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ISSUE BRIEF

Illinois Should Decouple from Federal CARES Act Tax Breaks

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Part of the federal economic stimulus created under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, involved increasing the tax relief businesses could claim under the existing net operating loss and excess business loss tax breaks. Among other things, the Cares Act made these tax cuts retroactive, meaning businesses can claim losses and reduce their tax liability for years in which the pandemic had no impact on their profitability.

Because the Illinois income tax code is predicated on federal law, whenever Congress increases existing tax relief already received by businesses at the federal level, that tax relief automatically applies under Illinois law, resulting in a concomitant reduction in tax revenue for the state. According to State Representative Mike Zalewski, this change in federal law could result in Illinois losing anywhere from $500 million to $1 billion in tax revenue this year, unless Illinois “decouples” from the federal change, as requested by the Pritzker Administration.

For the following reasons, at this point in time decoupling from the aforesaid federal tax breaks under the CARES Act would constitute both good tax policy and rational budget policy for Illinois:

1. The Federal government not only can deficit spend, but should deficit spend to help stimulate economic growth during periods of constrained private sector demand. Illinois, however, is *not* allowed to deficit spend, and is supposed to introduce a balanced budget annually. Hence, while Congress was acting rationally in context of its responsibilities and budgetary reality, Illinois law makers have the duty to consider whether increasing the tax relief already afforded under the net operating loss and excess business loss provisions makes sense in context of Illinois’ state-level responsibilities and budgetary reality.
2. Considering that Illinois is already facing a General Fund deficit of $3.9 billion this year, the loss of an additional $500 million to $1 billion in revenue would require Illinois to cut spending on services even more than currently planned. And making additional cuts to public services covered by the General Fund would be poor public policy, given that over $9 out of every $10 of that service spending covers the core areas of education, healthcare, social services and public safety.
3. In fact, making additional cuts to those core services during a pandemic will harm communities across the state in two ways. Not only will those communities lose the public services that are cut—despite the fact that demand therefor is either constant, as in the case of public education, or in some cases increasing due to the pandemic—but their local economies will suffer as well.
4. The reason local economies will suffer has everything to do with consumer spending, which accounts for around 67% of all economic activity. When General Fund spending on core services is cut, those cuts are primarily made to the wages of the teachers, social workers, healthcare providers and correctional officers who are on the front line delivering services locally. These public sector workers are middle-income, so they have a high “Marginal Propensities to Consume”—which simply means they spend rather than save most of their income. Similarly, when they lose income due to General Fund spending cuts, they spend less in the local economy. Nobel Prize winning economist Joseph Stiglitz found that this creates a negative economic multiplier that results in private sector job loss.
5. Hence, while the federal government is able to continue stimulating the private sector economy despite losing revenue from these CARES Act tax breaks because it can deficit spend, Illinois does not have that luxury. And since the state would have to offset the cost of this tax relief with equivalent spending cuts,

Illinois’ failure to decouple would reduce demand in local economies statewide. That, in turn, will harm most small businesses in the state.

6. Of course, even if Illinois decouples, businesses in the state that otherwise qualify will still receive the increased tax break at the federal level. And it won’t be the owners of small businesses who qualify. The expanded net operating loss and excess business loss tax breaks created under the CARES Act can only be claimed by individual business owners who have more than $250,000 in annual income if they are filing singly, or more than $500,000 of annul income if filing jointly. That is less than 3% of all taxpayers in Illinois, and includes virtually no small businesses.
7. Five states have already decoupled from these CARES Act tax breaks, including Colorado, Georgia, Hawaii, New York, and North Carolina. Colorado, New York, and Hawaii have Democratic governors. Georgia has a Republican governor. North Carolina, which has a Democratic governor, also has a General Assembly controlled by the Republican Party. Hence state governments, with leadership from both parties, are deciding to decouple from the expansion of the net operating loss and excess business loss tax breaks provided under the CARES Act, predicated on their respective state-level situations. Illinois should do the same.

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