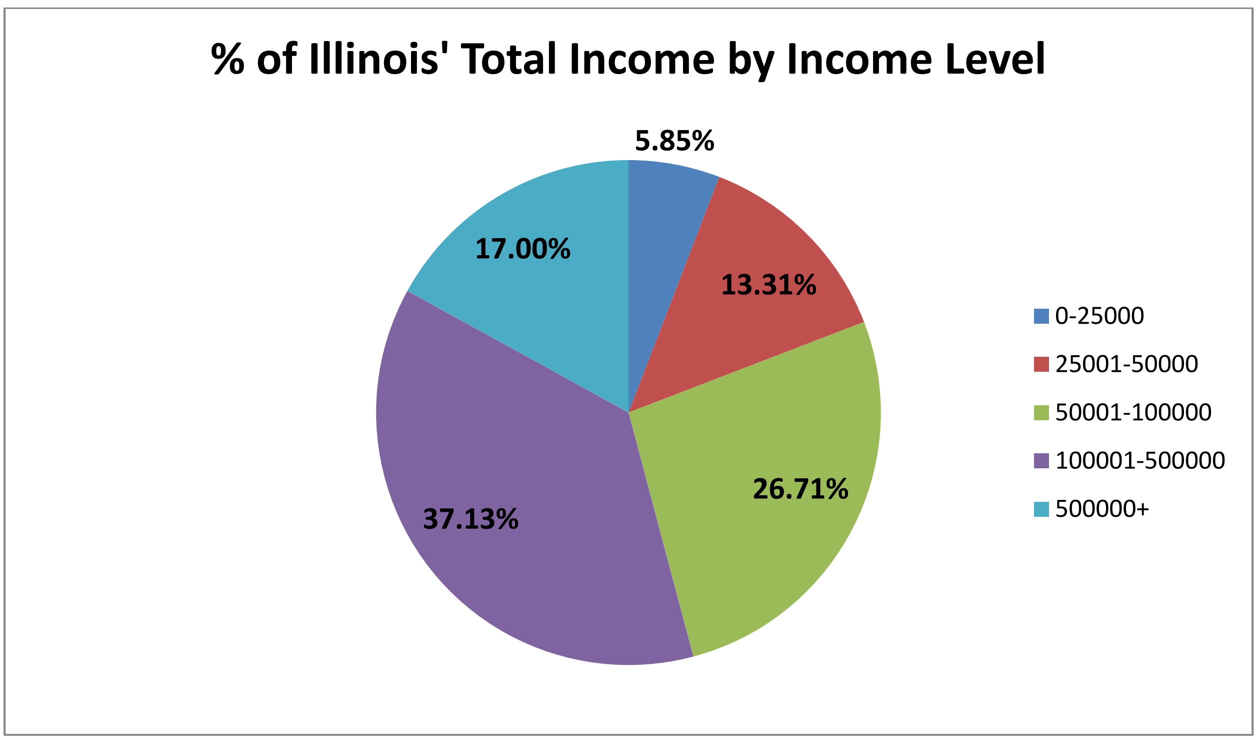
How would such a Chicago income tax work? Inspector general Joe Ferguson posited that a flat city income tax of 1% would generate $500 million.[3] What level might a graduated income tax generate?

State income tax data gives us a ballpark estimate. According to the Illinois Department of Revenue (IDOR), residents of Chicago had $64,297,789,040 in adjusted gross income (AGI) in tax year 2010.[4] IDOR also broke down Illinois tax returns by income level. 5,531,602 Illinois returns were filed in total in tax year 2010:

- 38.32% of total filers earned less than $25,000 and received 5.85% of AGI.
- 23.10% of filers earned between $25,001 - $50,000 and received 13.31% of AGI.
- 23.55% of filers earned between $50,001 and $100,000 in income and received 26.71% of AGI.
- 14.32% of filers earned between $100,001 and $500,000 in income and received 37.13% of AGI.
- 0.71% of filers earned more than $500,000 and received 16.999% of AGI.[5]

This data in graphical form follows on the next page.





If we assume that Chicago's distribution mirrors the rest of the state and we set graduated tax rates as follows:

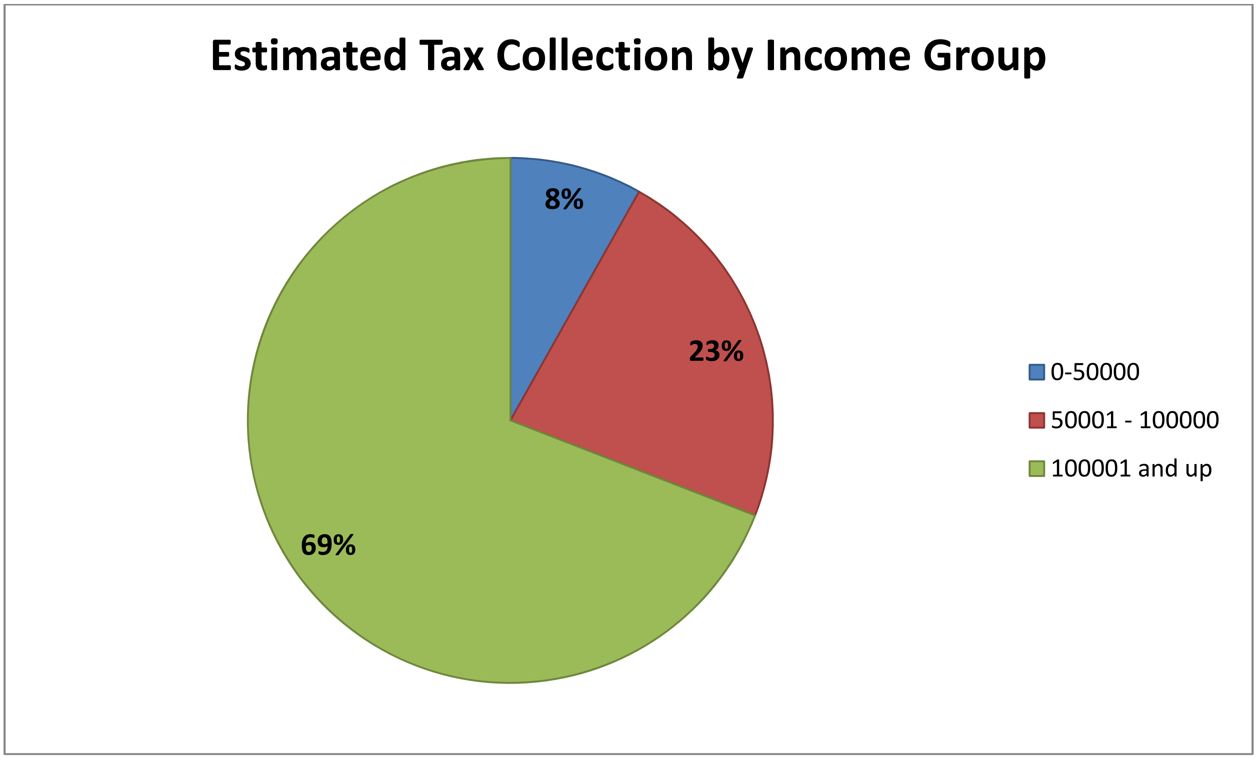
- 0.5% for those filers earning less than $50,000
- 1.0% for those filers earning between $50,000 and $100,000
- 1.5% for those filers earning more than $100,000

Then Chicago would receive the following revenues:

- 0.5% tax rate: 0.1916*0.005*64,297,789,040 = $61,597,281.90
- 1.0% tax rate: 0.2671*0.01*64,297,789,040 = $171,739,394.53
- 1.5% tax rate: 0.5413*0.015*64,297,789,040 = $522,065,898.11

Total: $ 755,402,574.54

By percentage, each group would pay the following:



To adjust for income differentials between Chicago and the rest of the state, and to account for tax deductions and credits (e.g. education, child care, earned income), we conservatively estimate that Chicago could generate **$600 million** with such a tax plan.

We propose that revenues generated from this tax be split equally between the city and CPS. Each body could count on **$300 million** from this proposal, and this disbursement would increase with improvements in the economy. For CPS, this disbursement would go to fund expanded enrichment education modeled on that provided by schools like Francis Parker and the University of Chicago Lab School. For the city, $100 million could go toward restoring vital public services like library hours, mental health clinics and hiring a sufficient number of police officers to return the department to its full staffing level. The other $200 million could go toward city workers' pensions to stabilize those funds.

2. Institute a commuter tax

This idea was also part of Ferguson's proposal. He proposed a flat 1% tax on incomes of those who live outside Chicago but work in the city. Commuter taxes have precedent: Philadelphia currently has one, New York City previously had one, and the state of New York also collects a version. The rationale? Suburban residents benefit from the urban core's global influence, as well as the income opportunities provided by employers based in the city. Ferguson valued this tax at $300 million based on the 620,000 non-residents who work in Chicago and earn an estimated $30 billion in income.[6] Our proposal is to incorporate the same graduated structure as outlined in section one. If the distributions are consistent, the breakdown of tax collections would be as follows:

- 0.5% tax rate: 0.1916*0.005*30,000,000,000 = $28,740,000
- 1.0% tax rate: 0.2671*0.01*30,000,000,000 = $80,130,000
- 1.5% tax rate: 0.5413*0.015*30,000,000,000 = $243,585,000

Total: $352,455,000

Some deductions and exceptions would be involved, but the $300 million number is a reasonable assumption. Dividing this tax stream between the city and CPS would result in **$150 million** to each taxing body. For CPS, this disbursement would go toward reducing class sizes. For the city, money could go to stabilize pension funds.

3. Cut the sales tax rate by 1% point and expand the sales tax list to include services

Chicago (and Illinois more broadly) has one of the most regressive tax systems in the country. Excise taxes on tires, a special soft drink tax, the bottled water tax, high cigarette taxes, telecommunication taxes and one of the highest sales tax rates in the country combine to hit low-income residents far harder than more affluent residents.

Cutting the sales tax by 1% point would help make Chicago's tax code fairer, would help offset the income tax and would encourage people to shop within the city limits. Of the 9.5% aggregate sales tax rate, the city receives 2.25%.[7] A 1% point sales tax cut equates to a 44.44% decline in the city's sales tax haul. The City of Chicago received $252,530,000 in city sales taxes in 2011.[8] A sales tax cut would thus result in a reduction of $112,235,555.56 in revenue to the city, but the income tax would more than offset this decline.

Another opportunity to offset lost revenue would be to expand the list of items covered by the city's sales tax to include services. Mayor Emanuel has already publicly supported such a tax plan.[9] Services to be included on this list are to be determined, though luxury services would be at the top of the list. While somewhat politically controversial, taxation of services occurs in states throughout the country. More importantly, taxation of services is crucial to the sustainability of government functions, as the service portion of the economy has expanded rapidly over the past three decades. According to the Office of the United States Trade Representative, "service industries account for 68% of U.S. GDP and four out of five U.S. jobs."[10] A 2007 Federation of Tax Administrators survey found that states apply taxes to 168 different services, including construction, oil fields services, investment advice, auto storage, dating services, lobbying and consulting, and cable TV.[11] Chicago already taxes amusements and TV service, so precedent for service taxes has been established. It is recommended that the tax rate on any services added to the list be a rate equal to the current 2.25% sales tax that Chicago directly receives. The possible revenue generation from a services tax could be **$450 million**.[12] We recommend a 50/50 split between the city and CPS on this additional services sales tax revenue for a total of **$225 million** to each. For CPS, this disbursement would be applied to providing a stable revenue stream for employee pensions.

4. Limit property tax increases to ½ the PTELL cap and develop a procedure to limit high-value abatements and appeals

Property taxes are functionally income taxes that are based on the value of a home or other form of developed property. Property taxes can indeed be regressive taxes, especially for those whose property value has appreciated faster than their wages have risen. Furthermore, the potential revenue available through property tax increases is limited because of PTELL (property tax extension limitation legislation), or the tax cap which limits increases in the city's property to 5% or the rate of inflation, whichever is lower. This element alone is likely sufficient reason to reject an expansion in the property tax. Because property taxes can be regressive, CPS should extend no more than ½ of the PTELL limit in any of the next three years. Such a pledge would mean only a modest change in taxes for most Chicagoans and yet would still raise revenue for CPS. Based on the FY13 property tax projection, CPS would still receive an additional **$20 million**. Chicago's property taxes are currently the lowest in the metro region. Homeowners do get a break for living in the city. That said, there is a significant property tax issue: the distribution of property tax collections has shifted over time, away from a roughly 50/50 split on commercial/industrial and residential property tax collections and toward a major increase in taxation on residential property, thereby creating a large burden on residential payers.[13] We should return to a more equitable distribution of property tax collections. One way would be for the city to limit abatements and appeals. Large-scale commercial and industrial property holders, as well as wealthy residential property owners have the financial capacity to hire tax appeal law firms that are highly effective in reducing their tax burden and limit the available revenue for public services. We recommend that property tax appeals for residential properties be limited to the first $600,000 of value (indexed to inflation in future years) and commercial/industrial properties limited to the first $10 million of value (indexed to inflation in future years).

5. End the TIF program

Chicago's TIF (tax increment financing) program has been a boon to private companies and a major drain on revenue available to public services. TIF districts cover more than 30% of the city, including such "blighted areas" as the Loop, the Near West Side, the South Loop, Hyde Park, and the North/Clybourn corridor. Politically connected developers reap public rewards to build new hotels, car dealerships and skyscrapers while public services are starved of vital revenue. To be fair, CPS has received significant TIF revenue for school construction. However, a disproportionate percentage of those funds have been used to build new selective enrollment schools that serve a small slice of the city's population. We propose that the TIF program is ended immediately, that a surplus is declared in all TIF funds, and that available funds are returned to the respective taxing bodies. Additionally, ending the TIF program ensures that any future revenue growth will flow to the taxing bodies rather than developers. CPS could use its share for pension funding. We also propose that the city create a capital projects fund with its share of the former TIF revenue. Available revenue is unclear at this point, but ending the TIF program would provide a steady and rising flow of revenue to all local taxing bodies.

6. Maintain the state education funding formula

The State of Illinois should encourage the city to exercise its home rule power to implement these proposals. As such, the State should not change the school funding formula to reduce available state funding to CPS. The current formula bases state funding on available local resources, average daily attendance (ADA) and poverty level.[14] Based on the formula, CPS is scheduled to receive about $1.226 billion in education funding from the state of Illinois.[15] However, the state was unable to fulfill the entire appropriation for this year, and CPS will receive about $130 million less.[16] Because of this cut in support, the state should provide the entire funding for FY13 and in future years to determine the effects of the other tax proposals outlined here.

7. Revenue Generation

These proposals could generate significant revenue for both the city and CPS. The total revenue generation based on these conservative estimates is:

City of Chicago: $562,764,444
CPS: $695,000,000

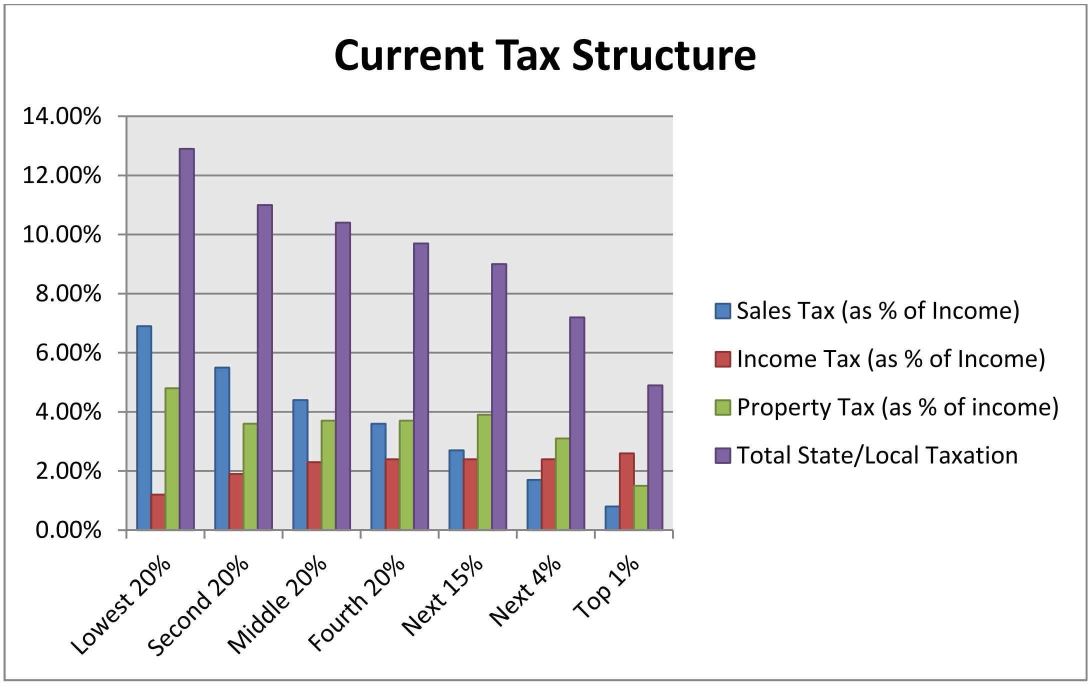
The final amounts would likely be higher for several reasons:

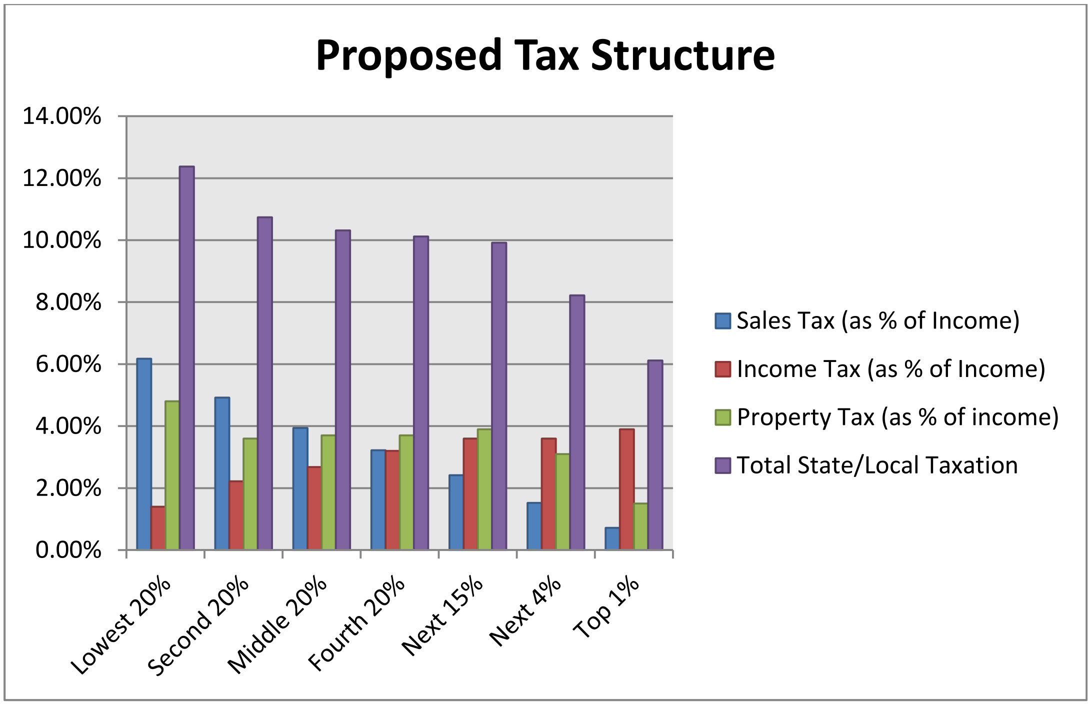
1. Income and sales taxes increase as the economy improves
2. Ending the TIF program leads to increased and ongoing property tax revenue
3. Reducing sales tax makes goods cheaper to purchase, thereby increasing the likelihood that people will purchase more goods, especially at lower levels of the income ladder. The services tax will have less effect, especially if taxes are directed toward luxury services.

8. Tax fairness?

Illinois has the fourth most regressive state tax structure in the country[17], and Chicago's heavy reliance on user fees, local sales taxes, and excise taxes likely makes the local situation even more regressive. While not perfect, this proposed tax plan would make local taxes much fairer than they currently are.

Based on 2009 tax data and calculations made through the rate changes proposed in this report, tax distributions would be as follows:





True tax fairness would require much higher taxes on the top end of the income distribution (top 5% and specifically the top 1%). Such fairness must be addressed at the state level – we recommend a graduated state income tax – as well as changes at the federal level (again, with a significant expansion of the top marginal income tax rates). Full funding for key public services can only come by collecting revenue from the parts of the economy that have grown. For instance, during the first year of recovery after the Great Recession, the top 1% of income earners collected 93% of all income growth.[18] As such, effective tax policy suggests that taxes should increase at the top end of the income distribution. We call on policymakers to make the economically sensible, if politically difficult, decision to adjust our tax policy to meet the needs of our modern society.

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[1] City of New York Comprehensive Annual Financial Report of the Comptroller, Fiscal Year 2011, p. 57 (PDF)

[2] "New York City Income Tax" retrieved 8/28/12 from http://taxes.about.com/od/statetaxes/a/New-York-City-Income-Tax.htm

[3] "Inspector puts city income tax, Lake Shore Drive tolls on the table" retrieved 8/28/12 from http://www.suntimes.com/news/metro/7892293-418/a-36pt-hed-in-here-a-36pt-hed-in-here.html

[4] Calculation derived from publicly available IDOR data available in spreadsheet form and accessed 8/28/12 at http://tax.illinois.gov/AboutIdor/TaxStats/2010/index.htm

[5] Calculation based on IDOR data.

[6] Chicago Inspector General Office "Income Taxes – Create a Commuter Tax" accessed 8/28/12 at http://chicagoinspectorgeneral.org/major-initiatives/budget-options/2011-budget-options-online-version/revenue-options/income-taxes-create-a-commuter-tax/

[7] Civic Federation. (2012). "Selected Consumer Taxes in the City of Chicago." Accessed 8/28/12 at http://www.civicfed.org/sites/default/files/Feb2012SelectedConsumerTaxesinChicago.pdf

[8] City of Chicago Comprehensive Annual Financial Report, FY 2011, p. 41

[9] "Emanuel Revives Plan to Expand Sales Tax to Services, Cut Tax Rate" retrieved 8/29/12 from http://chicago.cbslocal.com/2011/09/28/emanuel-revives-plan-to-expand-sales-tax-to-services-cut-tax-rate/

[10] http://www.ustr.gov/trade-topics/services-investment/services accessed 8/29/12

[11] Federation of Tax Administrators 2007 Spreadsheet with differential tax rates available at http://www.taxadmin.org/fta/pub/services/services2007.xls and accessed 8/29/12

[12] Chicago Inspector General's calculation. Available at http://chicagoinspectorgeneral.org/major-initiatives/budget-options/2011-budget-options-online-version/revenue-options/sales-taxes-broaden-the-sales-tax-to-include-more-services/ and retrieved 8/28/12

[13] Chicago Public Schools Comprehensive Annual Financial Report, FY 2011, p. 116

[14] For an explanation and details of the full formula, please see http://www.isbe.net/funding/html/gsa.htm

[15] Calculations available at http://webprod1.isbe.net/gsainquiry/default.aspx

[16] http://webprod1.isbe.net/gsainquiry/default.aspx available through payment schedule link

[17] Institute on Taxation & Economic Policy, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States", 4th Edition, January 2013. Available at http://www.itep.org/pdf/whopaysreport.pdf

[18] Picketty, T. & Saez, E. (2012). "Striking it Richer: The Evolution of Top Incomes in the United States" Updated article from *Pathways Magazine* (2008). Retrieved 10/2/12 from http://elsa.berkeley.edu/~saez/saez-UStopincomes-2010.pdf