

ILLINOIS PROPERTY TAXES

Property taxes are the only major revenue source for which the Illinois state and local tax burden exceeds the national average—indicating a fundamental imbalance in the state’s tax structure. And while various “property tax relief” measures have been enacted, these tax breaks are unavailable to many low-income Illinoisans—indicating a lack of balance within the property tax base itself. The state’s continued reliance on regressive local property taxes as a source of revenue to fund important services—especially elementary and secondary schools—introduces important issues of equity, since poor school districts are frequently unable to raise sufficient levels of property taxes to provide their desired level of services. For this reason, state property tax reform should be central to any ongoing school finance reform effort.

The Illinois Property Tax Burden: How High?

While property taxes have declined as a share of taxes nationwide, the share of state and local tax revenue derived from the property tax in Illinois has actually *risen* somewhat over the past two decades. In fiscal 1999, Illinois property taxes represented 37.1 percent of all taxes collected in the state; only 11 other states derived a greater share of their tax revenue from the property tax. Expressed as a percentage of personal income, the Illinois property tax burden is well above the national average, and is growing even as the property tax burden nationwide has declined. In fiscal 1999, state and local property taxes represented 3.8 percent of personal income in Illinois—significantly more than the 3.2 percent national average. As a result, the state’s ranking has increased from 21st to 12th highest by this measure over the past two decades. In the past decade alone, Illinois property taxes have grown more than twice as rapidly, on a per capita basis, than property taxes in the nation as a whole—and more quickly than almost all neighboring states.

Trends in Illinois Property Taxes

	As a % of Personal Income				As % of Total Taxes			
	1979	US Rank	1999	US Rank	1979	US Rank	1999	US Rank
Illinois	3.5%	21	3.8%	12	35.0%	19	37.1%	11
Indiana	2.9%	30	3.4%	19	33.0%	24	33.2%	15
Iowa	3.8%	19	3.5%	15	37.9%	13	33.0%	16
Kentucky	1.8%	48	1.9%	44	17.7%	44	17.1%	44
Michigan	3.9%	18	3.2%	22	35.8%	16	29.5%	23
Missouri	2.5%	37	2.3%	39	28.3%	32	23.6%	37
Wisconsin	4.0%	17	3.9%	11	33.9%	21	31.7%	19
ALL STATES	3.3%		3.2%		31.6%		29.5%	
IL/ US avg	106%		120%		111%		126%	

Source: Bureau of Economic Analysis, Bureau of the Census

The Distributional Impact of Illinois Property Taxes

Illinois property taxes are regressive: lower-income taxpayers generally pay more, as a share of income, than do better-off taxpayers. The 20 percent of Illinois taxpayers making less than \$15,000 pay 4.3 percent of their incomes on property taxes. The middle 20 percent of Illinoisans, with average incomes of \$36,400, pay 2.7 percent of their incomes in property taxes. The wealthiest one percent of Illinois residents, with average incomes of \$1.2 million, pay 2.2 percent of their incomes on property taxes.

Compared to other states, the Illinois property tax is unusually regressive—and unusually high. A 1996 ITEP study found that the residential property tax burden in Illinois was 12th highest nationally as

Average Annual Growth in Per Capita Property Taxes: 1989-1999

	Growth Rate	US Rank
Illinois	3.3%	11
Indiana	4.4%	2
Iowa	-0.5%	44
Kentucky	3.3%	10
Michigan	-1.8%	48
Missouri	3.2%	15
Wisconsin	1.4%	31
ALL STATES	1.5%	

Source: Bureau of the Census

a percentage of state income, and that the state's residential property tax was the 8th most regressive such tax in the nation.

The chief reason that property taxes are regressive is that home values are a much higher share of income for middle- and lower-income families than for the wealthy. It is common for a middle-income family to own a home valued at two or three times their annual income. Wealthier taxpayers are less likely to own homes worth as much relative to their income levels. Since property taxes are based on property value, they generally take a larger share of income from middle-income families than from the better-off. Far from representing a taxpayer's "ability to pay," property taxes tend to be highest for those with the least ability to pay. And property taxes are insensitive to variations in taxpayers' income: a taxpayer who suddenly becomes unemployed will find that his property tax bill is unchanged, even though his ability to pay it has drastically fallen. (By contrast, income tax bills depend on the level of earned income, so income taxes are much more sensitive to taxpayers' "ability to pay"—an important consideration as state unemployment increases.)

While the public's attention to property taxes is usually focused on the taxes paid by homeowners, the property tax also affects taxpayers who rent, rather than own, their own—and the property tax is also paid by businesses.

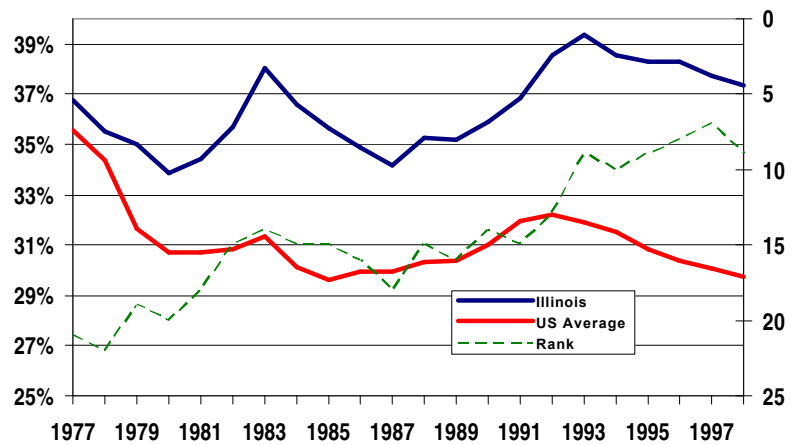
Renters are generally assumed to pay some of the property taxes falling on owners of rental real estate indirectly, in the form of higher rents. This is an important consideration, because most of the property tax relief dollars spent in Illinois are currently targeted to homeowners.

Because renters tend to be poorer than homeowners, the omission of renters from the state's major property tax relief programs (including the homestead exemption and the five percent property tax credit) increases the property tax burden on those least able to afford it—the very poorest Illinoisans.

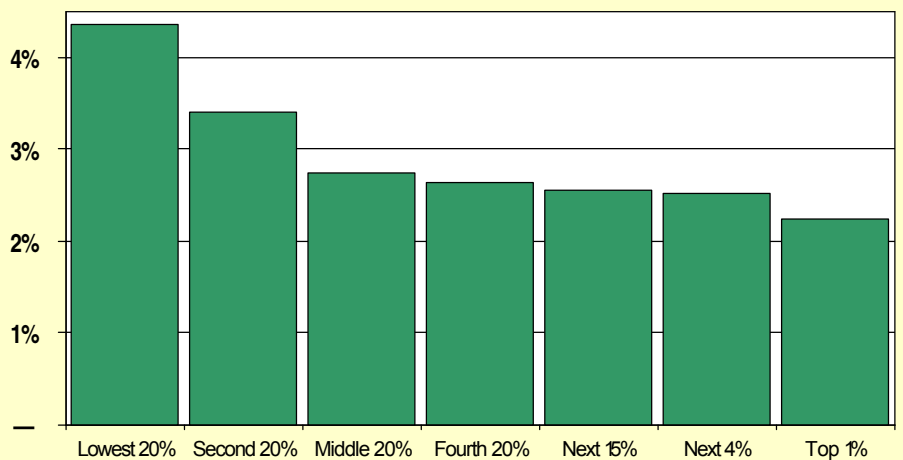
Property taxes are also levied on businesses. A good portion of the business property tax is exported to out-of-state shareholders and owners. This is an important consideration, because without the business property tax, many businesses that utilize Illinois government services would go largely untaxed.

As is the case with the personal income tax, a portion of Illinois property taxes on individuals is offset by federal income tax deductions—resulting in a "discount" of about \$300 million compared to a non-deductible tax.

The Increasing Role of Property Taxes:
Property Taxes as a share of Illinois State and Local Taxes, 1977-1998



2000 Illinois Property Taxes as Shares of Family Income
(Includes both individual and business taxes)



Defining the Tax Base

Property taxes are generally divided into two categories: *real* property, which includes land, buildings, and improvements, and *personal* property, which includes all non-real property. While real property taxes are used widely in all fifty states, many states have lessened their reliance on personal property taxation. Illinois is one of only ten states nationwide that have completely eliminated personal property from the tax base. Since personal property items such as motor vehicles are typically the largest personal property asset in a household's portfolio (and are generally the second-largest asset of any kind, after homes), this trend has curbed the growth of property tax revenues nationwide. Yet the exclusion of personal property from the Illinois tax base appears primarily to have encouraged higher taxation of the remaining taxable property.

The Illinois property tax is reduced by two types of exemptions. First, a large amount of property is simply not counted as part of a taxing district's assessed value because of the nature of its ownership. Property owned by federal, state and local governments, religious organizations, and education or charitable groups is all exempt from taxation.

Second, an equally large amount of property is excluded from assessed value because of the nature of the property itself. Tangible and intangible (items such as stocks, bonds, and invested property more generally) personal property are both completely exempt from tax.

A third broad category of property is included in assessed value, but then exempted from assessed value based on factors such as household income (in the case of the homestead exemption) or corporate investment behavior (in the case of manufacturing tax abatements).

Property Taxes and Local Responsibilities

Like most states, Illinois raises the vast majority of its property taxes at the local level. More than 98 percent of Illinois property tax revenues were raised at the local level in fiscal 1997. Since local property tax revenues are designated overwhelmingly for funding elementary and secondary education in each district, the state's reliance on local property taxes creates inequities between available funding for property-wealthy and property-poor districts. In recent years, lawmakers have sought to reduce the funding disparities between districts by increasing the "foundation level" of total district per-pupil spending. This move has helped to ensure that more property-poor districts can provide levels of spending that approach the statewide average. Yet there are indications that substantial spending disparities exist between school districts.

Property Tax Relief Mechanisms

Illinois provides several state-funded property tax relief mechanisms, including exemptions and credits. Most of these mechanisms are targeted exclusively toward homeowners and businesses.

Property Tax Exemptions

The most frequently used form of state property tax relief for homeowners is the **Homestead Exemption**, which usually exempts a flat dollar amount, or a flat percentage of home value, from property tax. The Illinois homestead exemption, enacted in 1978, is relatively unusual in that it is calculated by reference to the *change* in home value since 1977. In particular, the amount of homestead exemption available to a homeowner in tax year 2000 is the increase in assessed value of the property for the current tax year over its assessed value in 1977. The value of the homestead exemption is capped at \$3,500 (\$4,500 in Cook County).

Because the Illinois maximum homestead exemption is calculated as a fixed dollar amount, the exemption is mildly progressive in its impact on homeowners: a \$4,500 exemption represents a larger share of a property's value for less expensive homes. Yet because the exemption is limited to owner-occupied homes, the homestead exemption is completely ineffective in offsetting property taxes paid by renters.

The Illinois homestead exemption has also diminished in value since it was first enacted. The \$3,500 maximum homestead exemption has not been increased since 1978. As a result, the exemption is worth much less today than in 1978: if the \$3,500 maximum had been indexed for inflation, it would be \$9,200

today. And the rapid growth of property values during this period means that the homestead exemption is growing less effective as a property tax relief tool every year. The dollar value of homestead exemptions granted in 1997 was just over 10 percent of the equalized assessed value of residential property—down from 19 percent in 1983.

In addition to the homestead exemption, Illinois also allows an exemption for the value of additions to a residential property. The **Homestead Improvement Exemption** is limited to \$45,000 of added home value, and is limited to the first four years after the improvement is complete and occupied.

Enacted in 1971, the **Senior Citizens Homestead Exemption** is an exemption of \$2,000¹ of equalized assessed value for real property. Like the regular homestead exemption, the Senior Citizens exemption is restricted to owners or lessors of residential property who are liable for real estate taxes on the property. This exemption is given in addition to the homestead exemption. The Senior Citizen exemption is also similar to the regular homestead exemption in that its real value has declined over time, and in its inapplicability as a tax relief mechanism for senior citizens who rent their homes.

The **Senior Citizens Assessment Freeze Homestead Exemption** was designed to allowed elderly homeowners to avoid increases in the assessment on their homes. Taxpayers without household income of \$40,000 or less can elect to maintain the equalized assessed value of their homes at the base year values.

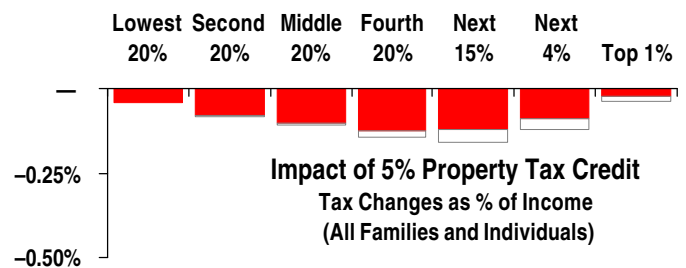
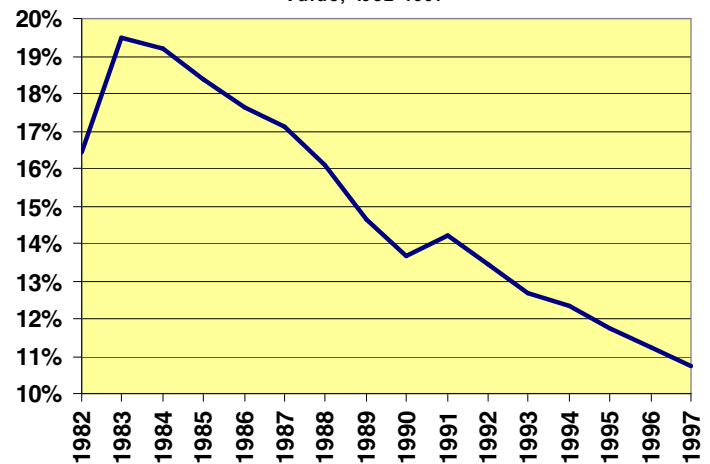
Finally, the **Disabled Veterans' Exemption** allows disabled veterans to exempt up to \$58,000 of their home's assessed value.

Property Tax Credits

The most important property tax credit available to Illinois homeowners is the property tax credit available on state income tax forms. Illinois homeowners may claim a income tax credit of 5 percent of property taxes paid. Because the credit is claimed on state income tax forms, it functions as a *refund* through which property taxes already paid are rebated to income taxpayers—an odd approach to property tax relief, since it depends on *income* tax liability. The progressivity of the credit is limited by several important features:

- Because the credit is limited to Illinois homeowners who paid property taxes on their primary residence, it is not available to taxpayers who rent their home or apartment—even though it is generally accepted that a substantial portion of property taxes on rental properties are passed

The Declining Value of Homestead Exemptions: Illinois Homestead Exemptions as a % of Equalized Assessed Value, 1982-1997

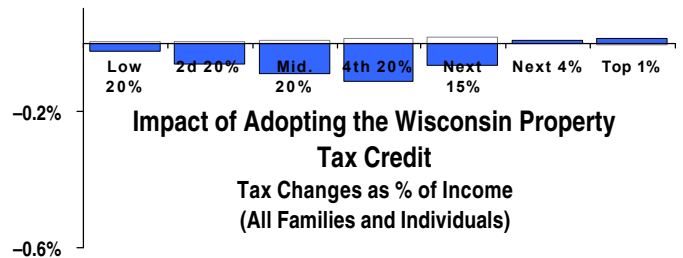


¹As originally enacted, the exemption was worth \$1,500. The value of the exemption was increased to \$2,000 in 1983, with a \$2,500 exemption for counties with more than 3 million residents.

through to renters.

- While the maximum credit is calculated as 5 percent of property tax liability, the amount of the credit which can be claimed is limited to the total amount of personal income taxes paid. This means that low-income taxpayers with relatively high property tax burdens may not be able to use the full amount of this credit. And elderly taxpayers, whose income tends to be concentrated in non-taxable pension and Social Security income, may be entirely ineligible for the credit.
- Because the credit is calculated as a percentage of property taxes rather than as a dollar amount, taxpayers with more expensive homes enjoy the same percentage reduction in property tax liability. There is no limit on the income levels at which taxpayers may take advantage of this credit. By contrast, the Wisconsin credit for property taxes paid is capped at \$300 per household. The Wisconsin approach reduces the cost of the credit and targets its benefits more effectively to low-income taxpayers. Even though the Wisconsin credit is calculated as 12 percent of property taxes

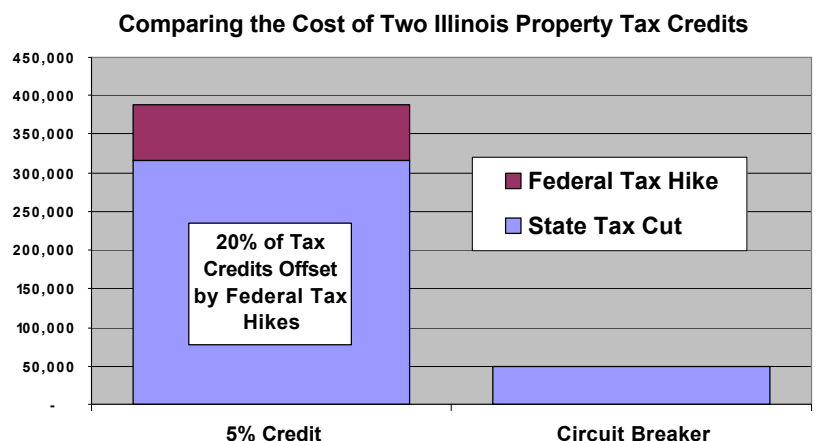
(compared to 5 percent for the Illinois credit), the Wisconsin credit would cost \$175 million less if allowed in Illinois than the current credit does—and would provide a larger tax cut, on average, to the poorest 95 percent of Illinois taxpayers. The chart at right shows the net impact of Illinois replacing its 5 percent property tax credit with the Wisconsin credit in 2000.



One additional feature of the existing property tax credit that receives relatively little attention is its effect on the federal income taxes paid by Illinoisans claiming the credit. Almost 20 percent of the Illinois income tax cut from this credit is directly offset by increased federal income tax payments. This means that less than 80 percent of the state revenue loss from this credit finds its way into the pockets of Illinois residents. One way to reduce this “leakage” would be to phase out the property tax credit above a certain income level. The “Options” chapter of this study shows the impact of limiting the property tax credit to the first \$300 of tax liability—as was done with the one-time “property tax rebate” issued in 1999. Such a change would increase state income tax collections by \$38 million in 2000—and would *reduce* federal taxes paid by Illinoisans by over \$10 million.

The other major form of property tax relief targeted at Illinois senior citizens is the state’s **Elderly Circuit Breaker** program. The program is called a “circuit breaker” because it is targeted only to taxpayers whose property tax burden exceeds their ability to pay them. The Illinois circuit breaker is targeted to lower-income elderly homeowners and renters property tax relief. In 2000, the state disbursed \$51 million in direct relief to 200,000 individuals through this program, for an average credit of \$256 per recipient. The amount of this credit available to homeowners is limited by four factors: the age of the taxpayer, the amount of property taxes paid, household income, and a dollar limitation. Only taxpayers over 65 are eligible, and the maximum credit available is \$700 minus 4

½ percent of household income, with a flat \$70 maximum for eligible taxpayers with income over \$14,000. The maximum income for eligibility was \$14,000 from 1972, when the circuit breaker was first enacted, through 1997. In 1998, the income threshold was raised to \$16,000. Legislation enacted in 2000 increased the basic income threshold to \$21,218 for households containing one person, and provided higher thresholds for larger households: effective calendar year 2001, the income eligibility threshold for a



two-person household is \$28,480, and the threshold for a three person household is \$35,740.

Even at its recently expanded level, the elderly circuit breaker costs significantly less than the annual 5 percent property tax credit. As the chart at right shows, the 5 percent property tax credit reduces state income taxes by \$390 million in tax year 2000, compared to \$50 million for the circuit breaker. And the federal tax *hike* due to the 5 percent credit is actually greater than the state tax cut due to the circuit breaker. In other words, the loss to Illinois state taxpayers due to the 5 percent credit's federal offset could fund a doubling of the Illinois circuit breaker's current cost.

Business Property Tax Relief Measures

Illinois allows three property tax measures that are targeted specifically to businesses: enterprise zones, tax increment financing, and tax abatements.

Enterprise zones are designed to encourage economic development in economically depressed areas. Taxing districts are allowed to abate property taxes payable on new development that takes place in these enterprise zones.

Tax increment financing (TIF) districts were designed to encourage economic development in Illinois. TIF agreements are not tax cuts, but are *dedications* of tax revenues for particular purposes. The most recent Department of Revenue estimate is that TIFs cost \$254 million in tax year 1996.

Local governments are allowed to issue three types of **tax abatements** for various business activities, including the creation of new business facilities in Illinois, or the expansion of existing facilities. Each local taxing district is limited to a maximum total abatement of \$1 million in each year. Abatements can include commercial and industrial abatements, leasehold abatements, and urban decay abatements.

1999 Property Tax Rebate

Legislation passed in July of 2000² created a one-time property tax rebate, targeted to Illinois homeowners with positive income tax liability. The rebate was tied to the amount of tax credit claimed by Illinois taxpayers in 1999 for property taxes paid. The linkage to the income tax credit meant that the rebate inherited several important characteristics of the credit:

- The rebate was not limited at higher income levels. Taxpayers at all income levels could claim the maximum amount of the credit.
- The rebate was limited to homeowners. Because the income tax credit is not available to Illinois taxpayers who rent their residences, the rebate was unavailable to these taxpayers as well.
- The rebate was limited to taxpayers with positive income tax liability. Since the property tax credit is nonrefundable, taxpayers with zero income tax liability before credits cannot claim it—and taxpayers with very low levels of income tax liability cannot claim the full amount. Since the rebate was tied to the amount of property tax credit claimed, any limitation on the amount of credit claimed by low-income taxpayers was passed on to the property tax rebate.
- While the rebate was not considered to be taxable income for Illinois state tax purposes, the rebate amounts were fully taxable on the 2000 federal tax forms for all Illinois residents who claimed their Illinois property tax liability as an itemized deduction.

However, the property tax rebate differed from the property tax credit in one important way: the amount of the rebate was capped at \$300. This increases the progressivity of the rebate somewhat while minimizing its cost.

While the rebate was roughly proportional—giving almost identical cuts as a percentage of income to most of the income distribution—the taxability of the rebate on federal itemizers' returns means that a substantial percentage—more than 15 percent—of the state tax reduction enjoyed by Illinois taxpayers was

²House Bill 3876, Public Act 91-703.

offset by a federal income tax increase. And for the very highest-income taxpayers, close to 40 percent of the state tax cut went straight to the federal government rather than to Illinoisans. This is an inherent feature of “rebate” proposals that target their benefits to all taxpayers—the percentage of a state income or property tax cut that actually goes to a state’s residents will decline as the percentage of the cut going to high-income taxpayers increases. The greater the percentage going to low-income taxpayers, the greater the percentage that will remain in the state rather than adding to the federal tax coffers.

Any government spending program that simply threw away fifteen percent of its allotted spending totals would be sharply criticized as government waste—yet relatively little attention has been paid to the inefficiency of Illinois policymakers’ efforts at property tax relief. More precisely tailoring such property tax credits in future would reduce the overall cost of these tax “rebates” and would ensure that a greater percentage of their tax cuts are actually passed through to Illinoisans.

Property Tax Limitations

Since the passage of California’s Proposition 13 in 1978, legislators and voters in many states have enacted limits on the growth of property tax revenues. These limitations tend to place artificial and sometimes arbitrary limits on the ability of local governments to raise revenue and provide the services demanded by their constituents. Illinois limits property taxes paid, through the Property Tax

Extension Limitation Law of 1991 (PTELL). The approach taken by Illinois is relatively unusual, however, in that it limits the *aggregate* amount of property taxes collected in a particular district, and in that most districts are allowed to choose whether the PTELL limits should apply.

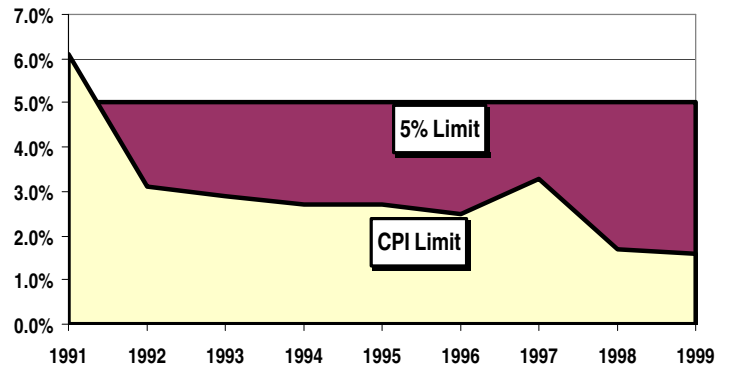
The PTELL limits were created as a response to high property tax growth in the late 1980s. The PTELL limits were designed to act as a backstop to increasingly ineffective property tax *rate* limits that were already in effect at the time: much of the increase in property tax burdens in Illinois during this period had been due not to rate increases but to increases in assessed value. The PTELL law limits the annual growth of property tax extensions to 5 percent or the previous year’s increase in the Consumer Price Index (CPI), whichever is less. Since the program was created, the CPI change has been substantially lower than the 5 percent limit in each year except for 1991, as shown in the chart at right. In 1999, this meant that property tax extensions in counties with the PTELL limit could grow by just 1.9 percent over the 1998 level. The main problem with these limits is that the 5 percent limit is arbitrary—and the CPI limit flies in the face of many states’ experience with growth in educational costs. In school districts where the cost of educational inputs is growing at a rate greater than inflation—as is generally true of teacher salaries, for example—the PTELL limits can force districts to pare back necessary education expenses to meet the limits.

The legislation creating PTELL mandates its use in Cook County and in the “collar counties”³ surrounding Chicago, but allowed all “downstate” counties to decide whether to impose PTELL limitations. Since 1991, more than two dozen downstate counties have enacted the PTELL limitations.

Personal Property Tax:

Illinois is one of only ten states to exempt all personal property from taxation.

PTELL Property Tax Growth Limits, 1991-1999



³Dupage, Kane, Lake, McHenry, and Will Counties.

Illinois abandoned taxation of individual personal property in 1970, and exempted business personal property in 1979.

One disadvantage of completely exempting personal property from taxation, while taxing real property, is that tax administrators must be able to distinguish between items of personal and real property—and that real property owners have an incentive to blur this distinction by claiming items as personal property which are better characterized as real property.

Another frequently overlooked disadvantage of exempting personal property is that personal property taxes on individuals can be deducted by federal itemizers in computing their federal taxable income. This means that up to 31 percent of the personal property tax burden can be exported to the federal government. Therefore, the exemption of personal property may diminish the state's ability to export its tax burden.

The exemption of personal property also makes it more difficult to mitigate over-reliance on taxation of residential real property. One of the most striking Illinois property tax trends over the past fifteen years is the movement toward greater reliance on residential property taxes as a source of property tax revenue—and a simultaneous movement away from business and agricultural property taxes. As recently as 1984, business and agricultural property taxes constituted 52 percent of property tax extensions in Illinois—but by 1997 that percentage had declined to just 44 percent. Residential property taxes in Illinois represent a substantially greater share of total property tax extensions in 1997 than 15 years earlier. To some extent, this probably represents an increase in the share of new construction that is residential in nature—but this trend also reflects the inability of local governments to tax personal property.

Conclusion

Illinois property taxes are among the highest in the nation. And at a time when property taxes have declined as a revenue source for state and local governments nationwide, Illinois has maintained its over-reliance on this regressive source of tax revenue. The results of this revenue imbalance is predictable: the state's tax system is made more regressive than in neighboring states with a more balanced tax system, and the use of local property tax revenues for school funding causes fundamental problems equity between wealthy and poor school districts.

Moreover, the existing tax credits and exemptions designed to offer property tax relief are poorly targeted. Non-elderly taxpayers—and taxpayers who rent, rather than owning a home—receive relatively little property tax relief. Any substantial reform of the state's tax structure should reduce the reliance of Illinois local governments on property tax revenue—and should make the remaining property tax burden more equitable through the use of expanded low-income credits.

Property tax relief has been one of the most frequently discussed tax reform topics in Illinois for more than a decade. The difficulty of achieving property tax reform is largely a product of the close linkage between property taxes and school funding: elementary and secondary education in Illinois has historically been funded primarily through property tax revenues, which means that any reduction in property taxes potentially places K-12 education funding in jeopardy—while raising the specter of loss of local control of funding of schools. Yet the future adequacy of Illinois education may depend on the willingness of state policy makers to rectify the state's revenue imbalance.

**Sources of Illinois Property Tax Revenue
1982-1997**

