

### What the Illinois tax increase means for residents and corporations

On Jan. 13, 2011, Illinois Governor Pat Quinn passed a significant rate increase, effective as of Jan. 1, 2011.

The individual income tax rate jumped to 5 percent from 3 percent, while the Illinois corporate income tax rate for C corporations rose to 7 percent from 4.8 percent. Since such businesses are also subject to the state's personal property "replacement tax" of 2.5 percent, their combined tax rate will reach 9.5 percent.

*C corporations with fiscal year-ends will be subject to two rates in the years in which the corporate income tax rate changes (e.g., 2010 to 2011 and 2014 to 2015). For such fiscal years, the corporation may prorate its income using the number of days before and after the rate change and applying the appropriate rate to determine the tax for each segment of the year. Alternatively, specific accounting for the pre- and post-change segments of the year may also be used with the appropriate rate to determine the taxpayers' income tax. The Illinois Department of Revenue will issue rules on the specific accounting method.*

The rates are scheduled to decrease to 3.75 percent for individuals and 5.25 percent for C corporations after Dec. 31, 2014. As the law is currently written, rates will decline further after Dec. 31, 2024, sliding to 3.25 percent for individuals and 4.8 percent for C corporations.

Provisions are in place for rates to go back to pre-Jan. 1, 2011, rates if the Illinois state government's spending exceeds specified limits. However, because spending "limits" can be adjusted by the Illinois legislature at will, this is considered very unlikely.

Other key aspects of the legislation include:

- > **Suspension of net operating loss deduction** (excluding S corporations) for tax years after Dec. 31, 2010, and prior to Dec. 31, 2014. Current carryover provisions – 12 years for losses incurred on or after Dec. 31, 2003 – will be extended for the number of years of the suspension.
- > **Reinstating the Illinois Estate and Generation-Skipping Transfer Tax Act** for deaths occurring after Dec. 31, 2010. The tax, which had been allowed to lapse Dec. 31, 2009, is equal to the full amount of the state tax credit allowed under the Internal Revenue Code that was effective Dec. 31, 2001, but limits the exclusion amount to \$2 million.
- > **Changing the "prior years" safe harbor percentage.** Installments for underpayments due after Jan. 31, 2011, and prior to Feb. 1, 2012, increase to 150 percent from 100 percent of the amount shown on the return for the preceding taxable year if there was a liability and the preceding year was 12 months long.
- > **No additional relief for Illinois property owners.** The property tax rebate program that was included in the original bill was eliminated from the final bill. The current credit of 5 percent for property tax paid was retained.

Also, the aforementioned replacement tax rates – 2.5 percent for C corporations and 1.5 percent for S corporations and partnerships – were not changed by the legislation.

### What should taxpayers do in reaction to this rate increase?

Although these new rates do not apply to the returns that will be filed this tax season, this is a good time to consider *what can be done to reduce Illinois taxes in the coming years.*

For instance, for businesses that provide services, the method for sourcing revenues to Illinois should be reviewed since a fairly recent change made that accounting method generally favorable for companies that provide services to customers, including some that are located outside of Illinois.

# Baker Tilly Tax Alert

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Also, companies should consider what states they have nexus and where they are filing. Apportioning more income to states with tax rates lower than Illinois might save income tax dollars.

In addition to tax-savings opportunities, taxpayers should be mindful of:

- > **Deductions where Illinois doesn't follow the federal tax law.** When estimating tax costs and planning, take into account such items as bonus depreciation, section 179 expensing, and cancellation of debt income deferral provisions may be limited further increasing state tax liabilities.
- > **The likelihood of being subjected to the alternative minimum tax** since that is often a result of increasing state taxes. Planning should be adjusted to reflect this.

**For more information or any questions you might have on this topic, please contact your Baker Tilly advisor or send an e-mail to [tax@bakertilly.com](mailto:tax@bakertilly.com).**