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ILLINOIS' PROPOSED GROSS RECEIPTS TAX

A Modified GRT Could Be Paired With Other Tax Changes

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Summary

Governor Blagojevich of Illinois has proposed a new revenue source, a gross receipts tax (GRT), to provide funds for a major health care expansion, public education, property tax relief, and to help address the state's long-standing budget problems. A GRT is a low-rate tax on the receipts of all types of businesses. The governor's proposed GRT would exempt retail sales of food and drugs, Medicaid payments, and the receipts of non-profits and industries such as gaming and insurance already covered by other specialized taxes.

A GRT in Illinois has a number of significant advantages:

- its ability to raise substantial amounts of needed revenue and to provide a more stable revenue stream over the course of a business cycle than the corporate income tax;
- improved equity in tax payments among different forms of business organization (such as corporations and partnerships) and between goods-related and service-related industries; and
- a reduction in special-interest tax breaks.

There also are some drawbacks to a GRT. There are, however, relatively simple ways to modify the structure of a GRT to mitigate the problems and capitalize on the advantages. Specifically, this report discusses how a subtraction for the cost of inputs purchased from other businesses, coupled with a low-income credit, could mitigate most of the problems of the GRT.

One potential problem with a GRT is its impact on high-volume, low-profit margin businesses, for which the tax can represent a high percentage of potential profits. Another potential problem is that a GRT favors businesses that conduct most operations in-house over businesses that purchase intermediate goods and services from other firms, since the tax is imposed each time a business purchases inputs from an outside firm. (This latter problem is called "pyramiding.")

Illinois can address both of these problems, however, by allowing businesses to subtract the cost of goods purchased from other companies from the gross receipts subject to the tax. Texas and

Kentucky allow a similar, although broader deduction. If the cost of purchased inputs were deductible, a retail discount clothing store — an example of a high-volume, low-margin operation — would pay GRT not on its total receipts, but on its receipts *minus* the amount it paid the wholesaler for the clothes it sold. This would eliminate the disadvantage that such a store would have under a GRT compared to a boutique clothing store with much fewer sales but a high profit on each sale.

Similarly, the ability to subtract the cost of purchased inputs would eliminate most pyramiding, since the taxes paid during the intermediate stage of production would be included in the purchasing business's cost of purchased inputs and thus would not be taxed again. Modifying the GRT in this way would help level the playing field between companies that purchase goods and services from other companies and "vertically integrated" companies that include multiple stages of production and have in-house staff to provide legal, accounting, and other services.

Another potential problem with the GRT is the burden it can impose on low-income households. A GRT is initially paid by businesses but a substantial portion of the tax is likely to be passed on to final consumers through higher prices. Low- and moderate-income households generally would pay a larger percentage of their income in GRT than higher-income households. Low-income households spend rather than save a larger share of their incomes and also are likely to spend a greater share of their income in the state where they live.[1] This additional burden, however, could be offset by creating or expanding tax relief targeted to low- and moderate-income families.

It should be noted that these proposed changes — allowing a subtraction for the cost of inputs purchased and providing tax relief for families — would reduce the revenue gained from a new GRT somewhat below what the governor has estimated for his proposal. The modified GRT would likely raise 60 percent to 70 percent of the revenue that the Governor's proposal would raise. To reach the revenue level the governor has proposed, the modified GRT would have to be coupled with additional revenue sources. One possibility would be an increase in the income tax rate. It also might be desirable to retain and strengthen the corporate income tax, with the GRT allowed as a credit against the corporate tax.

The Governor's Proposal

In March, Governor Rod Blagojevich proposed the establishment of a gross receipts tax — a major new revenue source for the state. The GRT would be levied on Illinois businesses and would eventually replace the state's corporate income tax, according to the governor's plan.

A GRT is a tax on business receipts. It applies whenever a product or service — from the raw material through the finished product purchased by a consumer — "turns over" (i.e., is sold by one business to another) in the process of making products or providing services. For this reason, a GRT is sometimes called a "turnover tax."

[1] For a discussion of the geographic profile on different household spending patterns, see, for example, Andrew Bernat and Thomas Johnson, "Distributional Effects of Household Linkages," *American Journal of Agricultural Economics,* 73(2) May 1991.

For example, the provider of steel used to make a car would pay the GRT on the sales price of the steel it sells to the automaker, and a firm providing legal services to the automaker would pay the GRT on the fees it charges. When the automaker sells the car, it would pay the GRT on the revenue it receives from the car's sale.

A business computes the amount of GRT it owes by multiplying the GRT rate by the amount of revenue received from its sales of goods or services. A GRT can raise significant revenue with a very low rate because its base is extremely broad; a pure GRT covers *all* types of businesses and applies to *all* business revenue, not just profits.

The proposed Illinois GRT is not a pure version of the tax, however. It would apply only to Illinois businesses with more than $2 million in receipts, and would exempt retail sales of food and drugs, Medicaid payments, and the receipts of non-profits and industries such as gaming and insurance already covered by other specialized taxes, as well as receipts from the sales of products that are shipped out of state.

Advantages of a Gross Receipts Tax

Illinois would derive a number of advantages from a GRT:

- **Infusing much-needed revenue.** When fully phased in, the tax would raise over $7 billion annually, or about 25 percent of the state's current general fund budget. The governor has said that this additional revenue would be devoted to providing funds for a major health care expansion, public education, property tax relief, and to help address the state's long-standing budget problems. The GRT would not immediately replace the corporate income tax; instead, businesses would receive a credit against their GRT liability for corporate income taxes paid. The governor has stated that the corporate income tax would be eliminated in the future.

- **Creating a more stable revenue stream.** The revenue stream from a GRT is significantly more stable than that of a corporate income tax because businesses' sales are not subject to the wide swings that characterize their profits. For example, corporate income tax collections dropped 20 percent in fiscal year 2002 and climbed 54 percent in FY2004. This is considerably more volatile than business activity in the state over the same period. In contrast, the portion of the state's economic output attributed to private businesses rose 1.9 percent in 2002 and 6.6 percent in 2004.

- **Promoting tax equity among businesses.** All businesses in Illinois rely on government services. The state's transportation infrastructure and court system make it possible for corporations to do business in Illinois, for example, while the state's education system provides a supply of trained workers for corporate operations. Yet a considerable number of businesses in the state pay *no* corporate income tax; Governor Blagojevich has noted that 37 of the Fortune 100 companies paid no Illinois state tax despite having $1.2 billion in annual sales in Illinois. He has further noted that on average from 1997 to 2004, nearly half of all corporations with at least $50 million in annual Illinois sales did not pay any state income taxes. Such businesses are contributing considerably less to the costs of the government services they use than businesses that do pay the corporate income tax.

Key Features of Proposed Illinois Gross Receipts Tax

Tax Base

The tax would be levied on business receipts from sales of products and services in Illinois.

Tax Rates

There would be two tax rates:

- ❒ 1.95 percent on sales of services
- ❒ 0.85 percent on sales of goods

Exemptions

The following sales would be exempt from the GRT:

- ❒ Sales of businesses with receipts of less than $2 million
- ❒ Retail sales of food and medicine
- ❒ Sales of goods for export out of state
- ❒ Receipts from Medicaid payments
- ❒ Receipts of non-profits
- ❒ Receipts of businesses covered by specialized taxes such as gaming and insurance

Other Features

- ❒ The amount of GRT owed would be reduced by the amount of corporate income tax paid
- ❒ The tax is projected to bring in over $7 billion in revenue per year once fully phased in

Many businesses are able to avoid Illinois' corporate income tax by structuring themselves in other than a classic corporate form, including as a partnership, subchapter "S" corporation, or a limited liability company (LLC). Businesses operating in these forms in Illinois pass their profits through to their owners, who may pay tax at Illinois' lower personal income tax rate — or may not pay tax to Illinois at all if they live in other states. Unlike most states, Illinois does not require that taxes be withheld before profits are distributed to out-of-state owners or even that these owners sign a statement acknowledging that they owe and will pay taxes to Illinois on these profits.

- **Ensuring that service industries contribute.** The increasing importance of the production and consumption of services in the state's economy has reduced the growth of sales tax revenues — a major revenue source for Illinois — because sales taxes are levied largely on tangible goods and not on services. This problem is particularly acute in Illinois as the state's sales tax base is one of the narrowest in the country. Illinois' sales tax base includes only 17 of 168 services identified by the Federation of Tax Administrators as potentially taxable. Service industries such as legal, technology, and accounting firms sell services that are not subject to the sales tax. Adding a broad-based tax like the GRT would help broaden the state's business tax base.

A GRT has advantages over the expansion of the retail sales tax base to include services as a way to ensure that service industries contribute to the cost of government services. First, a gross receipts tax is initially a tax on businesses. While a significant portion of the tax may be passed on to consumers, some of the tax will be absorbed by the business through reduced profits and paid by business owners who tend to have higher incomes than the average consumer. In addition, GRT rates are considerably lower than retail sales tax rates because the broader base includes many more types of service industries than could typically be included under a sales tax. Moreover, the GRT falls on all sales of services. By contrast, no state in recent years has expanded its sales tax to more than a relatively limited selected group of services. The GRT has the advantage of treating all services equally.

- **Eliminating tax loopholes.** A GRT would allow the state to make a fresh start in taxing businesses without losing revenue from the exemptions and credits that have proliferated over time in the corporate income tax and the sales tax. A GRT has a very broad base that covers both goods-producing and service-producing businesses of all types. As a result, it is not subject to some major corporate income tax avoidance mechanisms, such as methods of organization in non-corporate form. The experience of other states such as Washington suggests, however, that Illinois will have to be careful not to add exemptions and credits to the GRT in the future in response to pressure from specific industries. It would be important to retain this advantage.

Concerns With A Gross Receipts Tax

This section outlines the major concerns that have been raised about GRTs. The next section explains how these concerns can be addressed.

The first concern relates to high-volume, low-margin businesses. The GRT does not distinguish among businesses based on how profitable they are. Businesses with a high volume of sales but a low profit margin (such as gas stations or discount clothing stores) are taxed at the same rate as highly profitable companies such as jewelry stores, or boutique clothing shops, even though they may be less able than those latter companies to pay the tax.[2] For example, a discount clothing store might sell items at just 1 or 2 percent above the price it paid a wholesaler for them; a GRT of even 0.5 percent or 1 percent would reduce the store's net income substantially and could affect its ability to make a reasonable profit.

Another concern is "pyramiding," or the taxation of inputs as well as final products. The GRT is levied each time a product or service is sold — whether the sale is of a finished product to the end consumer or of an input to a firm that will use it to create the final product. As a result, the total amount of GRT paid on a final product may be significantly higher than the GRT rate levied on the final product's sale may suggest, because each of the raw materials or services "consumed" in the creation of the final product would have been taxed when it was purchased. For example, the steel and tires used to produce a car, as well as any outside legal, accounting, or other services involved in the car's production, would be taxed as they are sold to the automaker and the automaker may pass along this cost in the price of the final product.[3]

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[2] Other types of businesses could have difficulty paying the tax in years of low profitability.

[3] The lower the rate of the tax the less likely it is that companies would make decisions about their organization as a result of pyramiding of tax rates. Thus, lowering the rate of the GRT could also mitigate some of these problems. This would, in turn, lower the revenue that the tax raised, requiring reduced spending or the need to raise additional taxes.

Is the GRT a "Hidden" Tax and Is This a Problem?

A number of critics of the Governor's proposal argue that a Gross Receipts Tax will reduce the accountability and transparency of Illinois' tax system and could result in poor policy choices in the future.

The GRT is a tax on businesses rather than on individuals. Like other business taxes it will be passed on to individuals — either to owners of capital through reduced profits, to consumers through higher prices or to workers through lower wages. Most economists agree that a considerable portion of a GRT will be passed on to consumers like a retail sales tax but, unlike a sales tax, the amount of the tax will not be shown on the bill a customer receives.

Some argue that this will make it easier for future governors to raise the GRT rate without having a full discussion of the impact of the higher tax. In reality, history shows that any proposals to raise business taxes — all of which are paid only indirectly by individuals — are subject to considerable debate by the legislature and receive scrutiny in the media. Businesses and their trade organizations are well positioned to take note when changes to business taxes are proposed and are unlikely to let them slip through without adequate debate.

In one sense it is very appropriate that the GRT be reflected in the price of the products sold. The GRT should reflect the cost to a business of the government services that allow it to operate in Illinois just as other business inputs such as materials, compensation and privately provided services are reflected in the price of their product.

A gross receipts tax is not the only tax levied on businesses that is not seen on bills to consumers. Businesses also pay property taxes which are reflected in the cost of doing business and potentially in the price of products. One of the proposed uses of the GRT in Illinois would be to reduce property taxes – both directly through targeted credits and indirectly by providing additional state aid for schools. In total, the impact of the GRT on consumers will likely be considerably less than the total amount of revenue raised, when the reduction in this other "hidden" tax is accounted for as well as the likelihood that businesses will not pass along the full amount of the GRT.

Pyramiding can cause economic distortions by creating incentives for businesses to act in inefficient ways. For example, some larger companies may have a choice between buying their inputs from other firms or making the inputs themselves; if they buy the inputs, the purchases are subject to the GRT, but if they make the inputs themselves, the purchases are not. Thus, the GRT may push companies to "vertically integrate" — that is, to bring services and production of inputs into the company rather than buying them from outside firms — in order to avoid the tax, whether or not this would otherwise be the most efficient way to make the final product. (How much of a push towards vertical integration the GRT provides would likely depend on the GRT rate and the number of times inputs are turning over.) In addition, companies that can vertically integrate would have a price advantage — and thus a competitive advantage — over companies that cannot. Pyramiding also can magnify the problems of a GRT for high-volume, low-margin businesses if it results in increased prices for purchases from wholesalers.

The potential economic distortions caused depend on the amount of pyramiding that occurs. Studies of the Washington state Business and Occupation tax and the New Mexico GRT show a not insubstantial amount of taxation of business inputs.[4] New Mexico estimates that 15 percent to 30 percent of GRT revenues result from taxation of business-to-business transactions.

Another potential problem with pyramiding may occur for businesses that sell products out of state. A GRT could put Illinois businesses at a disadvantage when selling products out of state because they would be competing with businesses than do not have to pay the GRT. The tax proposed by Governor Blagojevich would moderate this problem by exempting the revenue from final sales that are exported out of the state. However, these exported items might still have some tax costs embedded in them if, for example, the raw materials used to make them were purchased in the state.

Concerns have also been raised about a GRT's effect on individuals. A considerable portion of a GRT would likely be passed along to the buyers of the taxed firm's products through higher prices. As a result, a GRT is similar to a sales tax from the perspective of individuals. Like the sales tax, a GRT is regressive: lower-income people will pay a larger share of their income in GRT-related costs than high-income people, on average, because low-income families spend rather than save a larger share of their income. In addition, lower-income people are more likely to spend their money close to home, where the goods and services are subject to the GRT.

The governor partially addressed this concern by exempting retail sales of food and drugs — two necessities that make up a significant share of family expenses — from the GRT. However, sales of these items from a manufacturer to a retailer would be subject to the tax, and much of this tax would likely be passed along to consumers.

Finally, some are concerned that the GRT may reduce the transparency and accountability of the tax system by creating a "hidden tax." To the extent that a significant portion of the GRT is paid by consumers of finished products through higher prices, the GRT would be largely invisible to the purchaser of the end product — unlike the sales tax which is shown on a sales receipt. As a result there is concern that the rate of the Gross Receipts Tax would not be subject to full consideration and debate by the public. (See the box on page 6 for further discussion of this issue.)

Modifications to the GRT Can Address These Concerns

As noted above, the governor's proposal addresses several of the concerns traditionally raised about GRTs. It would help firms that sell products out of state by exempting from the GRT the revenue from those out-of-state final sales. It would help lower-income people by exempting retail food and drug sales from the GRT. And it would help start-up businesses that are not yet profitable, as well as "mom and pop" businesses with low profitability, by exempting firms with less than $2 million in receipts from the tax.

Nevertheless, Illinois could do much more to mitigate the potential problems with a GRT — as other states with GRT-type taxes, such as Texas and Kentucky, have done.

[4] The base of the Washington State B & O tax — total receipts reported to the state's Department of Revenue — significantly exceed Washington's total gross state product. This is the result of the taxation of goods at more than one stage of the production process. An analysis for the Washington State Tax Structure Committee estimated an average pyramiding rate of 2.5.

PROVISIONS OF STATE GROSS RECEIPTS-TYPE TAXES					
State	**Items Taxed**	**Rate**	**Size of Business**	**Food and/or medicine exempt?**	**Exports exempt?**
Illinois proposed	Receipts of all non-exempt businesses	1.95% for Service producing businesses 0.85% for Goods-producing businesses	Businesses with less than $2,000,000 in receipts are exempt	Yes, retail sales of food and medicine	Yes
Delaware	Gross receipts of all non-exempt businesses	Selected rates: Manufacturers: 0.180% Wholesalers: 0.307% Retailers: 0.576% Food processors: 0.154% Occupational/Professional/General Services: 0.384% Additional rates for specific industries	Retailers and wholesalers can deduct $80,000 per month. Manufacturers can deduct $1 million per month.	No	In most cases.
Kentucky	Tax is an alternative minimum calculation coupled with the corporate income tax. Corporations can choose one of two bases: gross receipts or gross profits (gross receipts minus cost of goods sold.)	The lesser of: 0.095% of gross receipts or 0.750% of gross profits (gross receipts minus costs of goods sold)	Businesses with both gross receipts and gross profits of less than $3,000,000 are exempt.	No	No
Ohio	Receipts from commercial activity of non-exempt businesses	0.26%	Businesses with receipts under $150,000 are exempt; those with receipts between $150,000 and $1,000,000 pay $150	No	Yes
Texas	The lower of: 70% of revenue; revenue minus cost of goods sold; or revenue minus compensation cost	0.5% of sales of retailers and wholesalers 1% of sales for all other businesses	Businesses with gross receipts under $300,000 are exempt (may rise to $600,000)	No	Yes
Washington	Gross receipts as measured by gross sales, gross income or value of products produced in state	Retailing: 0.471% Wholesaling: 0.484% Manufacturing: 0.484% Services: 1.5%	Businesses with gross income of less than $28,000 are exempt	No	No

Note: This table does not include state taxes that are called gross receipts taxes but that function as retail sales taxes such as those in New Mexico and Hawaii. In addition to the taxes listed, Illinois, Delaware and Kentucky have corporate income taxes while Ohio and Washington do not. The Texas tax described here will replace the state's corporate franchise tax which includes a tax on corporate profits.

- **Ensure fair treatment for high-volume, low-margin businesses.** Illinois could significantly reduce the impact of the GRT on high-volume, low-margin businesses if it allowed businesses to subtract the cost of purchased inputs from the total receipts subject to the GRT. Allowing businesses to subtract the cost of purchased inputs would help high-volume, low-margin businesses, which would be able to subtract the amount they paid for their inventory from the amount of their final sales and pay GRT only on the difference.[5] Thus, businesses with different profit margins would be treated more fairly under the GRT. Texas and Kentucky allow a similar but somewhat broader deduction by allowing businesses to subtract the "cost of goods sold," — which means the cost to the company of the inputs used to make the final product — from the base of their GRT.[6]

- **Eliminate most pyramiding.** Allowing businesses to subtract the "cost of purchased inputs" also significantly reduces the problem of pyramiding. For example, if an automaker buys $10,000 worth of parts from another company to make a car that it sells for $25,000, its total receipts from the car sale for GRT purposes would be $15,000 ($25,000 in sales minus the $10,000 paid for parts). The GRT would not be paid twice on those parts.

- **Retain a corporate income tax to ensure that all businesses pay their fair share.** Some states, seeking both to ensure that businesses benefiting from state government pay their fair share of taxes and to continue tying business taxes to ability to pay, have retained their corporate income tax even while enacting a GRT-type tax. In Kentucky's case, the amount of GRT owed can be credited against the amount of corporate income tax owed, so businesses pay the larger of the two. Delaware levies both a GRT and a corporate income tax but does not link the two. New Hampshire, levies a value-added tax that shares characteristics with a gross receipts tax, which it also allows as a credit against its corporate income tax.[7]

  Illinois could choose to retain its corporate income tax and allow the GRT as a credit against it. This would insure that all types of businesses — including those with relatively low receipts but high profits — pay a fair share. This would be particularly effective if Illinois took the opportunity to repair some flaws in the corporate income tax. (See below.)

- **Protecting lower-income and moderate people.** The regressive impact of the GRT could be mitigated through the expansion or creation of tax credits targeted on low and moderate income families. An efficient way to offset the GRT's impact on low-wage working families would be to significantly expand the state's earned income tax credit (EITC). The Illinois EITC equals just 5 percent of the federal EITC. Only one other state with an EITC has a rate this low. Even absent a new GRT, there are many reasons to expand the current EITC. The GRT

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[5] Texas also allows businesses to subtract either the costs of the inputs purchased for production or the total amount spent on worker compensation; of course a rational business will choose to deduct whichever is greater.

[6] By "cost of purchased inputs" we mean the amount that one company pays to another company for goods and materials that are either purchased for resale or are used in the production process. It differs from "cost of goods sold", which also includes the labor and other costs required to produce a final product or prepare an item for resale.

[7] A value-added tax eliminates the problems of pyramiding by taxing only the incremental value added by businesses at each step of the production and wholesaling process. New Hampshire is the only state with a value-added tax. Most economists consider value-added taxes superior to gross receipts taxes in terms of their impacts on the economic decisions of businesses. However, VATs have proven politically unpopular in the United States. The only other state with a VAT — Michigan — has just repealed the tax, and attempts to institute VATs in other states have failed.

would make a major expansion even more important, since food and medicine would be taxed under the GRT at levels before the final sale. Additional tax relief could be targeted to low- and moderate-income families that do not qualify for the EITC.

Raising Sufficient Revenue

Exempting inputs from the GRT base would raise somewhat less revenue than the governor's proposed GRT. While a precise estimate of the reduction in revenue that would result from these types of changes is beyond the scope of this paper, examination of data on business-to-business sales and the experience of other states suggests that allowing the exemption of cost of goods sold would reduce revenues from the proposed GRT by 30 to 40 percent. Thus rather than raising $7.6 billion when fully phased in, the GRT would raise approximately $4.6 to $5.3 billion.

Some of the difference could be made up by raising the GRT rate, although GRTs generally work best when the rate is fairly low. As a result, achieving the goals in education, health, and property tax relief that the governor and the legislature are discussing would likely require additional revenue increases. These increases could be designed to fall on a wider range of residents than a GRT alone.

One option would be raising the income tax rate. Depending on the amount garnered from the GRT and other sources, the income tax rate increase could be relatively modest. A one percentage point increase in Illinois' personal income tax rate would raise approximately $3 billion.

Retaining the corporate income tax as described above — with businesses paying the larger of the GRT or the corporate income tax — could also bolster GRT revenues. The corporate income tax could be improved at the same time in order to make it a better candidate for retention with a modified GRT. For example, a return to a three-factor apportionment formula (sales, property, and employment) would spread the tax more broadly. In addition, the definition of businesses subject to the corporate income tax could be expanded to include Subchapter S corporations and some limited liability companies. Or, Illinois could require that taxes be withheld before profits are distributed to out-of-state owners or that these owners sign a statement acknowledging that they owe and will pay taxes to Illinois on these profits. These changes are described more fully in the Appendix to this paper.

Conclusion

Governor Blagojevich's GRT proposal is a constructive step toward making Illinois' tax system stronger and fairer while providing resources needed to help address state priorities. While concerns have been raised about the possible effects of a GRT, the most serious of these could be addressed by a few modifications to the governor's proposal.

Appendix: Some Options for Improving the Illinois Corporate Income Tax

(1) Eliminate the single sales factor formula and return to a three-factor apportionment. When a corporation produces and/or sells goods and services in more than one state, each state requires the business to pay tax on just a portion of its profit. The tax laws of the large majority of states determine the portion of the corporation's profit that is subject to tax in relation to the shares of the corporation's total property, payroll, and sales located in each state.

Under New Jersey law, for example, a widget manufacturer that had its only factory and all of its employees in Trenton but sold all of the widgets outside the state would have one-half of its total, nationwide profit taxed in New Jersey. (Like many states, New Jersey gives the same weight to the location of sales as it does to the location of property and payroll combined.) The remaining half of the corporation's profit could be subjected to tax by the states in which its products are sold. This result reflects a broad consensus that states that provide services to a corporation's property and workers and states that provide a market for the corporation's output should be empowered to tax roughly equal shares of the corporation's profit.

Illinois, on the other hand, has apportioned the income of multi-state corporations based only on the amount of sales they have in Illinois since 1998. This approach is called a single sales factor formula. Returning to a three-factor apportionment formula would raise additional revenue and ensure that multi-state corporations pay their fair share of corporate income taxes.

(2) Expand the definition of businesses subject to the corporate income tax to include Subchapter S corporations and some limited liability companies. Or, Illinois could improve personal income tax collections from out-of-state owners by requiring that taxes be withheld before profits are distributed to out-of-state owners or that these owners sign a statement acknowledging that they owe and will pay taxes to Illinois on these profits.

(3) Modify the statutory definition of the unitary group to include unregulated investment subsidiaries and captive insurance companies. Illinois is in litigation with Exxon and Waste Management right now over whether their captive insurance companies can be combined. In addition, the fact that Illinois' corporate income tax statute doesn't allow financial institutions to be combined with non-financial entities has been a recurring problem, with corporations setting up out-of-state investment affiliates and isolating income and assets in them as well in order to reduce taxes owed to Illinois.

(4) Switch to the so-called "Finnigan" approach to unitary combined reporting (named for a California court case in which the issue was first raised). This issue arises when on or more members of a multicorporate group are subject to the Illinois corporate income tax ("have nexus") and other members of the same group do not. Under this approach, any sales into the state by out-of-state corporations that don't have corporate income tax nexus in Illinois are deemed to be sales made by the parent or sister corporations that *are* taxable in Illinois. This change is particularly important if Illinois retains the single sales factor formula.