ILLINOIS ECONOMIC
and
FISCAL COMMISSION

SALES TAX ISSUES IN ILLINOIS

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EXECUTIVE SUMMARY

Sales taxes are a predominate and important factor in Illinois' taxing structure. They are the general revenue fund's second largest revenue-generating source and make up approximately 25% of total revenues. Sales tax laws within Illinois as well as throughout the nation are diverse, and sometimes confusing. The following report attempts to provide basic facts and information that surround sales tax issues in Illinois.

- To begin, the report gives definitions for both the sales Use Tax and Occupation Tax. Also, a sales tax rate, revenue, and exemption history is provided. Illinois' sales tax rate has grown from 2% in 1933 to the current rate of 6.25%. Sales tax revenues are divided between State and local governments: 80% of the tax goes into the State's treasury and 20% is given to local municipalities. Local governments also have the option of instituting home-rule taxes, which bring additional revenue to their cities.

- Over time, revenues and exemptions from sales taxes have also increased. Although general revenue sales taxes have historically grown, fiscal year 2001 yielded a disappointing figure of nearly $6 billion, which is approximately a 1% decrease from the previous year. This is primarily due to the six-month suspension of motor fuel sales taxation and the sluggish economy. It is anticipated that fiscal year 2002 will perform better, as there will be a full year to realize sales taxes on motor fuel and it is projected that the economy will perform better during the second half of the fiscal year. Total sales tax exemptions were approximately $3 billion in fiscal year 2000.

- The Internet has greatly effected virtually all facets of economic activity, including states' sales tax revenues. Currently, E-tailers are not subject to the same sales tax scrutiny as other main street businesses. Therefore, many believe that Net companies have an unfair sales tax advantage over main street retailers. In addition, it has been concluded that states are losing revenues as a result of Internet sales tax practices. Utilizing data from the U.S. Department of Commerce in conjunction with methodology in an earlier Earnst & Young study, it is estimated that in the year 2000, Illinois lost approximately $60 million in sales tax revenues. Other studies, in particular one from the University of Tennessee, have projected that tax losses would be significantly higher.

- Another important issue that will have an impact on sales taxation is the Streamlined Sales Tax Project (SSTP). The SSTP is an effort by states to simplify and modernize sales and use tax collection and administration. The goal of the Project is to substantially reduce or eliminate the costs and burdens of sales tax compliance for businesses via a combination of simplified laws and administrative policies. As of August 2001, Illinois was one of many states that have made a significant step by passing initial legislation relating to the implementation of the SSTP. It is awaiting the Governor's signature.

- Finally, a sales tax flowchart has been developed in order to depict the intricacies of Illinois sales taxation. Several decisions and many steps are involved in order to determine what the end sales tax will be for a consumer.

Illinois Sales Taxes

Definition of Sales Taxes

A sales tax is a levy placed on a good or service when it is purchased from a company that has a physical presence (or "nexus") in the same state as the consumer. When a consumer buys a good or service from a retailer that is outside of his or her state, they pay a use tax. Illinois is one of 46 states (including the District of Columbia) in the nation that requires its residents to pay sales taxes when purchasing retail merchandise. If the seller does not charge Illinois Sales Tax, the purchaser owes the tax directly to the Department.

Illinois sales taxes are actually derived from four different tax acts; the Retailers' Occupation Tax (ROT) and its complement the Use Tax (UT), the Service Occupation Tax (SOT) and its complement the Service Use Tax (SUT).

The Retailers' Occupation Tax is generally referred to as the sales tax. The tax is imposed on Illinois retailers on the gross receipts from sales of tangible personal property. Illinois retailers forward the collected Retailers' Occupation Tax to the Department of Revenue for deposit into the State's Treasury. The ROT's partner, the Use Tax, applies to Illinois purchasers who buy property out of state at a lower tax rate or from a vendor who does not have a physical nexus within the State. The difference between the lower tax rate and Illinois' sales tax rate must be forwarded to the Department of Revenue as a Use Tax. The purpose of the Use Tax is to protect in-state retailers from competition from out-of-state retailers who may not be subject to the Retailers' Occupation Tax.

The Service Occupation Tax is imposed on service providers when tangible personal property is transferred within the course of performing a service. The tax is measured by the selling price of the tangible personal property transferred as an incident to the sale of the service. Likewise, the Service Use Tax is also imposed upon the purchaser for the privilege of using property that was acquired incident to the purchase of a service. However, this tax would apply when a purchaser obtains property from an out-of-state service provider who does not have a "nexus" within the State and is not obligated to collect Illinois sales taxes.

History of Sales Taxes

State sales taxes originated during the Great Depression, when the main source of revenue for state and local governments, property taxes, collapsed with property values. In 1930, twenty-three states began using the sales tax as an additional revenue source. Due to problems with our own State budget, Illinois adopted a "temporary" 2 percent sales tax in 1933. In 1935, the tax was made permanent, and the rate was raised to 3 percent.

While the State rate ranged between 2 and 3 percent, municipalities and counties were allowed to impose a local sales tax beginning in 1955 and 1959, respectively. Also, in 1955 the Use Tax was added at the same rate as the Retailers' Occupation Tax. Six years later, the Service Use Tax and Service Occupation Taxes were added to the Illinois sales tax structure. By 1984, the State rate increased to 5 percent and the County Supplementary Tax Act authorized all counties except Cook County to impose a 0.25 percent sales tax. In addition, the State tax on certain food and medical supplies and machinery and parts used in manufacturing was eliminated (local taxes remained on the exempt items).

Effective January 1, 1990, as part of Sales Tax Reform, a uniform State sales and use tax rate on general merchandise of 6.25 percent was established. The local sales tax acts and the County Supplementary Tax Act were repealed and the Department of Revenue began administering Non-Home rule sales taxes in September 1990. Many of these taxes were already in effect but were administered by the locals themselves.

While the number of local municipalities and counties instituting home rule sales tax rates has grown, the State sales tax rate has remained constant at 6.25% for the past eleven years. Table 1 outlines the history of Illinois sales tax rates.

TABLE 1: Illinois Historical Sales Tax Rates

Effective Date	Rate
July 1, 1933	2.00%
July 1, 1935	3.00%
July 1, 1941	2.00%
July 1, 1955	2.50%
July 1, 1959	3.00%
July 1, 1961	3.50%
July 1, 1967	4.25%
October 1, 1969	4.00%
January 1, 1984	5.00%
January 1, 1990 – Current	6.25%

SOURCE: Department of Revenue

Current Sales Tax Rate and Distribution of Funds

The current State sales tax rate is 6.25%, of which the State retains 80% of the tax and local governments receive the remaining 20%. Therefore, a 5% sales tax is given to the State, and 1.25% is provided to local governments.

Proceeds from the 5% portion of the State sales taxes (or 80% of total State sales taxes) contribute to the following:

- 1.75% to Build Illinois Fund
- 3.8% to Build Illinois Fund to retire bonds
- 0.4% to Local Government Distributive Fund
- 0.27% to Illinois Tax Increment Fund
- Remainder to the General Revenue Fund, with four transfers out:
  - 25% reserved for transfer to Common School Fund
  - 25% of net revenue collected from RTA sales tax to Public Transportation Fund
  - 2/32 of net revenue from counties and municipalities that have Downstate mass transit districts to the Downstate Public Transportation Fund.
  - 2/32 of net revenue from Madison, Monroe, and St. Clair Counties to the Metro-East Public Transportation Fund.

Proceeds from the 1.25% portion of the State sales tax (or 20% of the total State sales tax) is returned to local governments in the following manner:

- 16% of net proceeds to the Local Government Tax Fund
- 4% of net revenue to the County and Mass Transit Fund

History of Revenues and Projections

Sales tax revenues are one of Illinois largest revenue sources, second only to the personal income tax. Between fiscal years 1990 and 2000, general revenue sales steadily increased. In fact, in fiscal year 2000, revenues exceeded $6 billion and grew almost 7.5% over the previous fiscal year. This impressive year was followed by one of the most disappointing sales tax revenue generating years. For the first time in over eleven years, GRF sales tax revenues decreased from the previous year at a rate of over 1% to yield a year-end figure of less than $6 billion. The six-month suspension of motor fuel sales tax (estimated to cost the state $157 million in sales tax revenues) coupled with a deflating economy greatly attributed to the less-than-stellar fiscal year 2001 figures.

It also should be noted that sales tax revenues as a percentage of total general revenues has declined from almost 30% in fiscal year 1990, to less than 25% in fiscal year 2001. It is anticipated that fiscal year 2002 will offer better figures than the previous year due to the full-year return of the motor fuel sales tax. In addition, the current forecast expects to see the second half of the fiscal year improving over the prior year. Table 2 provides historical details and projections of the general revenue sales tax beginning in fiscal year 1990.

TABLE 2: General Revenue Sales Tax Receipts

Fiscal Year	Tax Revenues	% Growth	Total General Revenue	% Growth	Sales as a % of Total
1990	3.827		12.841		29.8%
1991	3.864	1.0%	13.261	3.3%	29.1%
1992	3.986	3.2%	14.217	7.2%	28.0%
1993	4.094	2.7%	15.050	5.9%	27.2%
1994	4.371	6.8%	16.186	7.5%	27.0%
1995	4.650	6.4%	17.302	6.9%	26.9%
1996	4.799	3.2%	18.136	4.8%	26.5%
1997	4.992	4.0%	18.854	4.0%	26.5%
1998	5.274	5.7%	19.984	6.0%	26.4%
1999	5.609	6.3%	21.674	8.5%	25.9%
2000	6.027	7.5%	23.250	7.3%	25.9%
2001	5.958	-1.1%	24.106	3.7%	24.7%
2002*	6.378	7.0%	24.826	3.0%	25.7%

Dollars in billions
*IEFC Estimate

All appropriated sales tax revenues encompass the entire amount of sales tax revenues that Illinois receives. Generally, there are five designated areas that are recipients of all appropriated revenues. The Build Illinois Fund receives 1.75% of revenues, 3.8%

is given to retire Build Illinois Bonds, the Local Government Distributive Fund gets 0.4%, the Illinois Tax Increment Fund receives 0.27%, and the remaining revenues are deposited into the General Revenue Fund.

All Appropriated sales tax revenues historical trends mirror the general revenue trends. All Appropriated revenues grew steadily between fiscal year 1990 and 2000. Fiscal year 2001 yielded disappointing figures, predominately due to the same factors that affected general revenue lack-luster results, discussed earlier. It is anticipated that fiscal year 2002 will yield a more positive outcome. Table 3 provides a historical review of All Appropriated sales tax revenues

TABLE 3: AAP Sales Tax Revenues

Fiscal Year	AAP Revenues	Growth Rate
1990	4.095	
1991	4.214	2.8%
1992	4.282	1.6%
1993	4.485	4.5%
1994	4.796	6.5%
1995	5.355	10.4%
1996	5.564	3.7%
1997	5.800	4.1%
1998	6.119	5.2%
1999	6.523	6.2%
2000	7.022	7.1%
2001	6.963	(0.8%)
2002*	7.424	6.6%

Dollars in billions
*Estimated

History of Exemptions

Upon the inception of the State sales tax, almost all general merchandise was subject to taxation. However, as the years progressed, the amount of allowed exemptions escalated along with the sales tax rate, yielding a smaller tax base but continued revenue growth.

Beginning in 1933 (when the State sales tax was implemented), allowed exemptions included feed and seed for farmers and occasional sales exemptions. Between 1955 and 1979, the number of exemptions continued to grow to include among other things, sales to exempt organizations, newsprint and ink, rolling stock, and farm chemicals. But it wasn't until after 1979 that the amount of exemptions allowed by the State began to proliferate (Appendix 3 provides a list of exemptions and the year they were enacted).

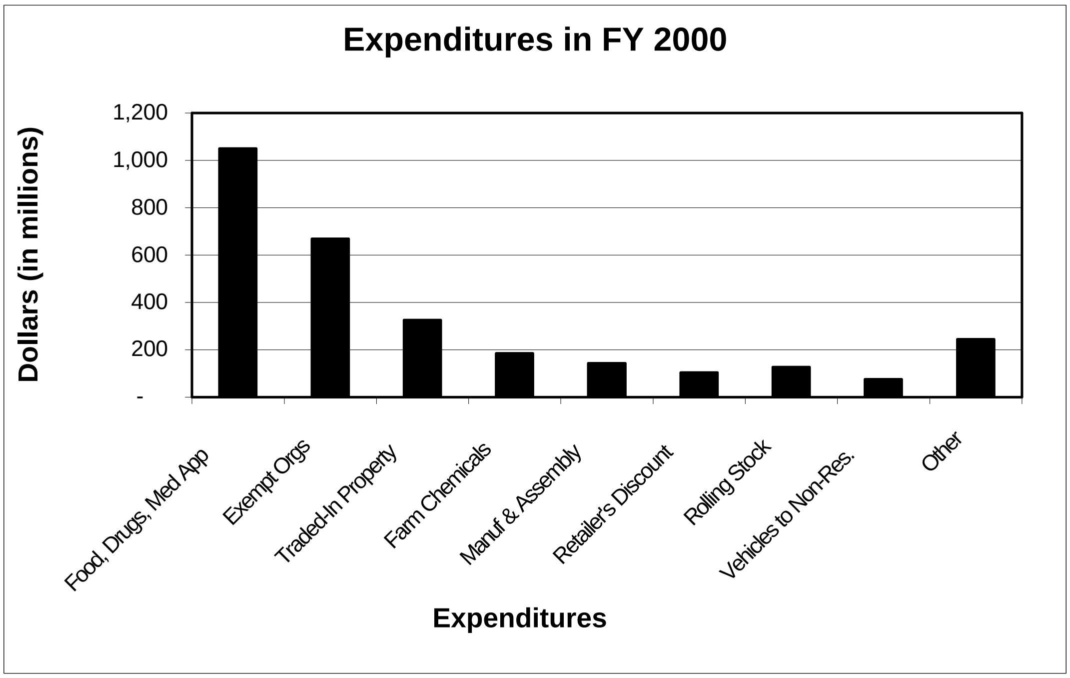
In 1979, sales taxes were eliminated on sales of machinery and equipment to manufacturers. Exemptions for machinery and equipment to printers, coal mines, oil field drillers, distillers of ethanol, and farmers quickly followed in 1980. Also in 1980, the State began to reduce the tax rate on sales of food (grocery), drugs, and medical appliances to individuals. Between 1985 and 2000 sales tax exemptions were added for property used in pollution control facilities, property used with an enterprise zone, legal tender, medallions, and bullion, photo processing machinery, coal and oil machinery, leased property to hospitals or governmental bodies, and many more. In January 1995, manufacturers began earning additional sales tax credit (Manufacturer's Purchase Credit or MPC) that could be applied toward the tax due on purchases of non-exempt items. MPC earned is a percentage of the tax the manufacturer would have paid on the purchase of machinery and equipment if the machinery and equipment had not been exempt from tax.

Many organizations that do not have to pay sales taxes on their purchases also increased in number. Certain senior citizen organizations, county fair associations, not-for-profit music or dramatic arts organizations, and certain licensed day care centers are all exempt from sales taxation. In addition, sales by elementary or secondary teacher-sponsored student organizations and certain sales by not-for-profit service organizations operating for the benefit of persons 65 or older are also exempt from sales taxes.

Chart 1 provides major classes of exemptions for Illinois for fiscal year 2000. As depicted, the food, drug, and medical appliance sales tax reduction accounts for the greatest amount of sales tax exemptions, followed closely by sales to exempt organizations.

Appendix 6 provides a numerical description of sales tax exemptions. In addition, the appendix gives historical figures for sales tax exemptions from fiscal years 1995 through 2000. As the chart indicates, the dollar amount of all exemptions has increased steadily over the past five years. In fact, the rolling stock exemption and the sales of vehicles to nonresidents more than doubled. Except for the traded in property exemption (which has increased a mere 8%), all other categories have gained more than 30%. Total exemptions for fiscal year 2000 were almost $3 billion, which is as 38% increase over fiscal year 1995 figures.

CHART 1: Major Classes of Illinois Sales Tax Exemptions



Comparison of States

Sales taxes are not unique to Illinois. Virtually every state in the nation has some sort of sales taxation. Table 4 provides sales tax rates for Illinois and its neighboring states. As indicated, Illinois sales tax rates are the highest among all of its neighboring states. In fact, Illinois 6.25% sales tax appears to rank among the nation's largest tax rates. Rates range between 0% (for Alaska, Delaware, Montana, New Hampshire, and Oregon) and 7% (Mississippi). Appendix 1 provides details of each of the states sales tax rates.

TABLE 4: Comparison of State Sales Tax Rates		
State	State Rate	Range of Local Rates
Missouri	4.225%	.5% – 4%
Indiana	5.0%	0%
Iowa	5.0%	0% – 2%
Wisconsin	5.0%	.1% - 1%
Kentucky	6.0%	0%
Illinois	**6.25%**	**.25% – 2.75%**

Not only do sales tax rates vary widely across the nation, but so do the items taxed and the definition of these items. For example, some states tax necessity items (such as food, clothing, medical appliances, and drugs), while some do not. Others have a reduced tax rate. Even more, the definition of the non-taxable goods may differ among states. Non-taxable food in one state might be defined as only food that is consumable off the sales premises, while another state may exempt all food from sales taxation, regardless of where it will be consumed.

Thus, the diversity of sales tax rates, applied products, and accompanying definitions make it difficult, at best, to form any kind of analytical state comparison of the various states sales tax revenues. Table 5 provides a numerical summation of State and local sales tax revenues for Illinois and its boundary states and Appendix 2 provides details for every state. Total revenues generated from sales taxation may have a direct relationship with state population, the sales tax rate, as well as the comprehensiveness of the items taxed.

TABLE 5: 1999 State and Local Government General Sales Tax Revenues	
State	**Revenue**
Illinois	**$6.5**
Indiana	3.3
Wisconsin	3.3
Missouri	2.7
Kentucky	2.1
Iowa	1.6
Dollars in billions. SOURCE: State Rankings 2001	

Although Illinois ranks first among its neighboring states for total sales tax revenues, when considering these revenues on a per-capita basis, Illinois is in the lower half (see Table 6). The primary reason is most likely because Illinois' population far exceeds its neighboring states. Therefore, although Illinois has a higher sales tax rate and generates more total sales tax revenues, it appears that on a per-capita basis, its citizens do not pay as much as others in its neighboring states.

TABLE 6: 1999 Per-Capita State and Local Government Sales Tax Revenues	
State	**Revenue**
Wisconsin	$622
Iowa	574
Indiana	557
Kentucky	527
Missouri	497
Illinois	**491**
SOURCE: State Rankings 2001	

Internet Taxation

Several issues surround the topic of Internet taxation; however, the primary focus is whether to collect sales and use taxes on goods and services sold over the Internet. Contrary to what some believe, sales and use taxes for sales made on the Internet would not be a new tax. Sales taxes are already in place in most state and local governments and, when the tax is not collected by the internet retailer, it should be reported by the purchaser on his or her State tax returns.

Due to the US Supreme Court *National Bellas Hess* case in 1967 and the *Quill* decision in 1992, it is not required for a seller who does not have a nexus in a state to collect sales taxes because it is considered an undue burden on the seller. Therefore, Internet retailing companies only pay sales taxes in the state in which they have a physical presence. For example, Amazon.com (who has a nexus in the State of Washington) primarily sells books and CD's, pays sales taxes to Washington for only those sales made to Washington residents. The company is not obligated to charge sales taxes on sales made to non-residents. This provides Amazon.com with an unfair tax advantage over main street merchandise stores such as Barnes and Noble, who also sell books via the Internet, but has a nexus in virtually every state. Barnes and Noble must comply with all of the states complicated sales tax regulations, which in itself is costly to administer.

Opponents to Internet taxation believe that forcing E-tailers to collect sales taxes will stunt the development of the Net economy. However, other political leaders have become increasingly concerned over the fact that these companies cut into the profits of constituents' main street stores. In addition, it is believed that the tax-free environment of the E-tailer is hurting state tax revenues which are becoming more scarce due to the lagging economy.

It appears that future legislation will aim toward maintaining the economic success of the Internet while also preserving precious main-street businesses and sales tax revenues. Recently the house judiciary subcommittee voted to extend the Internet Tax moratorium for five years and make the ban on access taxes permanent. It ignored the issue whether state sales taxes should apply to Internet transactions. This legislation is expected to reach the House floor in September.

Effect on Illinois

Due to the growing concern of E-commerce eroding states' tax revenues, beginning October 1999, the U.S. Department of Commerce began estimating E-commerce retail sales. To arrive at a viable figure, the U.S. Census Bureau provides monthly total retail sales (which are derived from the Monthly Retail Trade Survey) and combines them into a quarterly figure. Quarterly total retail sales figures are multiplied by a 'E-commerce' percent factor (that is estimated from the same sample used to evaluate U.S. total retail sales) to yield a quarterly estimate of E-commerce retail sales.

According to the Department of Commerce, the Monthly Retail Trade Survey (MRTS) is compromised of the following:

- A stratified simple random sampling method is used to select over 12,000 retail firms wholesales. They are weighted and benchmarked to represent the complete universe of over two million retail firms;

- Retail firms include businesses, such a building materials dealers, new car dealers, furniture stores, mail order and online retailers, eating and drinking places, grocery stores, department stores, and apparel stores, selling merchandise for personal and house hold consumption. Online travel services, financial brokers and dealers, and ticket sales agencies are not retail and are not included in either the total retail or retail E-commerce sales estimates;

- Retail E-commerce sales, while not previously identified separately, continue to be included in the total monthly sales estimates.

The previously mentioned information may be utilized to formulate an estimate of Calendar Year 2000 U.S. e-commerce retail sales. Quarterly E-commerce sales obtained from the Department of Commerce for Calendar Year 2000 are provided in Table 7 and serve as the basis for future calculations.

TABLE 7: Estimates of Total U.S. 2000 On-Line Sales

Year	Retail Sales	E-Commerce	E-Commerce % of Total Sales
2000			
Qtr 1*	714,425	5,526	0.77%
Qtr 2*	777,819	5,982	0.77%
Qtr 3*	772,796	6,898	0.89%
Qtr 4 *	817,715	8,881	1.09%
Total 2000	3,082,755	27,287	

Dollars in millions
*SOURCE: U.S. Department of Commerce

According to a 1998 Ernst & Young report titled "The Sky is Not Falling: Why State And Local Revenues Were not Significantly Impacted By The Internet," $20 billion of retail sales were done on the Internet during 1998, which is less than 0.3 percent of total consumer spending. The consultants also estimated that 80 percent of E-commerce sales are business-to-business sales in which the companies would not be subject to sales tax payments. Furthermore, the study indicated that: 63 percent of Internet retail sales are intangible services (i.e. travel and financial services), 11 percent of internet retail sales already result in taxes being paid by vendors or consumers, and

60 percent of taxable e-commerce purchases are of items that would otherwise be purchased by mail-order companies that are already exempt from sales taxes. The study concludes that less than $170 million in sales and use taxes was not collected in 1998, which calculates to 0.1 percent of total sales taxes collected by all state and local governments.

The Illinois Economic and Fiscal Commission has utilized base figures provided by the U.S. Department of Commerce (Table 7) as well as some of the statistics and methodology in the Ernst & Young study to formulate a projection of sales tax revenues lost due to Internet retail sales. The following was assumed:

- The report generated by Ernst & Young projected that sales and use taxes are remitted by e-commerce sellers and buyers on 4% of e-commerce sales. In addition, the report suggests that the substitution of e-commerce purchases for sales from other sellers (i.e. mail order) does not result in reduced sales and use tax. The report estimates that sales and use tax would not be collected on the 20% of online taxable sales that substitute for another remote sale. This revenue loss already is considered in a different category; it would not be accurate to attribute the revenue loss to electronic commerce.

- An average State and local tax rate of 6.5% is applied to revised e-commerce retail sales figure to estimate the total national revenue loss. To estimate Illinois' portion of the total loss, 4.5% (Illinois' approximate share of national economic activity) is applied to the national revenue loss figure

Utilizing the above factors, it is estimated that in the year 2000, Illinois could have lost more than $60.7 million in sales tax revenues due to the proliferation of Internet retail commerce. Even more, it is believed that this figure will continue to grow as Internet use and popularity escalates. Table 8 provides an estimate of State sales tax dollars lost due to the e-commerce. In addition, an Illinois Economic and Fiscal Report Titled "Internet Taxation Issues and Impact" provides details of Internet taxation and its effects on the State.

TABLE 8: Estimates of 2000 On-Line Sales	
Total U.S E-Commerce Retail Sales	27,287.0
Less: 4% of sales where taxes are paid	(1,091.5)
Less: 20% of sales that substitute	(5,457.4)
Revised Taxable Business-to-Consumer Sales	20,738.1
Estimate of Total Revenue Loss: U.S. (6.5%)	1,348.0
Estimate of Revenue Loss: ILLINOIS (4.5%)	60.7
Estimated State Share (80%)	48.5
Estimated Local Share (20%)	12.2
(Dollars in millions)	

The University of Tennessee Center for Business and Economic Research also estimated the impact of state sales tax revenues lost due to the Net economy. The study revealed a much greater projection of revenue losses. The research indicates a national revenue loss in 1999 of $1.2 billion (compare to the 1998 Ernst & Young figure of $170 million) growing to $10.8 billion in 2003. In addition, the study predicts that by 2003, Illinois will have a $454 million tax loss due to the lack of E-commerce sales taxation.

Obviously, there is a great difference between the figures predicted by the University of Tennessee and Ernst & Young. The difference indicated that there remains some uncertainty as to the impact of E-commerce on sales taxes revenues in Illinois. Undoubtedly, continued monitoring and evaluation will be done by various organizations to provide the dollar impact of the net economy on State sales tax revenues.

Streamlined Sales Tax Project

Consumers may have a difficult time understanding various sales tax regulations, but the real burden of sales tax comprehension and compliance rests with the retailer. It would appear Illinois sales tax laws could be very confusing for an interstate retailer, but for a multi-state retailer, mastering all of the nation's 7,600 various sales tax jurisdictions is nearly unthinkable. Even more, the cost of compliance is substantial for retailers. Forbes magazine indicated that a study done several years ago estimated the administrative cost of sales tax compliance is approximately 3.5% of revenues, which translates to billions of dollars.

In addition to the complexity of sales tax laws, retailers must deal with the influx of E-tailers that continue to threaten their market base. As stated previously, E-tailers have a unfair sales tax advantage over retailers (Sears Roebuck & Co. estimates that the advantage can cause a 6% to 8% price fluctuation), which creates an unlevel playing field among merchants.

The Streamlined Sales Tax Project (SSTP), which has been in effect for almost two years, is an effort created by State governments to simplify and modernize sales and use tax collection and administration. The goal of the Project is to substantially reduce or eliminate the costs and burdens of sales tax compliance for businesses via a combination of simplified laws and administrative policies. Implementation of the system would be paid for by the individual states.

The simplified system will incorporate uniform definitions within tax bases, simplified audit and administrative procedures, and emerging technologies to substantially reduce the burdens of tax collection. Two fundamental documents have been born out of the SSTP, which are the Uniform Sales and Use Tax Administrative Act, and the Streamlined Sales and Use Tax Agreement.

The Uniform Sales and Use Tax Administrative Act simply allows state tax authorities (who have adopted the Act) to enter into the Streamlined Sales and Use Tax Agreement with other states. Tax authorities may represent the state in negotiations with other states in the implementation of the Streamlined Sales and Use Tax Agreement. As of the beginning of August, many states have made progress towards participating in the SSTP. Table 9 provides the status of states in the SSTP.

TABLE 9: Status of SSTP Participating States				
Adopted Legislation:	Legislation Pending Approval:	Participant but has not Introduced Legislation	Observers	No Sales Tax
Arkansas	Alabama	Maine	California	Alaska
Florida	**Illinois****	Mississippi	Colorado	Delaware
Indiana	Iowa	New Jersey	Connecticut	Montana
Kentucky	Kansas	Ohio	Georgia	New Hampshire
Louisiana	Massachusetts	South Carolina	Idaho	Oregon
Maryland	Michigan	Washington		
Minnesota	Missouri	West Virginia		
Nebraska	North Carolina**			
Nevada	Pennsylvania			
North Dakota	Vermont			
Oklahoma	Wisconsin**			
Rhode Island				
Tennessee				
Texas				
Utah				
Wyoming				
South Dakota*				

*legislation forms task force to study the issue
**legislation passed by legislature and is pending Governor's signature

There are actually two model Acts. One is the SSTP model Act (which some states have adopted) and the other is written by the National Conference of State Legislatures (which other states have adopted). Essentially, both Acts are trying to simplify sales taxation; however, the main difference between the two is that the simplification procedures in the NCSL version are less comprehensive than those in the SSTP.

The Streamlined Sales and Use Tax Agreement is a document that provides necessary sales tax rules, regulations, and procedures in which enacting states and retailers will agree to comply. It is important to note that the Agreement has no direct effect on state law or its merchants. Before entering into the agreement, states must amend their own laws to conform to the requirements of the Agreement. Five states must sign the Agreement before it takes effect.

In order for the simplified system to work, retailers and states must first voluntarily elect to participate. This is done by states adopting legislation and enacting certain simplification measures. Uniform product codes and sourcing rules, uniform definitions of state tax laws, creating a central, one-stop registration system, and limiting local governments tax rate changes are among just some of the issues that must be addressed in the simplified system.

States, including Illinois have many issues to resolve before conquering the simplification of sales taxes. One obstacle is technology. State-certified specially designed software would need to be provided to small and mid-size retailers. Large retailers (such and Target and Wal-Mart) would simply have their existing software approved by the state. The software would have to calculate, collect, and remit use taxes for transactions in states in which retailers do not have a physical presence. In September 2000, SSTP participants approved a pilot project to test software. Kansas, Michigan, North Carolina, and Wisconsin are the pilot states who awarded contracts to companies to provide the software.

Another obstacle to the SSTP is that many sellers who do not have a nexus within a state will need an incentive (via a mandate) by the federal government before they would be willing to collect sales taxes. In fact Bill Curry, spokesman for Amazon.com has indicated that Amazon has no intention of voluntarily collecting sales tax outside of its home state of Washington. Furthermore, he believes that collecting sales taxes "is a nightmare to manage, and you don't (get compensated) nearly what it costs you."

Yet another obstacle is that sellers are worried that states could assert a possible relationship between sales and income taxation. Currently, sales and income tax nexus are not linked, so a seller may have a nexus for one and not the other. However, sellers are concerned that if they voluntarily collect sales taxes, then a state may also contend that income taxes should be paid.

Finally, individual states will have to battle with special interest groups as well as local governments who will not be anxious to relinquish certain benefits that they currently are experiencing. For example, special interest groups may have to forgo certain exemptions and tax loopholes that currently benefit their interests, and local government politicians may have to give up some control over home-rule taxes.

The issues surrounding the Streamlined Sales Tax Project are numerous and needless to say, state governments will have their work cut out for them. However, it is indisputable that the thought of simplified sales taxation is growing in popularity and is gaining political momentum.

Flow Chart for Sales Taxes:

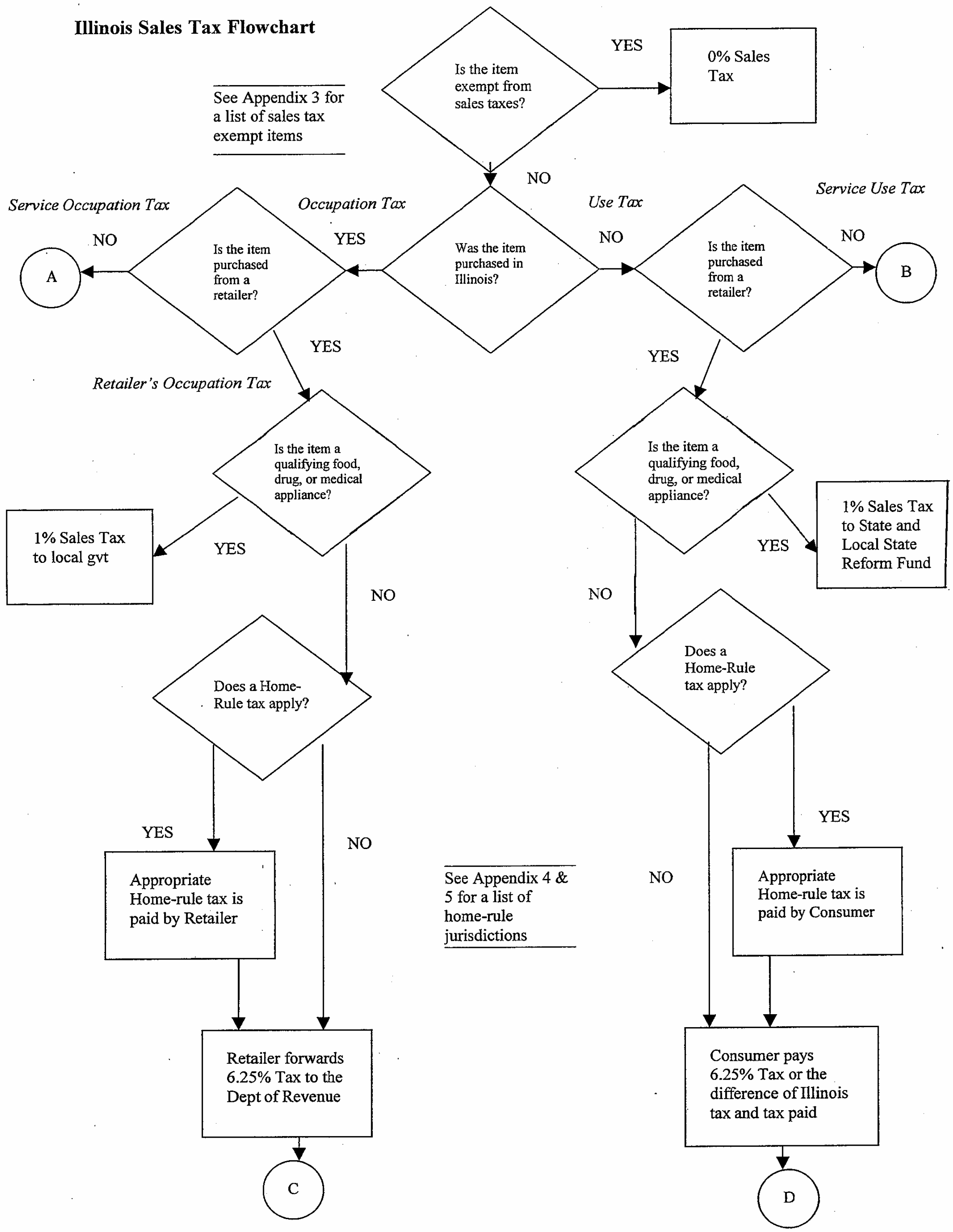
It already has been established that sales taxation laws, definitions, and practices are both confusing within our state as well as across the nation. The flow chart provided on the next page is an attempt to provide some organizational review of Illinois sales taxes and the distribution of funds.

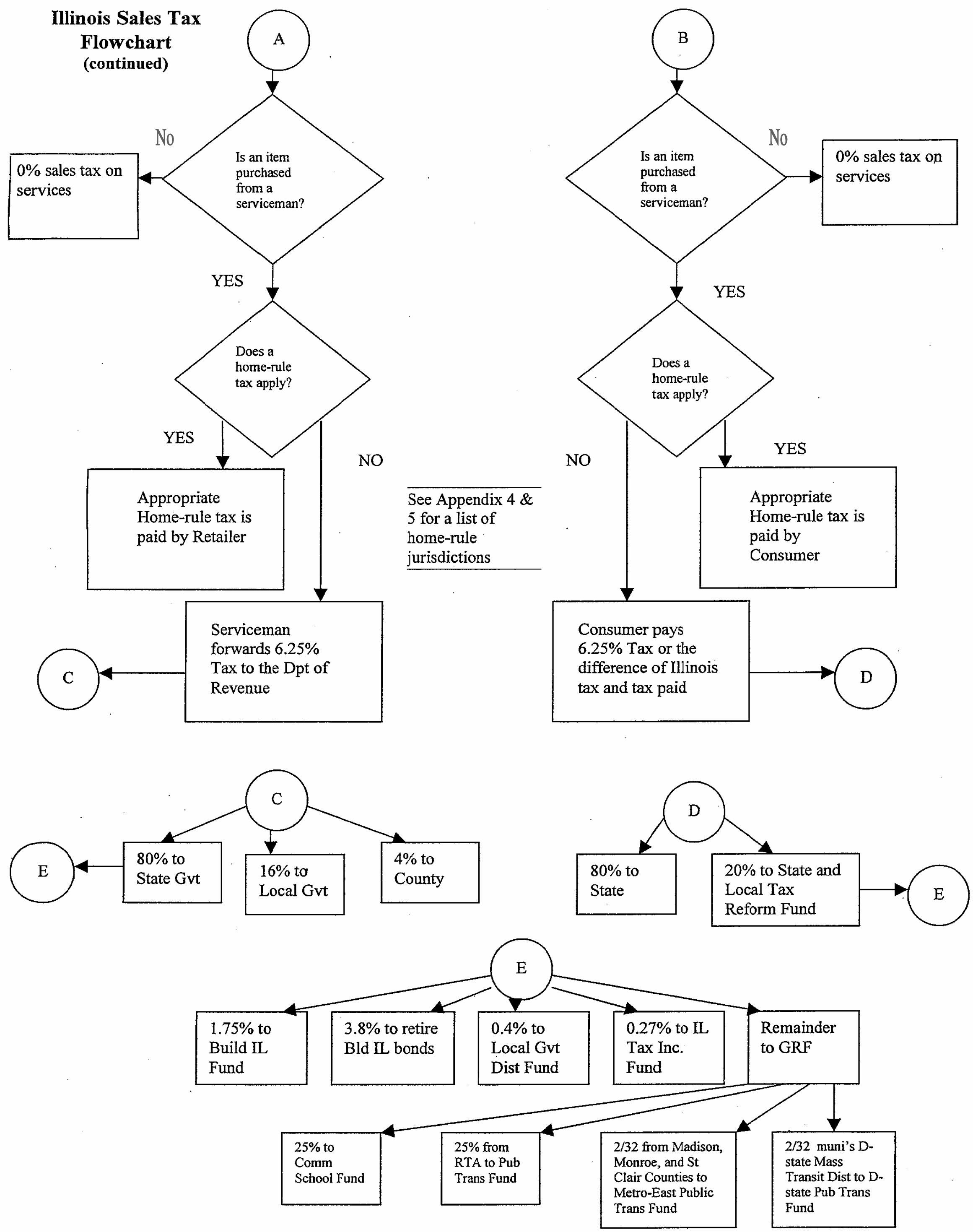
As the chart depicts, after an item is purchased, one must determine if it subject to sales taxation. Many items are exempt for sales taxation in Illinois and Appendix 3 provides a list of such items and the dates in which the exemption was enacted. If it is determined that an item is subject to sales taxation, then one must ascertain if it was purchased in Illinois. If the item is purchased from a vendor with a nexus in Illinois, it is subject to an Occupation Tax. If it is purchased from a vendor that does not have a physical presence within Illinois, the consumer is responsible to pay a Use Tax.

Additional considerations that must be made in order to determine the final sales tax. One must decide whether the item is considered a qualified food, drug, or medical appliance. These items are taxed at 1%, which is forwarded to local governments. Also, many local government units have additional home-rule taxes. These units are provided in Appendix 4 and 5.

Finally, once the sales tax is paid by either the retailer (Occupation Tax) or purchaser (Use Tax), the funds must be distributed between the State and local governments. Funds received by the State are primarily deposited into the General Revenue Fund. However, some money is given to the Build Illinois Fund, the Local Government Distributive Fund, and the Illinois Tax Increment Fund.

All of the previous considerations, plus some additional issues are depicted in the Illinois Sales Tax Flowchart on the follow two pages.


Illinois Sales Tax Flowchart
See Appendix 3 for a list of sales tax exempt items
Is the item exempt from sales taxes?
YES
0% Sales Tax
NO
Was the item purchased in Illinois?
Occupation Tax
YES
Use Tax
NO
Service Occupation Tax
Is the item purchased from a retailer?
NO
A
Service Use Tax
Is the item purchased from a retailer?
NO
B
YES
Retailer's Occupation Tax
Is the item a qualifying food, drug, or medical appliance?
YES
1% Sales Tax to local gvt
NO
YES
Is the item a qualifying food, drug, or medical appliance?
YES
1% Sales Tax to State and Local State Reform Fund
NO
Does a Home-Rule tax apply?
YES
Appropriate Home-rule tax is paid by Retailer
NO
Retailer forwards 6.25% Tax to the Dept of Revenue
C
Does a Home-Rule tax apply?
YES
Appropriate Home-rule tax is paid by Consumer
NO
Consumer pays 6.25% Tax or the difference of Illinois tax and tax paid
D
See Appendix 4 & 5 for a list of home-rule jurisdictions


Illinois Sales Tax Flowchart (continued)
A
Is an item purchased from a serviceman?
No
0% sales tax on services
YES
Does a home-rule tax apply?
YES
Appropriate Home-rule tax is paid by Retailer
NO
Serviceman forwards 6.25% Tax to the Dpt of Revenue
C
B
Is an item purchased from a serviceman?
No
0% sales tax on services
YES
Does a home-rule tax apply?
YES
Appropriate Home-rule tax is paid by Consumer
NO
Consumer pays 6.25% Tax or the difference of Illinois tax and tax paid
D
See Appendix 4 & 5 for a list of home-rule jurisdictions
C
80% to State Gvt
16% to Local Gvt
4% to County
E
D
80% to State
20% to State and Local Tax Reform Fund
E
E
1.75% to Build IL Fund
3.8% to retire Bld IL bonds
0.4% to Local Gvt Dist Fund
0.27% to IL Tax Inc. Fund
Remainder to GRF
25% to Comm School Fund
25% from RTA to Pub Trans Fund
2/32 from Madison, Monroe, and St Clair Counties to Metro-East Public Trans Fund
2/32 muni's D-state Mass Transit Dist to D-state Pub Trans Fund

APPENDIX 1: State Sales Tax Rates		
State	State Rate	Local Rate
Alabama	4%	1% - 7%
Alaska	0%	0 % - 7%
Arizona	5.6%	.25% - 3.8%
Arkansas	5.125%	.5% – 4.5%
California	5.75%	1.25% – 2.75%
Colorado	2.9%	.25% – 7%
Connecticut	6.0%	0%
Delaware	0%	0%
District of Columbia	5.75%	0%
Florida	6.0%	.5% – 1.5%
Georgia	4.0%	1% – 3%
Hawaii	4.0%	0%
Idaho	5.0%	.5% – 3%
Illinois	**6.25%**	**.25% – 2.75%**
Indiana	**5.0%**	**0%**
Iowa	**5.0%**	**0% – 2%**
Kansas	4.9%	0% – 3%
Kentucky	**6.0%**	**0%**
Louisiana	4.0%	.3% – 6.75%
Maine	5.0%	0%
Maryland	5.0%	0%
Massachusetts	5.0%	0%
Michigan	6.0%	0%
Minnesota	6.5%	.5% – 1%
Mississippi	7.0%	0% - .25%
Missouri	**4.225%**	**.5% – 4%**
Montana	0%	0%
Nebraska	5.0%	0% – 1.5%
Nevada	4.25%	0% – 3%
New Hampshire	0%	0%
New Jersey	6.0%	0%
New Mexico	5.0%	.125% – 2.438%
New York	4.0%	2% – 4.5%
North Carolina	4.0%	2% - 2.5%
North Dakota	5.0%	1% – 2%
Ohio	5.0%	.5% - 2 %
Oklahoma	4.5%	.2% – 6.25%
Oregon	0%	0%
Pennsylvania	6.0%	0% –1%
Rhode Island	7.0%	0%
South Carolina	5.0%	0% –2%
South Dakota	4.0%	1% –2%
Tennessee	6.0%	1% – 2.75%
Texas	6.25%	.5% – 2%
Utah	4.75%	1% – 3.25%
Vermont	5.0%	0% – 1%
Virginia	3.5%	1%
Washington	6.5%	.5% - 2.1%
West Virginia	6.0%	0%
Wisconsin	**5.0%**	**.1% – 1%**
Wyoming	4.0%	1% - 2%
SOURCE: Sales Tax Institute		

APPENDIX 2: State Sales Tax Revenues				
State	**Revenue**		**State**	**Per Capita**
California	$22,684,257		Washington	$1,260
Florida	13,881,122		Hawaii	1,221
Texas	13,104,114		Nevada	1,011
Michigan	8,304,882		Connecticut	981
New York	7,970,189		Florida	919
Washington	7,253,611		Michigan	842
Pennsylvania	6,659,123		New Mexico	835
Illinois	**5,948,973**		Mississippi	806
Ohio	5,872,943		Tennessee	769
New Jersey	5,054,438		Wyoming	724
Georgia	4,348,817		Minnesota	713
Tennessee	4,216,278		Arizona	693
Minnesota	3,404,441		California	684
North Carolina	3,342,157		Maine	661
Arizona	3,309,921		Texas	654
Indiana	**3,308,186**		Utah	646
Massachusetts	3,269,827		Kansas	635
Wisconsin	**3,264,695**		South Dakota	630
Connecticut	3,218,062		Arkansas	628
Missouri	**2,716,070**		**Wisconsin**	**622**
Virginia	2,394,516		New Jersey	621
South Carolina	2,347,155		South Carolina	604
Maryland	2,299,610		**Iowa**	**574**
Louisiana	2,266,867		Rhode Island	566
Mississippi	2,230,309		Idaho	561
Kentucky	**2,085,900**		Georgia	558
Nevada	1,829,874		**Indiana**	**557**
Colorado	1,703,608		Pennsylvania	555
Kansas	1,686,570		Massachusetts	530
Alabama	1,649,120		**Kentucky**	**527**
Iowa	**1,646,052**		North Dakota	525
Arkansas	1,602,491		Ohio	522
New Mexico	1,452,283		Louisiana	518
Hawaii	1,447,278		Nebraska	513
Utah	1,376,209		**Missouri**	**497**
Oklahoma	1,375,881		West Virginia	497
West Virginia	897,189		**Illinois**	**491**
Nebraska	855,409		Maryland	445
Maine	828,635		New York	438
Idaho	701,657		North Carolina	437
Rhode Island	561,193		Colorado	420
South Dakota	461,660		Oklahoma	410
Wyoming	347,410		Alabama	377
North Dakota	332,814		Virginia	348
Vermont	205,634		Vermont	346
Alaska	0		Alaska	0
Delaware	0		Delaware	0
Montana	0		Montana	0
New Hampshire	0		New Hampshire	0
Oregon	0		Oregon	0
District of Columbia	NA		District of Columbia	NA
SOURCE: State Rankings 2001				

APPENDIX 3: ILLINOIS EXEMPTIONS

Feed and Seed Exemption	1933
Occasional Sales	1933
Charitable, Religious, Governmental, and Educational Exemption	1953
Demonstration Use Prior to Resale	1955
Interim Use Prior to Sale Exemption	1955
Property Acquired by Non-Resident before Relocating in Illinois Exemption	1955
Traded-In Property Exemption	1955
Use by Nonresidents While Temporarily Passing Through Illinois Exemption	1955
Retailer's Discount	1960
Sales by Exempt Organizations	1961
Newsprint and Ink to Newspapers and Magazines Exemption	1965
Sales of Fuel to Vessels on Bordering Rivers	1968
Rolling Stock Exemption	1968
Pollution Control Facilities Exemption	1970
Sales Through Penny Bulk Vending Machines	1972
Sales of Motor Vehicles to Non-Residents Exemption	1974
Farm Chemicals Exemptions	1975
Nutrition Program for the Elderly Exemption	1975
Manufacturing and Assembling Machinery and Equipment Exemption	1979
Farm Machinery and Equipment Exemption	1980
Food, Drugs, and Medical Appliances Rate Reduction	1980
Gasohol Discount	1980
Low Sulfur Dioxide Emissions Coal Fueled Device Exemption	1980
Distillation Machinery and Equipment Exemption	1981
Graphic Arts Machinery and Equipment Exemption	1981
Building Materials within Enterprise Zone Exemption	1982
Teacher Sponsored Student Organization Exemption	1983
Sales to County Fair Association Exemption	1983
Replacement Vehicles Exemption	1984
Property Used in the Operation of Pollution Control Facilities	1985
Designated Personal Property within Enterprise Zone Exemption	1985
Legal Tender, Medallions, and Bullion Exemption	1985
Building Materials to High Economic Impact Business Exemption	1986
Coal Machinery and Equipment Exemption	1986
Oil Machinery and Equipment Exemption	1986
Photo Processing Machinery and Equipment Exemption	1988
Sales of Vehicles to Automobile Renters Exemption	1988
Sales to Not for Profit Music and Dramatic Arts Organization Exemption	1988
Senior Citizens Service Enterprises Exemption	1988
Specified Photoprocessing Charges Exemption	1988
Fuel and Petroleum Products for International Flight Exemption	1989
Machinery/Equipment for Operation of High Economic Impact Service Facility	1989
Nursing Homes Food Drugs and Medical Appliances Exemption	1991
Sales of Tangible Personal Property Used by Aircraft Maintenance Facilities	1991
Sales of Machinery and Equipment in Operation of Aircraft Maintenance Facilities	1991
Manufacturer's Purchase Credit	1995
Disaster Relief Donation and Infrastructure Repair Exemption	1996
Leased Property to Hospitals or Government Bodies	1996
Vending Machine Exemption	2000

SOURCE: Illinois Tax Expenditure Report
NOTE: A complete description of exemptions can be found in the 2001 Illinois Tax Handbook for Legislators.

APPENDIX 4: Home Rule Units and Combined Sales Tax Rate

Addison	7.25%	Hanover Park (DuPage)	7.00%
Alsip	8.00%	Harwood Heights	8.75%
Alton	7.00%	Highland Park (Lake)	7.00%
Arlington Heights	8.25%	Hoffman Estates (Cook)	8.25%
Aurora (DuPage County)	7.50%	Hoffman Estate (Kane)	7.00%
Aurora (Kane County)	7.50%	Joliet	7.50%
Aurora (Kendall County)	7.25%	Joliet (Will)	7.75%
Aurora (Will County)	7.50%	Lincolnwood	8.25%
Belleville	7.25%	Marion	7.00%
Berkeley	8.75%	Moline	7.00%
Berwyn	8.75%	Monee	7.50%
Bloomingdale	7.00%	Monmouth	7.25%
Bloomington	7.50%	Morton Grove	8.50%
Bolingbrook (DuPage)	7.50%	Mount Prospect	8.25%
Bolingbrook (Will)	7.50%	Mount Vernon	7.25%
Buffalo Grove (Cook)	8.25%	Mundelein	7.25%
Buffalo Grove (Lake)	7.00%	Murphysboro	6.75%
Burbank	8.50%	Niles	8.50%
Burnham	8.75%	Normal	7.25%
Cahokia	7.25%	Norridge	8.75%
Calumet City	8.25%	Northlake (Cook)	8.75%
Carbondale	7.25%	Northlake (DuPage)	7.50%
Carpentersville	7.50%	Oak Lawn	8.00%
Champaign	7.50%	Oak Park	8.75%
Channahon (Grundy)	7.25%	Palatine	8.25%
Channahon (Will)	7.50%	Park Ridge	8.25%
Chicago (Cook)	8.75%	Pekin (Peoria)	7.50%
Chicago (DuPage)	7.50%	Pekin (Tazewell)	7.25%
Chicago Ridge	8.75%	Peoria	7.50%
Cicero	8.75%	Peoria Heights (Peoria)	7.50%
Cook County (Countywide)	*	Peoria Heights (Tazewell)	7.25%
Danville	7.50%	Peoria Heights (Woodford)	8.25%
Decatur	7.50%	Quincy	7.00%
DeKalb	7.00%	Rock Island	6.75%
Des Plaines	8.50%	Rolling Meadows	8.25%
Dolton	8.25%	Rosemont (Cook)	9.00%
East Hazel Crest	8.25%	Sauget	7.25%
East Peoria (non-homerule)	7.25%	Schaumburg (Cook)	8.50%
East St. Louis	8.00%	Schaumburg (DuPage)	8.75%
Elgin (Cook)	8.50%	Sesser	7.25%
Elgin (Kane)	7.25%	Skokie	8.50%
Elk Grove Village (Cook)	8.25%	South Barrington	8.75%
Elk Grove Village (DuPage)	7.00%	Springfield	7.25%
Elmhurst	7.00%	St. Charles (DuPage County)	7.00%
Elmwood Park	7.00%	St. Charles (Kane)	7.00%
Elmwood	7.50%	Stone Park	8.75%
Evanston	8.50%	Streamwood	8.25%
Evergreen Park	8.25%	Sycamore	7.00%
Fairview Heights	7.25%	Urbana	7.50%
Galesburg	7.25%	Washington	7.25%
Glendale Heights	7.00%	Watseka	7.00%
Granite City	7.50%	West Dundee	7.50%
Gurnee	7.00%	Wheeling (Cook)	8.25%
Hanover Park (Cook)	8.25%	Wheeling (Lake	7.00%

SOURCE: Illinois Department of Revenue

* Cook County imposes a 0.75% county home rule sales tax. For unincorporated areas in Cook County, the ST-1/ST-2 combined rate remains at 7.75%. For home rule municipalities within Cook County that impose home rule sales tax, the ST-1/ST-2 combined rate varies (see the entries for each municipality).

APPENDIX 5: County Public Safety Sales Tax Rates	
County	Rate
Boone County	0.5%
Brown County	0.25%
Carroll County	0.25%
Champaign County	0.25%
Knox County	0.25%
LaSalle County	0.25%
Marion County	0.25%
McDonough County	0.50%
Peoria County	0.25%
Pike County	0.25%
Richland County	0.50%
Stephson County	0.50%
Vermilion County	0.25%
Woodford County	1.00%
SOURCE: Illinois Department of Revenue	

APPENDIX 6: Historical Sales Tax Exemptions							
Exemptions	1995	1996	1997	1998	1999	2000	1995-2000 Growth
Food, Drugs, Medical App.	$771,400	$808,000	$864,000	$904,500	$918,000	$1,050,000	36.12%
Exempt Organizations	468,000	488,000	512,000	536,000	557,982	670,000	43.16%
Traded-In Property	300,00	300,00	300,00	300,00	300,00	325,000	8.33%
Farm Chemicals	138,500	144,000	151,000	158,000	164,000	185,000	33.57%
Manufacturing & Assembly	107,500	111,500	117,000	122,000	127,000	143,600	33.58%
Retailer's Discount	78,500	82,100	85,600	87,800	89,760	102,950	31.15%
Rolling Stock	46,100	55,800	50,000	85,000	70,000	127,500	176.57 %
Sale of Vehicles to Non-Residents	36,500	59,500	62,100	42,600	50,600	75,000	105.48 %
Other	176,710	171,803	190,555	195,575	195,699	244,993	38.64%
TOTAL	2,123,210	2,220,703	2,332,255	2,431,478	2,473,241	2,924,043	37.72%
SOURCE: Illinois Tax Expenditure Report (Dollars in thousands)							

BACKGROUND

The Illinois Economic and Fiscal Commission, a bipartisan, joint legislative commission, provides the General Assembly with information relevant to the Illinois economy, taxes and other sources of revenue and debt obligations of the State. The Commission's specific responsibilities include:

1) Preparation of annual revenue estimates with periodic updates;

2) Analysis of the fiscal impact of revenue bills;

3) Preparation of "State Debt Impact Notes" on legislation which would appropriate bond funds or increase bond authorization;

4) Periodic assessment of capital facility plans; and

5) Annual estimates of the liabilities of the State's group health insurance program and approval of contract renewals promulgated by the Department of Central Management Services.

The Commission also has a mandate to report to the General Assembly ". . . on economic trends in relation to long-range planning and budgeting; and to study and make such recommendations as it deems appropriate on local and regional economic and fiscal policies and on federal fiscal policy as it may affect Illinois. . . ." This results in several reports on various economic issues throughout the year.

The Commission publishes two primary reports. The "Revenue Estimate and Economic Outlook" describes and projects economic conditions and their impact on State revenues. "The Illinois Bond Watcher" examines the State's debt position as well as other issues directly related to conditions in the financial markets. The Commission also periodically publishes special topic reports that have or could have an impact on the economic well being of Illinois.

These reports are available from:

Illinois Economic and Fiscal Commission
703 Stratton Office Building
Springfield, Illinois 62706
(217) 782-5320
(217) 782-3513 (FAX)

Reports can also be accessed from our Webpage:

http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html