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Business leaders raise tax concerns

Criticism of proposed rates, lack of dialogue with governor

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Advertisement

March 11, 2007

Gov. Rod Blagojevich's proposal to radically change the way Illinois companies are taxed is already working well in Ohio, business leaders in both states say.

But the governor is approaching the tax against a tide of corporate opposition.

In Ohio, business and government worked together to devise a new and fairer corporate tax.

In Illinois, the governor did not consult business leaders and proposed a tax very similar to the one in Ohio, only much higher.

"There was no discussion with us or any of the other major trade groups," said Greg Baise, president of the Illinois Manufacturers' Association. He said he and officials of other business advocacy organizations would have eagerly worked with the administration on the topic of tax reform.

One administration source, speaking on condition of anonymity, confirmed that Blagojevich did not reach out to the business community.

"Did we bring Vite in the room or Baise or Whitley? No," said the source, referring to David Vite, president of the Illinois Retail Merchants Association and Doug Whitley, president of the Illinois Chamber of Commerce. The source said business leaders have in the past tried to block tax reform.

"I don't think they had any interest in working with us," the source said. "They have done nothing but obstruct."

Becky Carroll, spokeswoman for the governor, put it this way: "Some voices representing large corporations are committed to a system that unfairly burdens individuals and small businesses, and they have also opposed all of our past efforts to close unfair corporate loopholes."

"The governor doesn't know how to ask for help," Whitley responded. "He never has."

Even as the governor was releasing details about his proposed tax, Vite said he was against it.

"It is a tax increase," he said, and one that would particularly hurt retailers, who often have small profit margins.

State would tax overall income

Blagojevich might need some allies in overcoming massive business opposition to a tax system that he says is profoundly in need of change.

The governor is proposing to tax the gross receipts of businesses with \$1 million or more in revenue, whether they are profitable or losing money. In other words, the state would tax overall income rather than profits.

Service businesses would pay 1.8 percent of gross revenues, while manufacturing, construction and other businesses would pay one half of 1 percent.

Blagojevich says the gross-receipts tax will close loopholes that allow many businesses, some of them huge, to pay little or no taxes under the current system.

"There were 8,928 corporations with gross sales in Illinois of more than \$256 billion that paid no income taxes," Blagojevich said in a written version of his budget speech last week, citing data from 2004, the most recent year for which data is available.

The governor also said the gross-receipts tax is simple to understand, easy to comply with and would not apply to retail sales of food and drugs. Goods and services exported out of state also would be exempt.

Blagojevich wants the estimated \$6 billion in new revenue from the gross-receipts tax to fund increases in spending on education, to make health insurance more readily available and for other state purposes.

Leaders call it tax increase

The idea of a gross-receipts tax has landed with a dismal thud among Illinois business leaders, who see it as a \$6 billion tax increase, not reform of a porous and erratic system of corporate taxation.

Ohio has already done what Blagojevich proposes to do, but that state went about it very differently.

Several years ago, Ohio business executives and political leaders gathered to fix what was widely perceived as a dysfunctional corporate tax system. The goal was to improve the state's economy, not to raise tax revenues.

"It was a very collaborative effort between business and government," said Thomas Zaino, an attorney who represented the Ohio Business Roundtable, an organization for 100 major corporations in the state.

Zaino said government and business were eager to rid the state of an archaic tax on investments in machinery, equipment and buildings. They also wanted to replace the state's existing tax system for corporations.

A tax on the tools of production deters investment and job creation. Illinois got rid of a similar tax in the 1970s.

In 2005, Ohio adopted a gross-receipts tax. When fully phased in, the tax will be 0.0026 percent of gross revenues, slightly more than a quarter of 1 percent, and yield about \$1.4 billion a year.

Along the way, the state also cut personal income taxes.

Tax could cost consumers

The 0.0026 percent rate was deliberately set low to minimize the effect of what is called "pyramiding."

A good can be sold several times before it reaches its final consumer. With a gross-receipts tax, each transaction is taxed. The final consumer doesn't see those taxes, but, if they are passed through in the cost, they pay it. Depending on the number of transactions, the final cost can pyramid much higher than a sales tax.

A pyramiding gross-receipts tax concerns some economists.

"It would tax goods kind of capriciously depending on the stages of production," said George Tolley, president of RCF Economic and Financial Consulting Inc. and a former official with the Treasury Department.

Blagojevich's proposed tax is much higher than the one in Ohio.

An Ohio company with gross receipts of \$10 million would pay a tax of \$26,000.

"When it's fully phased in, it's a fairly minor tax," said J. Thomas Johnson, president of the Taxpayers' Federation of Illinois.

Under Blagojevich's proposal, a manufacturing company with \$10 million in revenue would pay \$50,000 and a services company would pay \$180,000.

"In comparison to Ohio, it has a bigger impact," Johnson said. He said the pyramiding effect becomes more pronounced as the tax rate increases, which compounds the higher cost for the final consumer.

Bruce Johnson, the former lieutenant governor of Ohio who headed the tax reform initiative for his state, said Blagojevich's proposed rate would have been difficult or impossible to sell to his state's business people.

"Ours was a tiny rate compared to that," Johnson said. "The businesses would have balked."

In Illinois, the businesses are balking.

The Chicagoland Chamber of Commerce, for example, is strongly opposed to the governor's proposal.

"The gross-receipts tax would no doubt be passed on to Illinois consumers as has happened in other states in the form of higher prices for everything from gasoline to appliances," said chamber President Jerry Roper.

"Already in Chicago, residents and businesses are subject to the nation's highest restaurant sales tax, second highest overall sales tax and one of the highest hotel and parking taxes," he said.

The Illinois Chamber of Commerce, which opposes the gross-receipts tax, notes that the tax favors bigger, vertically integrated businesses. They don't have as many taxable cash transactions as smaller

companies.

And Mark O'Donnell, sales manager for Kenwood Electrical Systems in Rockford, sees it as a disadvantage for relatively small companies like his. Kenwood's 42 employees manufacture cable assemblies and wiring harnesses for industrial applications.

"All the governor is doing is adding more taxes and more burdens onto the employers," O'Donnell said. He said the tax will eventually be paid by the consumers.

"One way or another, it is going to be passed on," he said.

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