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July 11, 2017

TO: Senator Alberta Darling, Senate Chair
Representative John Nygren, Assembly Chair
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Impact of Illinois Income Tax Increases

This memorandum provides information about the impact of the recent tax increase enacted by the State of Illinois on the Illinois/Wisconsin income tax reciprocity payments and the credit for taxes paid to other states in the 2017-19 biennium.

On Thursday July 6, 2017, the Illinois Legislature enacted a state budget by overriding Governor Bruce Rauner's earlier veto of the same provisions. The budget act (P.A. 100-0022) includes a number of revenue enhancements, including several impacting the state's individual income tax. Those provisions include increasing the state income tax rate from 3.75% to 4.95% effective July 1, 2017, changing state withholding tables effective immediately, limiting the standard exemption allowance to filers with adjusted gross incomes below certain thresholds ($500,000 for married-joint filers and $250,000 for all others), limiting the Illinois property tax credit based on the same income thresholds, increasing the credit rate for the state's earned income tax credit, and authorizing new state tax credits for classroom expenses incurred by education professionals and for research and development expenses. Based on conversations with several Illinois tax officials, these provisions are estimated to increase Illinois individual income tax collections by almost $5 billion in 2017-18.

Wisconsin has had an income tax reciprocity agreement with Illinois since 1973, where residents of each state who earn personal service income in the other state file a tax return and pay taxes on that income only in their state of residence. The reciprocity agreement with Illinois requires a compensatory payment when the net foregone revenues of one state exceed those of the other state based on a benchmark study of 1998 tax returns filed in the two states. Because the number of Wisconsin residents earning personal service income in Illinois exceeds the number of Illinois residents earning personal service income in Wisconsin, taxes foregone by Illinois exceed taxes foregone by Wisconsin, and Wisconsin makes a reciprocity payment to Illinois each year based on the estimated difference. The payment is made each December from a sum sufficient GPR appropriation. Personal service income includes wages, salaries, commissions, and fees earned by an employee, but does not include other types of income such as gains on the sale of property, rental income, other business income, and lottery winnings.

The reciprocity payment should not be viewed as a loss to the Wisconsin general fund. Without the agreement, Wisconsin residents working in Illinois would first pay taxes to Illinois and claim a credit for those taxes against the taxes owed to Wisconsin. Illinois residents working in Wisconsin would do the same, first paying taxes to Wisconsin and claiming a credit for those taxes when they pay taxes to Illinois. Without reciprocity, Wisconsin income tax collections would be lower by an amount that is approximately equal to Wisconsin's payment to Illinois. For income other than personal service income, Wisconsin residents who earn that income in another state pay tax on that income to the other state and then, claim a credit for that tax when they calculate their Wisconsin income tax.

In the Governor's budget, Wisconsin's income tax reciprocity payment to Illinois is estimated at $66,046,000 in 2017-18 and $67,667,000 in 2018-19. Earlier this year, this office arrived at similar amounts after reviewing the Department of Revenue's (DOR) calculations of those estimates. This office and DOR have re-examined the reciprocity payment estimates in light of the provisions in Illinois P.A. 100-0022 increasing Illinois' individual income tax collections in 2017-18 and arrived at similar results. The recently enacted Illinois tax provisions are expected to increase Wisconsin's 2018-19 reciprocity payment by an estimated $22,833,000 to $90,500,000. However, based on income tax collections for both states through June, Wisconsin's 2017-18 reciprocity payment is now estimated to be $64,000,000, or $2,046,000 lower than the amount in the Governor's budget. Combined, the reestimates for the two years are $20,787,000 higher than the amounts in the Governor's budget.

The Illinois tax changes will also result in Wisconsin residents claiming larger credits for taxes paid to other states. Higher credit amounts will first occur in tax year 2017, and higher credit amounts in subsequent years will affect estimated tax payments. As a result, Wisconsin individual income tax collections are estimated to be lower by $12,900,000 in 2017-18 and $17,200,000 in 2018-19. When combined, the reciprocity and tax credit changes are estimated to adversely affect the general fund's position by $50,887,000 in the 2017-19 biennium.

If you have any questions on this information, please let me know.

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cc: Members, Joint Committee on Finance