

MODERNIZING ILLINOIS' SALES TAX:

A pathway to a
sustainable future



THE CIVIC FEDERATION
RESEARCH • INFORMATION • ACTION
EST. 1894



Chicago Metropolitan
Agency for Planning

CTBA

Center For Tax and
Budget Accountability

Social and economic justice through data-driven policy.

ILEPI

ILLINOIS ECONOMIC POLICY INSTITUTE

For decades, various reports — many authored by our own organizations — have clearly demonstrated that expanding Illinois' tax base to include more consumer services would make the system both fairer and more sustainable.

As the second-largest revenue source supporting the state's general fund, and a critical component of municipal budgets, the performance and future of the sales tax should be of paramount concern for both state and local leaders.

Yet despite widespread acknowledgment of the need for improvement, the legal and administrative complexity of modernizing the sales tax in Illinois has prevented necessary reform. It has also perpetuated an outmoded system that unintentionally favors some businesses and consumers over others, which is fundamentally inefficient and contrary to the goals of sound tax policy.

As the state recovers from the COVID-19 pandemic and faces new challenges a quarter of the way into the 21st century, we can no longer defer progress on this critical issue. All the taxing bodies that rely on the sales tax are facing acute challenges related to the adequacy of their funding as federal pandemic aid expires, which adds urgency and resonance to the need to solve this problem.

Our organizations represent a broad range of government and tax policy viewpoints — from business and education to transportation and land use to fiscal accountability. We don't always agree, but we are united on this: **the time has come for Illinois to modernize its sales tax by expanding its base to include more consumer services.** This challenging but common-sense solution would improve the structure of the state's tax system and ensure that it has stable, adequate revenue to support the high quality of life that the people and communities of Illinois deserve.

This collaborative report outlines the history of how we got to this point, alongside a clear, compelling case for sales tax modernization and a roadmap for enacting the critical reforms necessary to secure a stronger fiscal future for Illinois.

Sincerely,

Erin Aleman, Executive Director
Chicago Metropolitan Agency for Planning

Joe Ferguson, President
The Civic Federation

Ralph Martire, Executive Director
Center for Tax and Budget Accountability

Josh Weger, Executive Director
Illinois Economic Policy Institute

TABLE OF CONTENTS

EXECUTIVE SUMMARY	4
▶ THE TIME HAS COME TO ACT	4
▶ KEY FINDINGS	5
▶ KEY IMPLEMENTATION CONSIDERATIONS	6
BACKGROUND	8
▶ HISTORY OF THE SALES TAX IN ILLINOIS	8
▶ CURRENT COMPOSITION OF THE ILLINOIS SALES TAX	8
▶ CURRENT PERFORMANCE OF THE ILLINOIS SALES TAX	11
POLICY CONSIDERATIONS FOR MODERNIZING THE SALES TAX IN ILLINOIS	14
▶ CURRENT: A MODERN SALES TAX ALIGNS WITH ECONOMIC ACTIVITY	15
▶ ADEQUATE: A MODERN SALES TAX MEETS REVENUE NEEDS ACROSS ECONOMIC CYCLES	16
▶ FAIR: A MODERN SALES TAX FULLY CAPTURES THE SPENDING OF HIGH-INCOME CONSUMERS	19
▶ EFFICIENT: A MODERN SALES TAX SUPPORTS ECONOMIC COMPETITIVENESS	22
▶ CONCLUSION	23
PRINCIPLES AND IMPLEMENTATION CONSIDERATIONS FOR MODERNIZING THE SALES TAX IN ILLINOIS	24
▶ ENSURE CONSTITUTIONAL UNIFORMITY	24
▶ STANDARDIZE TREATMENT OF COUNTIES, MUNICIPALITIES, AND SPECIAL TAXING DISTRICTS	25
▶ LIMIT TAX PYRAMIDING AND SUPPORT ECONOMIC COMPETITIVENESS	26
▶ EXEMPT CONSUMER SERVICES NOT GENERALLY SUBJECT TO TAXATION SUCH AS HEALTHCARE, HOUSING, AND CHILDCARE	26
▶ CAREFULLY CONSIDER THE APPROPRIATE RATE	27
▶ USE NEW REVENUES TO MAKE INVESTMENTS THAT WILL STABILIZE GOVERNMENT FINANCES AND FUND PUBLIC SERVICES	28
▶ PROVIDE EXPERTISE AND OVERSIGHT FOR IMPLEMENTATION AND EVALUATE PERFORMANCE AND USE OF THE EXPANDED TAX	30
NEXT STEPS	31
ENDNOTES	32

EXECUTIVE SUMMARY

As the State of Illinois' second largest revenue source, the sales tax is a critical tool that supports government operations and public services throughout the state. First implemented in the 1930s, Illinois' antiquated sales tax structure still primarily taxes goods rather than services. Due to this narrow tax base — which does not reflect the modern, service-oriented economy — the sales tax is falling short. Illinois needs a more strategic and sustainable fiscal structure that delivers consistent and reliable revenue growth, efficient spending, and economic competitiveness.

The time has come to fundamentally modernize the sales tax in Illinois to better reflect a 21st century economy. Applying the sales tax to consumer services would help secure Illinois' financial future and its ability to meet residents' needs by supporting critical public services, reducing tax inequities, and enhancing fiscal stability.

THE TIME HAS COME TO ACT

As a policy matter, a half-century of tax base erosion means the state's sales tax does not adequately capture current consumer spending activities. This results in disproportionately lower per-capita sales tax collections in Illinois compared to other states, despite a comparatively high composite sales tax rate.¹ The state's outdated approach also unintentionally and unfairly gives preferential tax treatment to service-producing businesses and high-income consumers over retailers and low- and moderate-income households who spend most on goods.

As a practical matter, slow revenue growth means Illinois' fiscal condition and its ability to invest in critical public services will be constrained for years to come. Despite recent progress that puts Illinois in a better position to respond to uncertain and ever-changing macroeconomic conditions, the funding needs facing the state are substantial. While it is important to practice strong financial stewardship to constrain cost growth over time — as noted in Governor Pritzker's State of the State and Budget for fiscal year 2026 — bold and targeted actions will be required to avoid drastic cuts to public transportation in northeastern Illinois, as well as to meet the state's obligations across a variety of other important expenditures like pensions and education. The sales tax is a critical source of funding for each of these public investments, but annual inflation-adjusted state sales tax revenues have consistently remained flat, growing only 11 percent between 1990 and 2023 (for a compound annual growth rate of 0.3 percent).

Modernizing the sales tax is essential for the State of Illinois to improve the soundness of its tax system, to achieve long-term fiscal stability, and to meet future economic challenges. As part of a path to sustainable revenue growth, Illinois should expand its sales tax beyond goods to include more consumer services. The benefits of such a policy change would include a more diversified, equitable, and sustainable tax structure that allows the state and local governments to consistently and effectively invest in programs and services.

KEY FINDINGS

Illinois' sales tax structure is outdated and misaligned with economic activity. The sales tax operates within a decades-old model that primarily taxes goods. Consumer spending has shifted significantly from goods to services over the past century, as expenditures on consumer services have grown 2.5 times faster than expenditures on goods over the last six decades.

Illinois currently taxes only 29 out of 176 consumer services through a variety of specific excise taxes on things like utilities and parking. Illinois' model diverges from most other states, many of which have modernized their own sales tax structures in recent years.

A sales tax on services would be less regressive than the current structure. The current system is unfair because high-income households spend five times more on untaxed services than low-income households, despite spending a smaller share of their income. Taxing services would correct this inequity that unintentionally favors wealthier individuals.

The state could also offset any negative impacts on lower income households by using some of the new revenues generated to expand income-targeted tax relief programs such as the Illinois Earned Income Tax Credit (thereby increasing income levels for the lowest earners) or reinstating the Circuit Breaker Property Tax Relief program (providing a property tax break based on income-level).

A sales tax on services would produce additional revenue to fund critical services. Recent estimates find that expanding the sales tax base to include a broad range of consumer services could generate up to \$2 billion annually for the State of Illinois, as well as hundreds of millions in revenue for local governments through existing local sales tax rates. The state can use these incremental revenues to address today's most pressing fiscal challenges, including education, transit, and unfunded pension liabilities.

KEY IMPLEMENTATION CONSIDERATIONS

This report lays out the policy considerations for expanding the sales tax base to include consumer services and introduces key principles for implementation. As Illinois considers and designs a sales tax on services, there are several principles that should be incorporated as part of an implementation plan:

- ▶ A service tax should be imposed on a broad set of consumer services to comply with the Illinois Constitution's uniformity clause, which requires that taxes be consistently applied, with reasonable exemptions.
- ▶ Any economically efficient plan to tax consumer services should include two important exemptions to support the state's households and businesses:
 - ▷ Essential services like housing, healthcare, and childcare that are generally not classified as volitional consumption should be excluded from any tax on consumer services. Taxing these transactions could cause significant disruptions for households of all incomes and would be contrary to the state's broader policy objectives.
 - ▷ Services purchased by businesses as an input into products later offered for sale should also be excluded. These business-to-business (B2B) transactions, which include services like accounting and legal support, are considered intermediate inputs that help create products that will be taxed when sold to the final consumer. Taxing these transactions would lead to tax pyramiding — an economically inefficient approach that results in uneven and inconsistent effective tax rates. Taxing B2B services would also damage Illinois-based businesses' ability to compete with peers in other states.
- ▶ To address existing taxes on services, the General Assembly should work with local governments to transition their existing service taxes (such as Chicago's tax on streaming services) and avoid double-taxation by multiple units of government. The state can ensure local taxing jurisdictions, including communities with existing service taxes, benefit from sales tax modernization by guaranteeing that any expansion of the state sales tax base is fully reflected at the local level.
- ▶ As part of an expansion of the sales tax base, taxing jurisdictions should consider potential adjustments to their current rates, with the goal of maximizing revenue while decreasing overall tax burden on consumers.



- ▶ Careful consideration must be given to the appropriate use of new incremental revenue. These resources should be targeted to advance the state's most pressing fiscal challenges, including:
 - ▶ Addressing the \$770 million public transit funding deficit estimated by the RTA and total \$1.5 billion needed annually to enable significant improvements to the transit system in northeastern Illinois;
 - ▶ Paying down Illinois' \$144 billion in unfunded pension obligations;
 - ▶ Fully funding the evidence-based K-12 education funding formula;
 - ▶ Making additional contributions to the state's rainy-day reserve fund; and
 - ▶ Funding tax relief for low-income households by increasing resources allocated to programs like the Earned Income Tax Credit and Circuit Breaker Property Tax Relief program.
- ▶ To support successful modernization of the sales tax, the state should create an independent advisory panel to work alongside state agencies to provide professional guidance and ongoing evaluation of tax performance, and, as needed, suggest adjustments over time.

For decades, Illinois has grappled with the question of expanding its tax base to include services. Past attempts faced political challenges and legal hurdles that, today, provide important lessons and parameters for future efforts. As lawmakers consider solutions to address the pressing challenges facing Illinois, success will require commitment to bold, thoughtful action and a sustainable future.



BACKGROUND

HISTORY OF THE SALES TAX IN ILLINOIS

Across the nation, many communities put sales taxes in place during the Great Depression after property taxes — previously the main source of revenue for state and local governments — collapsed alongside property values.² Twenty-three states began using the sales tax as a revenue source in 1930. Illinois followed suit shortly thereafter by imposing a temporary 2 percent sales tax on general merchandise in 1933. In 1935, the state made the tax permanent.³

Illinois continued to fine-tune the sales tax over much of the twentieth century. These efforts generally focused on adjustments to the sales tax rate and taxing authorities provided to local governments, although changes were made in the 1980s to exempt the sales of certain foods, medical supplies, and manufacturing equipment.⁴ Effective in 1990, the state overhauled the structure of the sales tax by eliminating local sales tax acts, imposing a uniform 6.25 percent sales tax rate on general merchandise and adopting new rules for home rule and non-home rule local government taxing authority.

In addition to state-level sales tax measures, the legislature also took special actions to support Illinois' public transportation systems. Following a period of financial distress among private sector transit providers in northeastern Illinois, the state established the Regional Transportation Authority (RTA) in 1973 to serve Cook, DuPage, Lake, Will, Kane and McHenry counties. Although the RTA was initially provided an annual operating subsidy, direct state support was ultimately replaced by the RTA sales tax — introduced in 1979 and made permanent in 1983 — and a partial state match of RTA sales tax receipts, which has historically been funded by state sales tax revenues.⁵ The legislature also began using sales tax revenues to fund direct state operating assistance to downstate transit agencies beginning in 1987.⁶

CURRENT COMPOSITION OF THE ILLINOIS SALES TAX

The uniform 6.25 percent rate adopted in 1990 remains in place today and is comprised of a 5 percent state rate and a 1.25 percent local rate. While both rates are imposed statewide and administered by the Illinois Department of Revenue (IDOR), the local revenues are distributed to units of local government where the sales occurred (1 percent to the municipality and 0.25 percent to the county).^a Of the 46 states with a state sales tax, just three others — California, Virginia, and Utah — have a combined state and local rate like Illinois.⁷

Local governments in Illinois have also retained the authority to impose local sales tax rates beyond the base 1.25 percent rate. Home rule counties and municipalities can impose local sales tax rates without a ceiling, while non-home rule counties and municipalities can impose local sales taxes up to 1 percent.^b Finally, the RTA sales tax is imposed in the six counties served by the

northeastern Illinois transit system. Following transit reforms in 2008, the RTA sales tax rate is 1 percent in Cook County and 0.75 percent in the collar counties.^c

Due to how the sales tax and taxing authority for different jurisdictions have been implemented and refined over time, sales tax rates in Illinois are structured as composite rates, or combinations of rates charged by overlapping authorities. The final sales tax rate paid by a consumer in any given part of the state is the combined total of the state rate and all local tax rates.

The highest composite tax rate in Illinois is imposed in Springfield, where consumers pay a 10.75 percent rate for all general merchandise purchases, which consists of the 5 percent state rate, the 1.25 percent standard local government rate, an additional 2.5 percent rate imposed by the city, a 1 percent rate for county school facilities, and a 1 percent rate imposed by the Springfield Business Improvement District (Figure 1).⁸

^a It is important not to conflate the state's 5 percent sales tax rate with the combined state and local 6.25 percent rate when comparing the sales tax in Illinois to other states.

^b Prior to 2024, non-home rule jurisdictions had to seek approval to implement and/or increase local sales tax rates via local referendum. This requirement was removed in fiscal year 2025, when the state eliminated the state-administered 1 percent local sales tax on groceries. Also, taxes imposed by non-home rule counties can be used to generate capital funding for schools (County School Facility Tax) and/or public safety services and facilities (County Public Safety Tax).

^c Cook County contributes its 0.25 percent share of the state-administered 1.25 percent local rate to the RTA, while 0.25 percent of the RTA rate imposed in the collar counties is returned to the counties to support transportation and public safety expenses.

THE SALES TAX IN ILLINOIS IS CURRENTLY COMPOSED OF FOUR UNIQUE TAXES

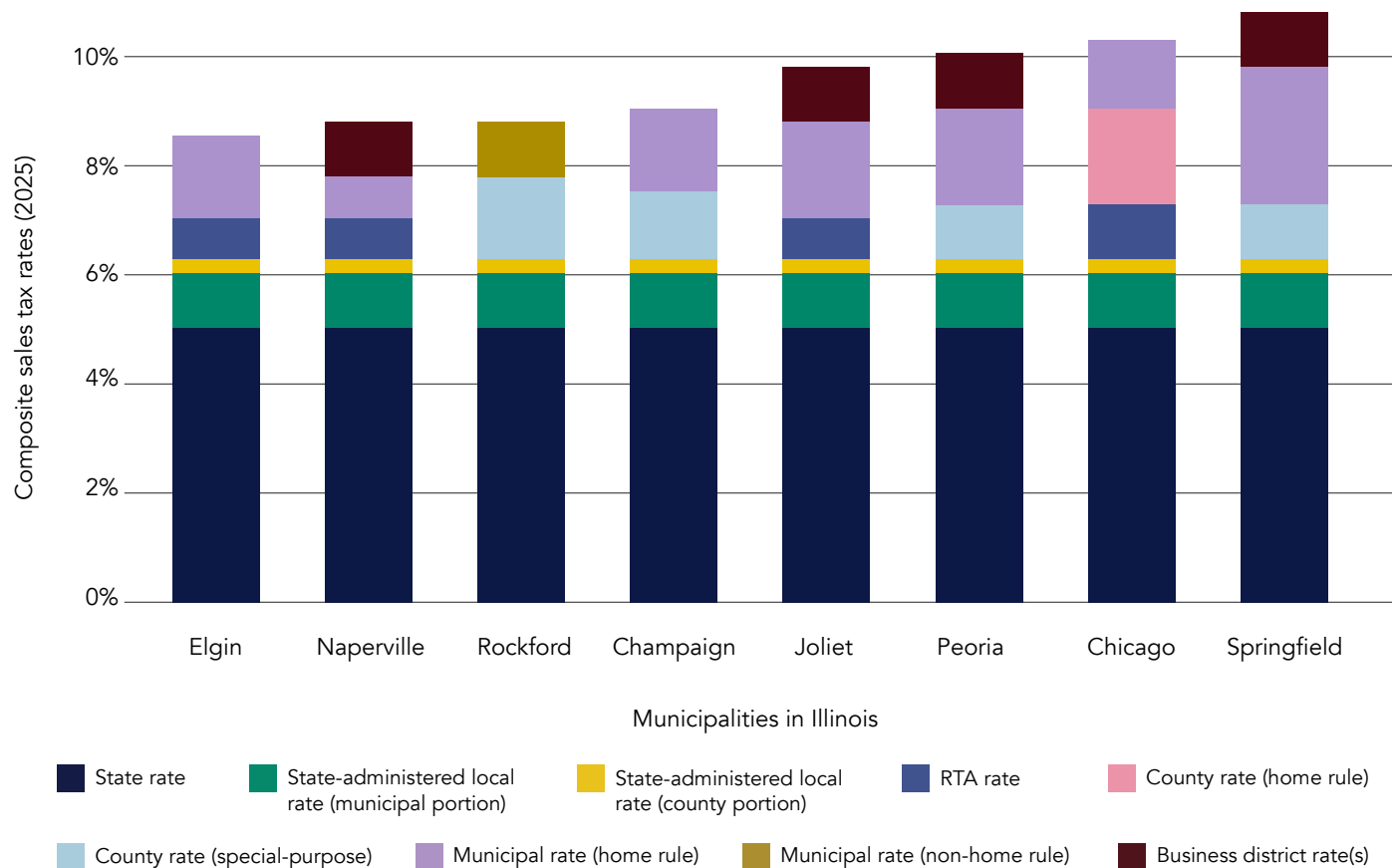
Although often referred to as a singular sales tax in Illinois, the state's tax on general merchandise is technically comprised of four different taxes, each enshrined in distinct sections of the state tax code.

The **Retailers' Occupation Tax** — which is what most people think of as the sales tax in Illinois — is assessed on the gross receipts that retailers collect from selling tangible property in Illinois. The **Retailers' Use Tax** is assessed on consumers who make out-of-state purchases on items included in Illinois' sale tax base, but use said items in Illinois.

The **Service Occupation Tax** and **Service Use Tax** similarly impose taxes on tangible personal property that is sold or acquired incident to the purchase of a service. These taxes notably do not apply to the services themselves. For example, when a car is repaired in Illinois, the tax is assessed only on the parts included in the repair, not the cost of the labor for the repair.

While most goods are considered general merchandise in Illinois, many essential consumer goods are categorized and taxed differently. For example, the state historically imposed a 1 percent local sales tax on food, drugs, and medical devices and disbursed the revenues to local governments. In 2024, Illinois lawmakers voted to eliminate this tax — effective January 1, 2026 — but allowed municipalities to reintroduce it locally. Other general merchandise items that are exempt from sales taxes include newspapers and magazines, as well as machinery and equipment used primarily in manufacturing or agriculture. Sales to nonprofit or public organizations are also exempt.

Figure 1: Composite tax rates are comprised of the state rate and all local tax rates



Source: Analysis of IDOR data.

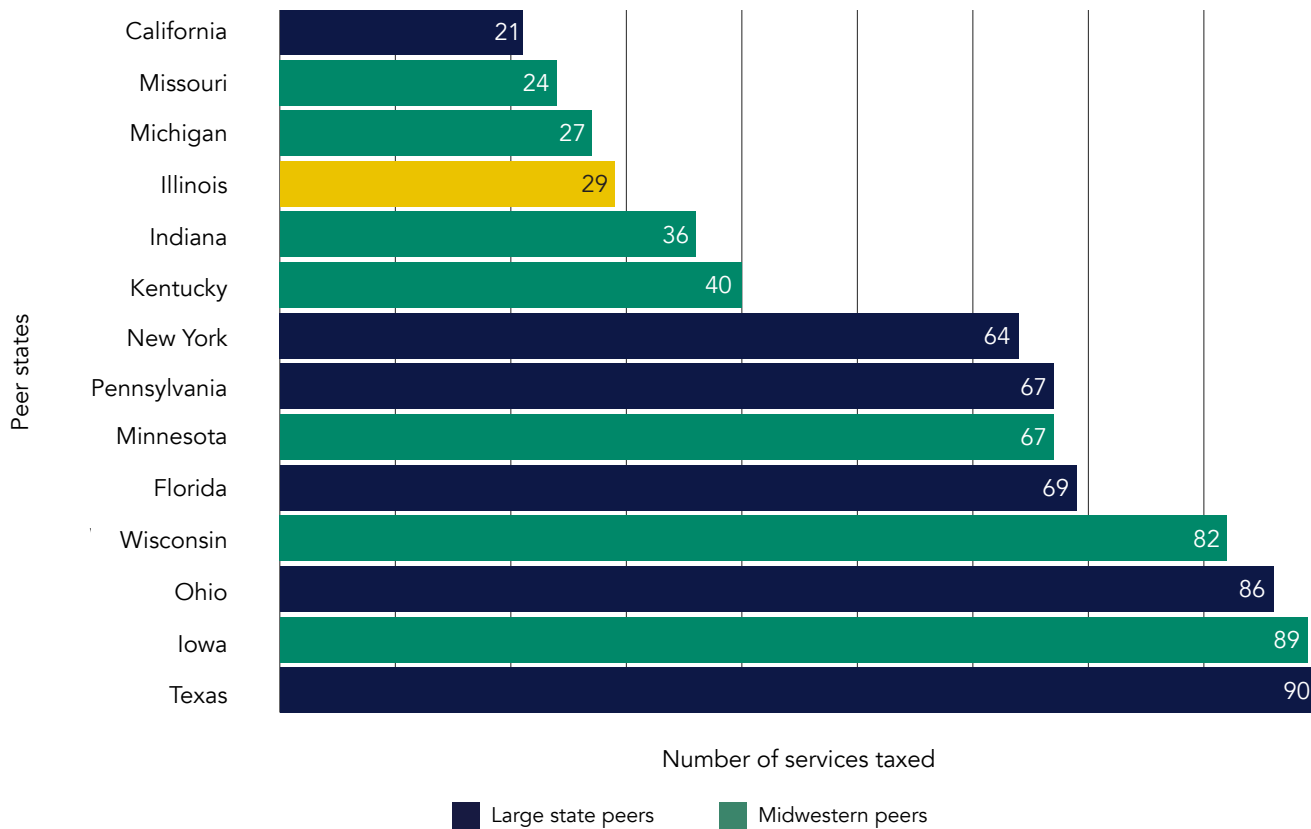
Note: Special purpose county rates include the County School Facility Tax (which can be imposed in any county besides Cook County) and the County Public Safety Tax. Municipal rates include both home rule and non-home rule sales taxes.

The current Illinois sales tax is imposed primarily on goods rather than services. This makes Illinois an outlier with an exceptionally narrow tax base when compared to most peer and adjacent states. A 2017 report by the Federation of Tax Administrators found that the state and/or local municipalities tax only 29 of 176 services.^d In comparison, among the 46 states with a general sales tax, the average number of service industries taxed is 58.2 (Figure 2 compares Illinois to neighboring and other large population states).⁹

The state does tax electricity, natural gas, telecommunications services, hotel and motel rooms, commercial parking lots and garages, and automobile rental services under separate rates and authorities, unlike other states. However, these taxes still do not reflect the broad array of services that consumers are increasingly using.

^d Primary non-utility related services taxed by the state or local governments within Illinois, according to the survey, include photo finishing services, packaged and downloaded software, admissions and amusements, and leases and rentals.

Figure 2: Illinois has far fewer services than most peer and neighboring states



Source: Analysis of 2017 Federation of Tax Administrators data.

CURRENT PERFORMANCE OF THE ILLINOIS SALES TAX

Today, the state sales tax represents one of Illinois' largest revenue sources, besides individual and corporate income taxes. In fiscal year (FY) 2024, the big three sources generated \$41.3 billion, or 78.5 percent of all state General Fund (GF) revenues (Figure 3). State sales tax revenues directly fund the GF, which is the primary source for most state agencies' regular operating and administrative expenses as well as state funding for education, economic development, human and health services, public safety, and environmental, natural, and cultural resources. State sales tax revenues are also critical for transit operations, as they fund the Public Transportation Fund (PFT) (the state's match of RTA sales tax receipts) and the Downstate Public Transportation Fund (appropriations to public transit agencies throughout the rest of the state).¹⁰

Local governments across the state also rely heavily on sales tax proceeds. In FY2024, state sales tax distributions and local sales taxes, on average, comprised 20 percent of Illinois' municipal revenues.¹¹ Sales tax revenues are largely unrestricted so local governments can use the funds to meet a variety of needs, including matching funds for important capital and infrastructure projects. Maintaining a robust sales tax is therefore uniquely important to meet state and local needs.

State and local sales tax revenues have grown in recent years due to some short-term trends, including higher-than-typical levels of consumer spending and rising inflation. Sales tax performance also got a boost in the wake of the Supreme Court’s 2018 decision in *South Dakota v. Wayfair*, which eliminated the previous requirement that a retailer be physically present in a jurisdiction for the collection of sales taxes. In 2021, the *Level the Playing Field for Illinois Retail Act* began the collection and remittance of some sales taxes from remote retailers and marketplace facilitators that were previously not collected.^e While these factors have buoyed the sales tax’s short-term performance in Illinois, the outlook for this important revenue is still diminishing over the long-term (Figure 4). As consumption patterns return to pre-pandemic trends, Illinois must strengthen this critical revenue source for the next century and beyond.

Figure 3: State sales taxes and individual and corporate income taxes are the state’s three largest General Fund revenue sources

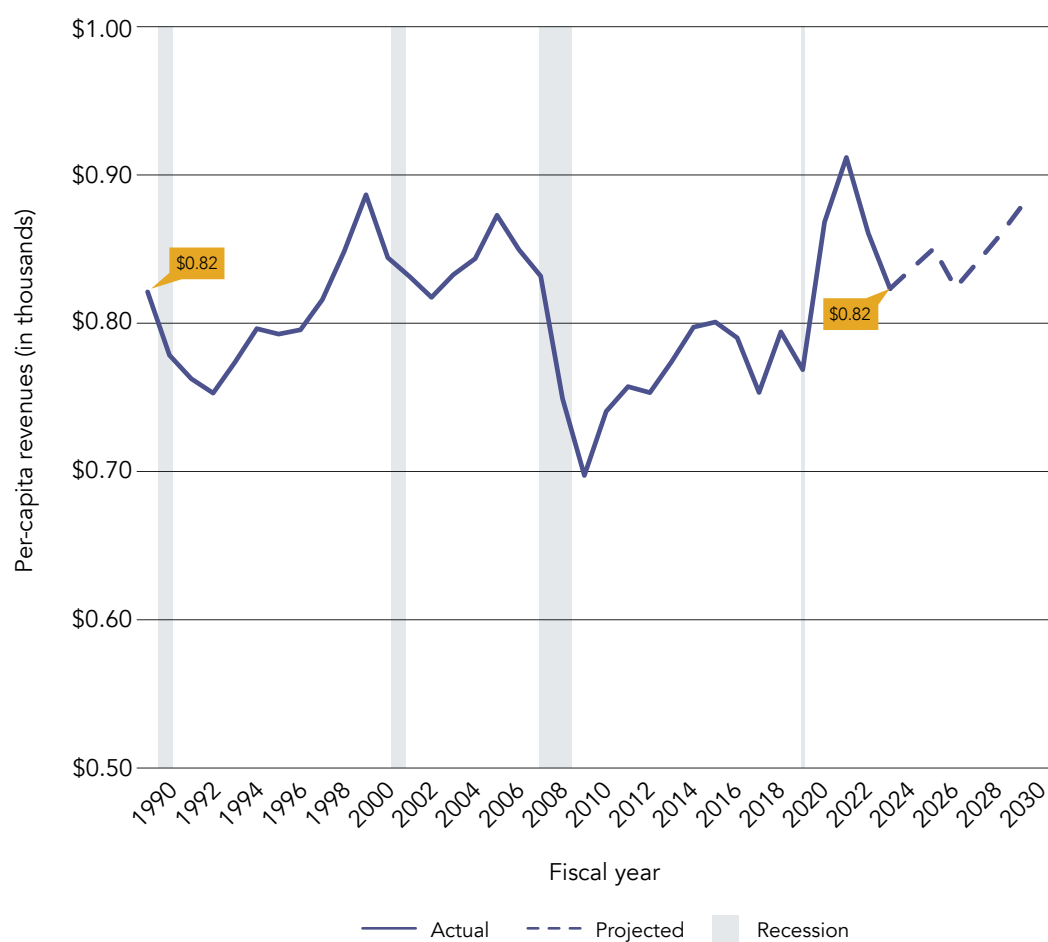
GF revenues by source (millions)	FY2024 revenues	Share of GF revenues
Cash receipts	\$45,315	86.1%
Individual income taxes	\$25,605	48.6%
State sales taxes	\$10,465	19.9%
Corporate income taxes	\$5,277	10.0%
Public utility taxes	\$695	1.3%
Investment income	\$654	1.2%
Inheritance tax	\$627	1.2%
Insurance taxes and fees	\$486	0.9%
Cigarette and tobacco products taxes	\$204	0.4%
Corporate franchise taxes and fees	\$202	0.4%
Liquor gallonage taxes	\$179	0.3%
Other taxes, licenses, fees, and earnings	\$921	1.7%
Federal sources	\$4,526	8.6%
State transfers	\$2,798	5.3%
Total state revenues (millions)	\$52,639	100.0%

Source: Illinois Comptroller Traditional Budgetary Financial Report for Fiscal Year 2024.

^e Public Act 103-983, effective January 1, 2025, subsequently required sales tax collections from retailers with any kind of physical presence in Illinois who make sales that are sourced outside of this state to Illinois customers.

Figure 4: Although sales tax revenues are forecast to grow 2 percent annually, per capita revenues are anticipated to remain below the 2022 peak between now and 2030

Illinois actual and projected per-capita sales tax revenues, FY1990 to FY2030 (2024 dollars)



Source: Analysis of historic data from Illinois Traditional Budgetary Financial Reports and forecasts from the Governor’s Office of Management and Budget’s (GOMB) Illinois Economic and Fiscal Policy Report (dated November 1, 2024) and Illinois State Budget Fiscal Year 2026.

Note: Projected revenues include FY2025 estimated revenues and 2026 budgeted revenues from GOMB’s Illinois State Budget for Fiscal Year 2026 released in February 2025. Projections for FY2027 and beyond were calculated by applying the rate of growth assumed in GOMB’s 2024 Illinois and Economic Policy Report to the figures from the budget document.

POLICY CONSIDERATIONS FOR MODERNIZING THE SALES TAX IN ILLINOIS

The soundness of a state's tax system depends on several interrelated factors, including the mix of revenues, the base of each tax, and tax burden distribution among taxpayers. **For a tax system to effectively generate revenue in a modern economy, it must be current, adequate, fair, and efficient.** Illinois is undermining its potential across all these elements by failing to address its narrow sales tax base.

TODAY		A MODERN SALES TAX WOULD...
Consumers increasingly spend more of their income on services than goods, but the sales tax does not capture these 21st century consumption patterns.	➔	Reflect current economic trends and accommodate future shifts.
Sales tax receipts are not growing in line with public costs, despite their importance as a source of state and local revenue.	➔	Ensure revenues are adequate to fund government services over time and across economic cycles.
High-income households spend nearly 5x as much as low-income households on consumer services, but none of these expenditures are taxed.	➔	Introduce a fairer and less regressive tax by shifting the burden toward higher-income households while also enabling other measures to support low-income households.
Uneven taxation of goods and services distorts the environment in which consumers make decisions and Illinois businesses compete.	➔	Purposefully and efficiently tax the final consumption of goods and services to minimize distortions in consumer and business behavior, ensure business competitiveness, and prevent high prices caused by tax pyramiding.

The following sections outline Illinois' sales tax performance today across these four priorities and highlight how modernizing the base to include more consumer services would help make the tax more productive, progressive, and in-step with the modern economy.

CURRENT: A MODERN SALES TAX ALIGNS WITH ECONOMIC ACTIVITY

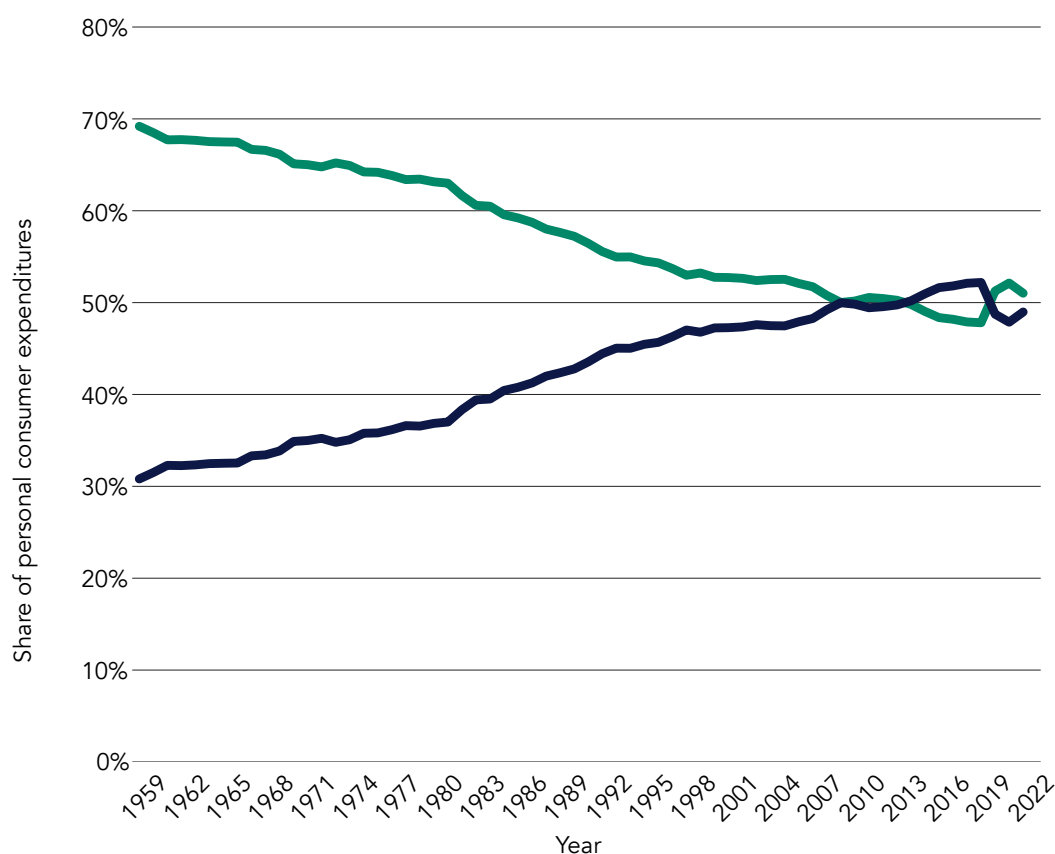
Today's economy looks very different than it did when the Illinois sales tax was originally put in place in the 1930s. Over the last century, the U.S. transitioned from an economy based on manufacturing and other goods-producing industries to a services- and information-based economy. With this transition came cheaper and more efficiently manufactured goods from within the country and overseas, rising standards of living, and increased disposable income, resulting in greater demand for services.

National consumer expenditure data shows that consumers today spend considerably more of their household income on services, and significantly less on goods, than they did historically (Figure 5). This is due, in part, to rising housing and healthcare costs, which have grown substantially since the mid-20th century but should not be considered taxable consumption since increased prices would further impact access.^{12,13,14} However, housing and healthcare do not explain the full story.

Figure 5: Consumers are increasingly spending more of their household incomes on services

Historic share of personal consumption expenditures by major type (excluding spending on housing and healthcare), 1959-2022

■ Goods
■ Services



Source: Analysis of data from the U.S. Bureau of Economic Analysis.

Expenditures on consumer services alone — services excluding healthcare and housing — grew 2.5 times more than expenditures on goods over the last six decades. In Illinois, while expenditures on goods rose 156 percent between 1997 and 2023, expenditures on consumer services rose nearly 200 percent over the same period. This shift can largely be attributed to the way that many formerly tangible goods now have digital replacements. Today's consumer downloads e-books, streams movies and music, stores files and photographs in the cloud, and subscribes to services for their home, vehicle, and even appliances.¹⁵ These are all forms of personal consumption, and there is an opportunity for the sales tax to be better aligned with this new reality. Aligning Illinois' tax structure with 21st century consumption patterns by expanding the base to include consumer services will ensure it is more effective and dependable.

ADEQUATE: A MODERN SALES TAX MEETS REVENUE NEEDS ACROSS ECONOMIC CYCLES

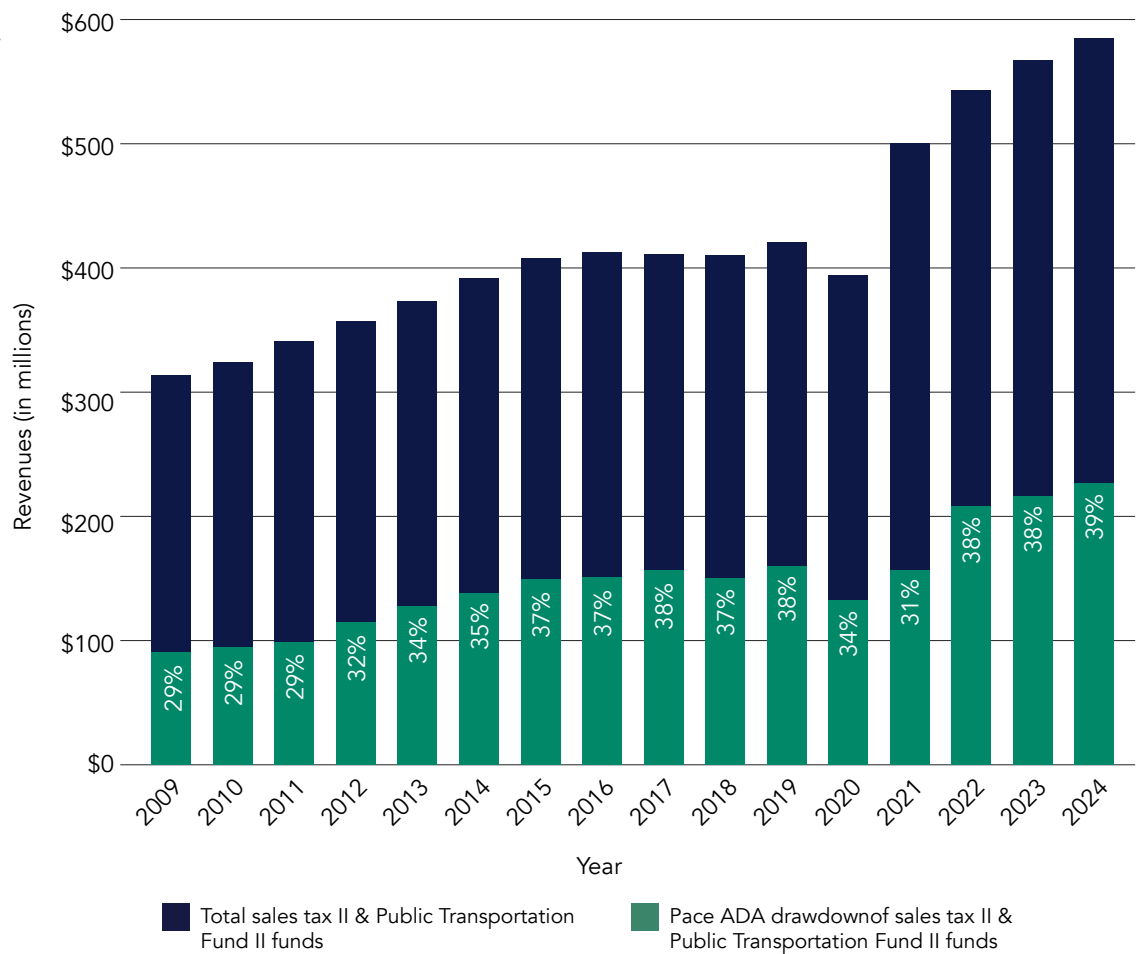
Effective government operations depend on predictable and stable revenues that grow in line with inflation, ensuring the ability to maintain services — even during economic downturns. A well-designed sales tax applied to the broadest possible base, even at low rates, is more reliable than many other taxes. However, with its narrow tax base, Illinois' sales tax has been inadequate to meet growing funding needs regardless of increases in nominal sales tax revenues.

Despite being the second largest revenue source for the state, sales tax has historically experienced very little growth. Illinois collected \$10.5 billion in sales tax revenues in FY2024, representing inflation-adjusted growth of only 11.3 percent over the last 35 years. As a result, on a per-capita basis — which accounts for population growth over time — real sales tax revenues in 2024 were nearly equivalent to revenues collected in 1990 (Figure 4). In comparison, the responsibilities and needs of the state have grown. While it is important for government to practice stewardship and responsibly constrain cost growth over time, it is just as essential that government invests in the public services that ensure a high quality of life and economic stability. Due to the deficiencies of the sales tax, other revenues have had to fill the gap and meet pressing needs. This has not only resulted in a higher tax burden for Illinois' residents — for example, the individual income tax rate was increased from 3 percent to 5 percent in 2010 (and today, continues to sit at 4.95 percent) — but a less competitive tax position for the state overall.¹⁶

The sales tax is similarly failing to deliver for other important services it funds directly, such as transit. Although the RTA sales tax has long been the primary public funding source for transit operations in northeastern Illinois, revenues have not kept pace with costs. For example, transit reforms in 2008 increased the RTA sales tax rate, increased the state match of RTA sales tax receipts, and dedicated new sales tax revenues to fund paratransit services. And yet, as paratransit costs and demand have grown, the share of sales tax revenues allocated to paratransit each year has also risen. This has, in turn, substantially eroded the revenues available to fund other transit costs, namely fixed-route bus and train service (Figure 6).¹⁷

Figure 6: Paratransit costs comprise a growing share of sales tax revenues used to fund transit

Statutory paratransit funding as a share of sales tax II revenues and the associated state match, 2009-2024



Source: Analysis of RTA budget data.

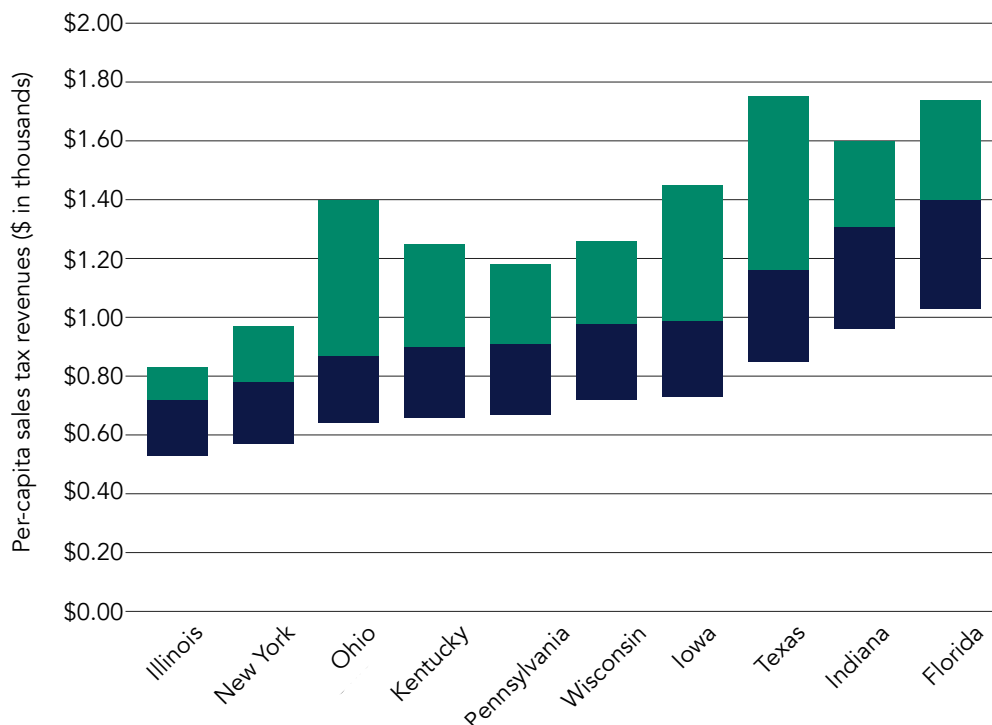
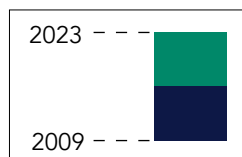
Modernizing the sales tax can help Illinois secure new, consistent funding to strengthen its overall fiscal condition and meet longstanding, pressing needs for the state and local governments. Peer midwestern states and other large population states that tax more services than Illinois, on average, have higher per-capita sales tax collections and greater levels of sales tax revenue growth. While Illinois' unadjusted per-capita sales tax revenues grew 56 percent between 2009 and 2023, most of which can be attributed to inflation, per-capita revenues for peer and adjacent states grew between 66 and 119 percent over the same period (Figure 7).

Many efforts have been made to estimate the level of new revenues that would be generated from sales tax modernization in Illinois. Most recently, CMAP's Plan of Action for Regional Transit estimated that expanding the sales tax base to include more services could add nearly \$2 billion in new annual state revenues, as well as generate new revenue for counties, municipalities, local governments, and transit agencies across Illinois (Figure 8).¹⁸ Although specific revenues would vary based on the details of any legislation enacted by the General Assembly and administered by IDOR, expanding the base to include more services could substantially improve performance without raising sales tax rates.

Figure 7: Illinois saw the lowest growth in per-capita sales tax collections between 2009 and 2023 compared to peer and neighboring states that tax more services

Change in per-capita sales tax revenues by state, 2009-2023

- Growth attributable to inflation
- Growth beyond inflation



Source: Analysis of data from Illinois Traditional Budgetary Financial Reports and the U.S. Census Survey of State Government Tax Collections.

Notes:

1. The U.S. Census Bureau changed its methodology for calculating Illinois state sales tax revenues in 2017 (for sales tax collections beginning in 2014) by incorporating local revenues from the 1.25 percent local sales tax rate in total state collections and then recording state disbursements of these local revenues as intergovernmental transfers. Illinois data sources were used to ensure state revenues are the basis of comparison.
2. Ohio is the only peer state identified that increased its state sales tax rate during the analysis period, from 5.5 percent to 5.75 percent. The increase accounts for 7 percent of the 61 percent increase observed.
3. Some revenue growth for peer states can be attributed to base expansions implemented during the analysis period. This includes Iowa, Kentucky, and Texas.

Figure 8: Sales tax modernization could generate nearly \$2 billion in new annual state revenues, as well as new revenues for other taxing jurisdictions (FY2026)

Jurisdiction	Applicable tax rate	Revenue estimates
State of Illinois	5.00%	\$1.955B
Counties	0.25%	\$50M
Municipalities	1.00%	\$390M
RTA	0.75-1.0%	\$315M

Source: CMAP Plan of Action for Regional Transit, Overview of key sales tax recommendations.

Notes:

1. 2026 figures assume year 2 of implementation and 75 percent compliance with the sales tax on services.
2. Collar counties currently retain one-third of the RTA sales tax rate imposed on goods (0.25% of the 0.75% rate) for their own transportation and public safety purposes. PART assumes the RTA would retain the full 0.75% RTA sales tax rate imposed on services. PART also assumed Cook County's portion of the local 1.25% state-administered local sales tax would continue to be directed to the RTA. Combined with the existing 1.00% RTA sales tax rate in Cook County, this results in a 1.25% total rate.

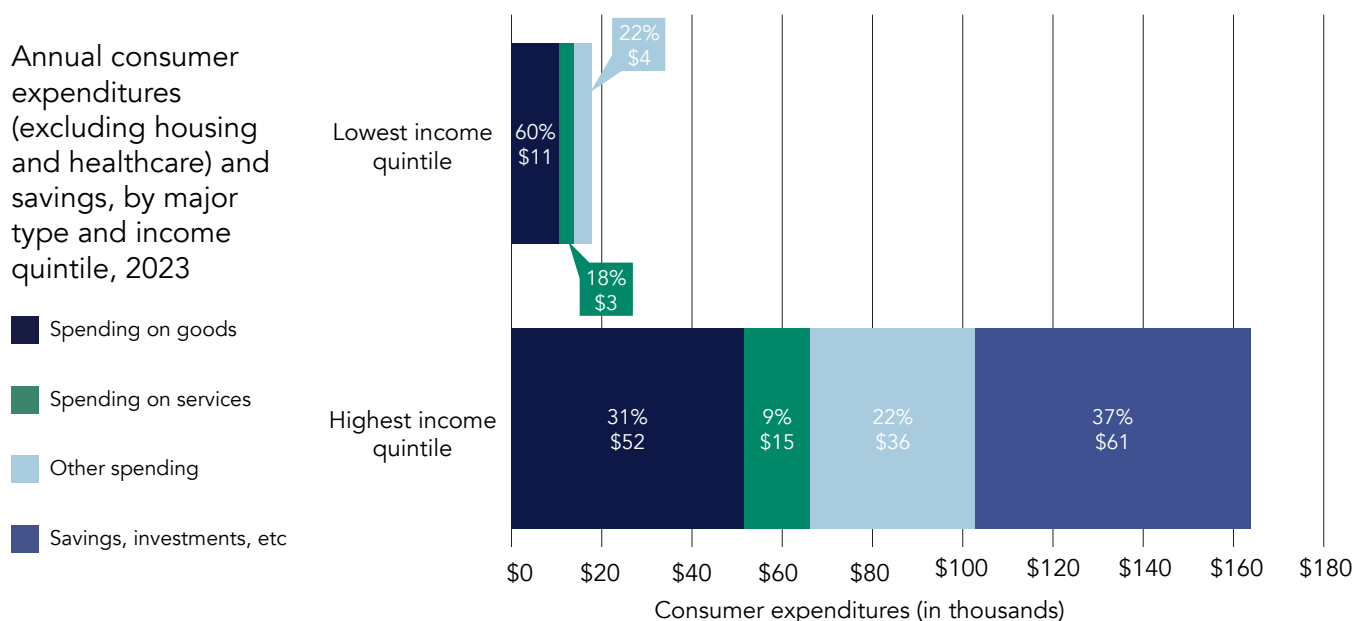
FAIR: A MODERN SALES TAX FULLY CAPTURES THE SPENDING OF HIGH-INCOME CONSUMERS

Over the past century, the U.S. has undergone a profound shift from a goods-based economy to a service-based economy. While this transition has been linked to rising productivity, greater economic output, and an improved standard of living, the benefits have been far from evenly distributed. Since 1970, higher-income households have seen more rapid income growth than lower-income households.¹⁹ As a result, in 2023, households in the highest income quintile earned 17 times more than households in the lowest income quintile.²⁰

This growing income disparity has led to starkly different consumption patterns across income groups. As illustrated in Figure 9, lower-income households allocate approximately 60 percent of their spending to goods, including necessities like food and clothing, leaving little room for discretionary spending on services such as personal care, home and vehicle repair, or gym memberships. In contrast, higher-income households have more flexibility to consume beyond basic needs.

Because consumption of personal services is largely discretionary and often untaxed in Illinois, higher-income households disproportionately benefit from this untaxed spending. Expanding the sales tax base to include additional services would correct an inequity in the current tax system — one that unintentionally favors wealthier individuals while neglecting the growing consumption of services.

Figure 9: Lower-income brackets have less discretionary income to spend on services than higher-income brackets



Source: Analysis of Bureau of Labor Statistics Consumer Expenditure data.

Notes:

1. Percentages may not add to 100 due to rounding.
2. Consumer expenditure data shows how household income is spent on current consumption — of goods and services — as opposed to how much is being saved for future consumption.

Modernizing the sales tax system is necessary, but it cannot fully address the inherent regressivity of the current structure. Many personal services are consumed across income levels, meaning that taxing these services would capture a larger share of the economic behavior of both higher- and lower-income households. However, it is important to acknowledge that the costs of consumer services vary widely, often depending on the income level of the consumer. For example, a basic gym membership will be cheaper than a membership at a high-end gym or a facility that offers specialized fitness courses, reflecting differences in household purchasing power (Figure 10).

While it might seem desirable to exempt services typically used by lower-income households to advance equity, doing so would also exempt services consumed by higher-income households. This would not only limit the potential revenue generated — higher-income household spending on services outpaces lower-income household spending on services 5 to 1 — but also perpetuate existing tax distortions.

Figure 10: Consumer service vary widely depending on the income level of the consumer

BUDGET GYM \$15 monthly x 10.25% service tax \$1.54 tax	MID-RANGE GYM \$40 monthly x 10.25% service tax \$4.10 tax	PREMIUM FITNESS CLASS \$175 monthly x 10.25% service tax \$18.04 tax	LUXURY GYM \$220 monthly x 10.25% service tax \$22.55 tax
---	--	--	---

Source: Approximate posted service costs in Chicago, Illinois as of February 2025.

Note: All costs reflect memberships that are tied to a specific location. For premium fitness classes, the monthly cost assumes eight classes per month or equivalent.

Research shows that a more effective, progressive approach to minimizing negative impacts on low-income households would be to create or expand programs that directly support these residents. This way, tax relief would be targeted specifically to those who need it most, rather than exempting broad categories that also include substantial luxury purchases. Some ideas the state could explore to achieve this goal include:

▶ **A portion of new state revenues can be used to increase Illinois' Earned Income Tax Credit.** In addition to providing respite for those most burdened by Illinois' flat income tax, this form of relief would increase the income levels — and therefore the consumer spending activity — of the lowest-income earners.

Washington state began funding a Working Families Tax Credit in 2021, which provides a credit for a portion of sales taxes paid by eligible low-income taxpayers. The credit ranges from \$315 to \$1,255 depending on the number of qualifying children in the household.

▶ **New revenues can be used to support property tax relief.** At the state level, service tax revenues could be used to fund a property tax circuit breaker that would provide relief for the lowest-income property owners. Alternatively, more responsive and stable sales tax revenues can lessen local governments' reliance on property taxes, especially in communities with high effective property tax rates and/or communities that have not historically benefitted from strong commercial tax bases.

▶ **Greater revenues, particularly at the state level, can be used to meet current and future funding needs to improve the quality of life and economic competitiveness in Illinois.** Essential public services such as transit and education have long been underfunded in Illinois. In addition to the Governor's Office of Management and Budget's lackluster forecasts for state revenues in the near-term, multiple fiscal crises are threatening the state's fiscal health including but not limited to the transit fiscal cliff, a projected shortfall in K-12 education funding, and the persistent underfunding of state pensions. With a more modernized, reliable revenue source, Illinois can address these critical funding issues which will, in turn, provide exponential benefits.²¹

Studies have shown that higher levels of public spending have a greater impact on gross domestic product (GDP) than tax cuts. According to Moody's Analytics, income tax cuts and corporate tax cuts are associated with only a 0.88 and 0.32 return on investment (or the GDP is estimated to grow only \$0.88 and \$0.32 with every tax dollar cut) respectively, while every dollar change in spending on the Supplemental Nutritional Assistance Program is associated with a return on investment of \$1.61.

EFFICIENT: A MODERN SALES TAX SUPPORTS ECONOMIC COMPETITIVENESS

The structure of the sales tax inadvertently influences consumer purchases of different goods and services based on whether they are taxed. For example, under the current system, a consumer can get landscaping services tax-free but must pay a tax to buy landscaping equipment, such as a lawn mower. Expanding Illinois' sales tax base to include services would lessen the impact of changes in consumer preferences and consumption patterns on sales tax revenues by reducing economic distortions. Minimizing these distortions would, in turn, encourage consumers to purchase goods or services to maximize their own welfare, rather than as a response to tax burdens.

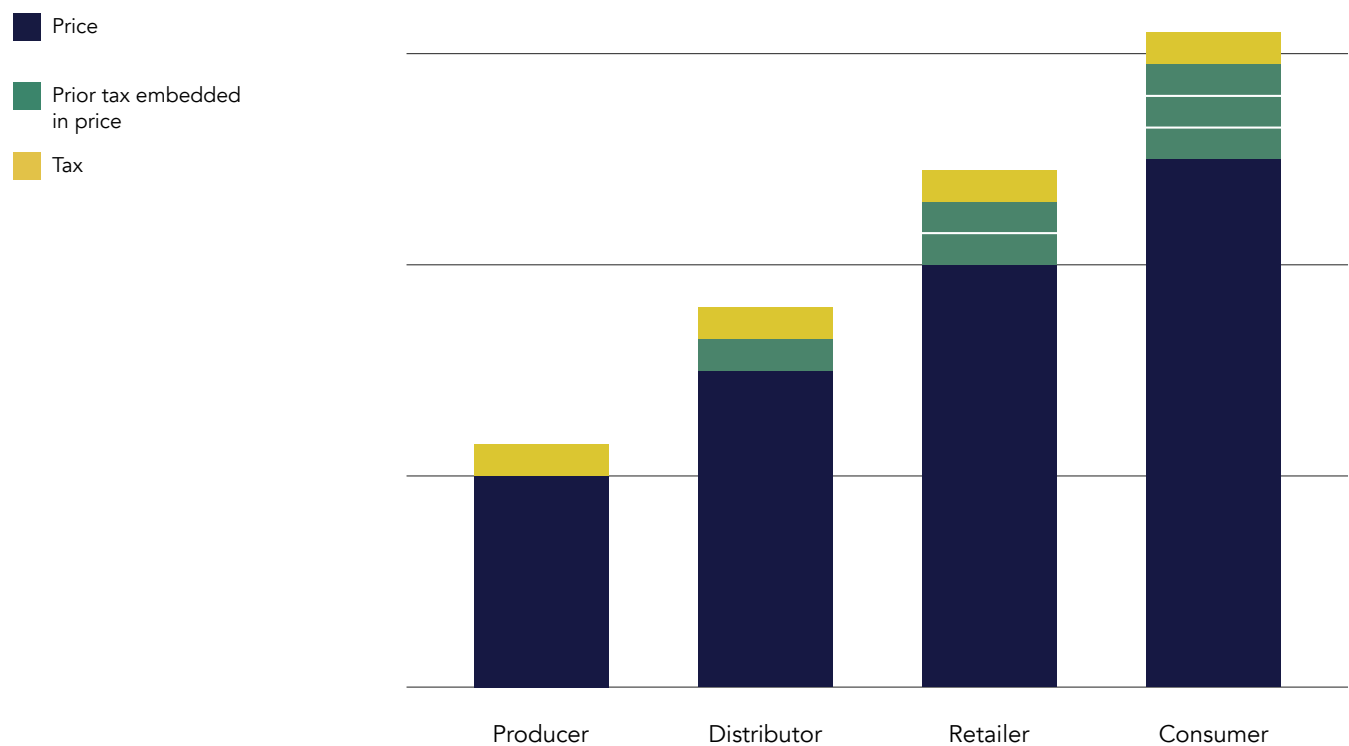
At the same time, while modernizing the sales tax can introduce horizontal equity into the tax system, it is crucial that additional distortions are not created by simultaneously taxing intermediate business transactions, also known as business-to-business (B2B) transactions. Taxing business inputs this way increases production costs, thereby limiting the economic gains that can be realized from economic activity.

Businesses might engage in any number of distortionary behaviors to sidestep these higher costs, including purchasing a cheaper but less effective technology or product — which hinders efficiency and productivity — or avoiding the taxable transaction altogether by bringing the production of otherwise taxable services and goods in-house. This artificial pressure to vertically integrate can price out smaller or less profitable firms that have far less capability to make the same choices. It can also create inefficiencies in a pre-existing service market where independent providers can typically provide a service more efficiently than a cheaper, in-house option.

Businesses might also choose to recapture higher production costs in the form of higher prices. When a tax is applied at multiple stages of the production process, the taxes are passed on and compounded until they are finally paid by the consumer of the final product, through a process known as tax pyramiding (Figure 11). This means the consumer will pay an effective tax that far exceeds what they see on their receipt.

Finally, the broad taxation of business inputs, or the taxation of a necessary high-cost input, could adversely impact economic competitiveness. Taxes imposed on business inputs represent an additional production cost that is likely not borne by competitors in other states, even if they sell into the same markets. Firms in states that tax an inordinate amount of business inputs are at a disadvantage with out-of-state competitors.²² Conversely, research has shown that excluding business inputs from the sales tax base contributes to greater levels of economic growth, even if sales tax rates increase proportionately to produce desired revenues.²³

Figure 11: Taxing business-to-business transactions creates a higher consumer price via tax pyramiding



Source: Analysis of information from the Tax Foundation.

CONCLUSION

Illinois’ existing sales tax base, which is narrowly focused on goods rather than services, results in a tax that is out-of-sync with the modern economy, that neglects to tax large tracks of consumer spending, and that does not keep pace with the cost of government services. To realize the many benefits of a broader sales tax, **Illinois should modernize its sales tax by expanding the sales tax base to a broad range of consumer services.** Thoughtfully and intentionally expanding the base of the Illinois sales tax would: modernize state tax policy to comport with the current economy; improve the productivity and progressivity of this important revenue tool; and enhance Illinois’ overall economic competitiveness.

PRINCIPLES AND IMPLEMENTATION CONSIDERATIONS FOR MODERNIZING THE SALES TAX IN ILLINOIS

Illinois has grappled with expanding its tax base to include services for decades. Past attempts faced political challenges and legal hurdles that, today, provide important lessons and parameters for future implementation efforts. Despite previous challenges, sales tax modernization can be successful if the legislature commits to bold, specific principles and outcomes as it implements expansion.

ENSURE CONSTITUTIONAL UNIFORMITY

One of the most important legal considerations for modernizing the sales tax is related to carefully navigating the state's constitutional requirement for uniformity. Article IX, Section 2 of the Constitution of the State of Illinois provides what is colloquially known as the uniformity clause:

In any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subjects and objects within each class shall be taxed uniformly. Exemptions, deductions, credits, refunds and other allowances shall be reasonable.

While other states have successfully modernized their sales tax bases, uniformity has been a key challenge in Illinois. Previous attempts to expand the sales tax base to include services have either run afoul of uniformity or have introduced undue complexity to try and circumvent it. These unsuccessful efforts show that any new approach to legally and responsibly modernizing the tax must focus on the following:

- ▶ Identifying a broad and uniform base for services that is designed to meet constitutional requirements to consistently and evenly treat the services taxed;
- ▶ Clearly articulating the legislative intention to tax the broadest possible base of consumer services and address the full spectrum of policy considerations;
- ▶ Minimizing the complexity of implementation and administration for service providers and consumers; and
- ▶ Providing reasonable exemptions.

Modernization efforts should also allow for a classification approach that reflects the actual services provided by businesses, rather than relying on vague industry classifications, to ensure a more consistent application of taxation.

STANDARDIZE TREATMENT OF COUNTIES, MUNICIPALITIES, AND SPECIAL TAXING DISTRICTS

To ensure the benefits of a modernized sales tax are fully realized, successful implementation will require proactive coordination with, and consideration of, local governments. Any expansion of the sales tax base at the state level should be reflected at the local level as well. Specifically, the state should extend the current 1.25 percent local sales tax rate to services and disburse the full benefit to local governments. The state should also ensure the expansion of the sales tax to consumer services is reflected in local sales tax bases. Allowing local jurisdictions to tax a broader base of goods and consumer services ensures they receive the full benefits of a modern, more sustainable tax. While this will be valuable for communities that have historically relied on sales tax revenues,

A BRIEF OVERVIEW OF JUDICIAL AND LEGISLATIVE ACTION ON ILLINOIS' SALES TAX

1967

Taxing a small set of specific services found not uniform

In 1967, the General Assembly attempted to extend the sales tax to four specific services. Service providers challenged this effort by filing a lawsuit alleging that the tax violated the uniformity clause. The Illinois Supreme Court agreed with the argument and struck down the expansion.

2017

Creating multiple distinct excise taxes found too burdensome

Hoping to tax services in a way that would be more resilient to court challenges, Senate Amendment 2 to Senate Bill 9 creating distinct excise taxes for various services, including storage, repair and maintenance, landscaping, and laundry. Each service would have been subject to its own 5 percent tax rate, with all proceeds going to the state. However, the proposal would have required service providers to file separate tax returns for the new taxes and established different exemptions that did not align with those provided for the state's existing sales tax. The approach introduced an administrative burden and complexities that resulted in its failure.

2009

Taxing service industries was more complex than taxing service providers

To modernize the sales tax, the Senate passed House Bill 174, which aimed to amend the Retailers' Occupation Tax Act by expanding the definition of sale at retail and listing various North American Industry Classification System (NAICS)^f codes subject to the sales tax.

To avoid unevenly taxing services, this approach taxed industries rather than specific services — which led to inconsistencies (e.g., travel agent services provided by businesses classified under the relevant NAICS code would be taxed, but the same services offered by a general retailer would not). The failure to distinguish between industries and providers in House Bill 174 — which created considerable complexities for businesses that operate across multiple industries and could have disadvantaged specialized services providers compared to general retailers offering the same services — did not move forward.

^f NAICS codes define industries as representing broad categories of economic activity, while providers are the individual businesses operating within these industries.

this change will be particularly advantageous for counties and municipalities that may not have dense retail land use patterns but could benefit from taxing consumer services. For the RTA, sales tax modernization is an integral step for wholly and sustainably addressing the transit fiscal cliff.

Efforts to implement statewide sales tax modernization should also standardize the tax base across different levels of government to prevent excessive taxation on a handful of services. Current municipal codes restrict local governments' ability to impose their own sales taxes on transactions already included in the state sales tax base.

However, municipalities and/or counties might currently tax services that would ideally be incorporated in a broad base expansion, such as the municipalities that tax streaming services like Chicago, Bloomington, East Dundee, Evanston, and Schiller Park.²⁴ Since it is not in the interest of the state or local communities to impose double taxation on the few services that are currently taxed locally — as exceptionally high rates would likely result in both negative perception issues and a chilling effect on economic activity — the state should work with these communities to provide a legal and administrative framework to transition their existing service taxes to the new system. Options include folding existing taxes into the expanded sales tax or repealing local taxes and ensuring local governments do not end up worse off revenue-wise by providing refunds if new revenues do not meet previous levels.

LIMIT TAX PYRAMIDING AND SUPPORT ECONOMIC COMPETITIVENESS

It is important that the expanded sales tax be applied primarily to consumer services to avoid taxing B2B services. Taxing services used as business inputs could lead to tax pyramiding — taxing the same business input several times before the final product, which then passes an increased price on to the end user.²⁵ Taxation of business inputs can also complicate the taxation of services used by a company across several states, or impact economic competitiveness by imposing taxes on business inputs that are not imposed elsewhere.²⁶

To successfully limit B2B service transactions from taxation, the state could explore the use of a business exemption certificate, which would be used by qualifying businesses to avoid taxation of qualifying services.

EXEMPT CONSUMER SERVICES NOT GENERALLY SUBJECT TO TAXATION SUCH AS HEALTHCARE, HOUSING, AND CHILDCARE

States that have a broad sales tax on services generally do not tax the services that could potentially cause significant disruptions to access, such as healthcare, housing, and childcare. These items should be broadly protected from taxation, which is possible while also adhering to the State of Illinois Constitution's uniformity clause. The uniformity clause simply requires real and substantial differences between taxed and untaxed objects, and that the classifications serve some reasonable relationship to the object of the legislation or public policy.

CAREFULLY CONSIDER THE APPROPRIATE RATE

Some stakeholders will correctly point out that many Illinois communities like Springfield and Chicago have relatively high composite sales tax rates imposed on goods, suggesting that there may be an opportunity to lower existing taxing authorities' sales tax rates in response to new revenue collected under an expanded base. On the other hand, the sales tax is a critical pillar of the state and local government general revenue system that has been eroding continuously since the 1990s. According to the Tax Foundation, for instance, because of Illinois' unusually narrow sales tax base, the existing state rate translates into \$201 per person per percentage point of revenue, which is 12 percent lower than the national average.²⁷ Lawmakers and decisionmakers at all levels of government must carefully weigh the substantial benefits of increased revenue against any actual tax relief advantages.

LESSONS FROM OTHER STATES

Iowa

Since first imposing a sales tax in 1934, Iowa has taxed a select number of services including utilities (metered gas, electricity, water, and communication services) and amusement and athletic event admissions. Iowa first expanded its base in 1967 to include additional services,²⁸ then further broadened its service tax base and increased its state sales tax rate several times, most recently in 2008.^{29,9} Currently, Iowa imposes a 6 percent sales tax rate and local jurisdictions are permitted to impose a local option sales tax up to an additional 1 percent.

As a result of these expansions, Iowa now maintains one of the most comprehensive lists of taxable services. Many of Iowa's taxable services are subject to specific exemptions noted on the Iowa Department of Revenue website, such as construction- and agriculture-related services. Iowa also regularly updates its tax code to account for emerging services and the broader economic shift toward an increased consumption of services. For example, Iowa revised its tax code to incorporate software as a service into the tax base in 2019.³⁰ The Iowa Department of Revenue also regularly issues informal guidance about the taxability of specific services that have not yet been defined by existing laws.

Kentucky

Over the past 6 years, Kentucky has added more than 40 services to its sales tax base (10 previously untaxed services were added in 2018, and an additional 30 services were added in 2022). Despite targeting services purchased for final personal consumption, some — like janitorial and industrial laundry services — are used as business inputs. However, Kentucky provides an exemption for businesses with annual gross receipts less than \$12,000.³¹

Notably, Kentucky's sales tax base expansion was part of a larger effort to alter the state's personal income tax and sales tax structure.³² In 2018, in addition to expanding the base to include more services, Kentucky consolidated the number of income tax brackets and lowered the income tax rate into a flat tax of 6 percent.

⁹ Iowa's 1 percent sales tax increase in 2008 coincided with the repeal of a 1 percent School Infrastructure Local Option Sales Tax.

USE NEW REVENUES TO MAKE INVESTMENTS THAT WILL STABILIZE GOVERNMENT FINANCES AND FUND PUBLIC SERVICES

Given state and local governments' ongoing financial challenges, any new revenues generated by a modernized sales tax should be used to make focused investments that will stabilize government finances instead of increasing costs over the long run. Those considering these policies should use the following principles to direct how future funding may and will be used.



Fund transit

Public transit is a key public service — and economic asset — for the state. However, its future is uncertain due to growing costs and insufficient revenues, which have the potential to inflict wide-ranging effects on the state's economy, businesses, and residents. The state should use new sales tax revenues to direct additional funding to all public transit systems in Illinois, including those in northeastern Illinois. This involves meeting funding commitments identified in the Plan of Action for Regional Transit, including contributing more to the Public Transportation Fund, fully funding paratransit services, and covering the costs of reduced fare requirements.

At the same time, the state must unite on governance reform for northeastern Illinois' transit system to ensure that these new revenues are spent efficiently and effectively.

Support state investments in fiscal sustainability and public services

While considerable progress has been made over the last few years to improve Illinois' long-term fiscal sustainability, there is still much to be done. Essential public services such as transit and education have long been underfunded in Illinois, as have state pensions. Beyond providing additional transit funding, the state's spending should prioritize improving its financial position and helping to offset any negative equity impact of a broadened sales tax. High-impact investments that help advance these goals include the following:

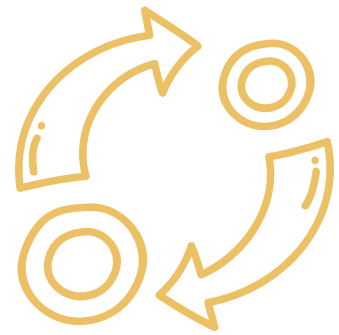


- ▶ The state should continue funding pensions, through additional contributions to the pension stabilization fund as well as responding to the funding needs associated with Tier II pension reform.
- ▶ The state should direct additional funding through the evidence-based school funding formula to address current funding shortages.
- ▶ The state should continue to pursue fiscal solvency by making additional contributions to the rainy-day fund.

- ▶ The state should increase the Earned Income Tax Credit to offset the impact of sales tax modernization on low-income households.
- ▶ The state should consider funding a new statewide property tax circuit breaker for low-income property owners. Circuit breaker programs are designed to provide relief when a person's property tax liability exceeds a certain percentage of their annual income and are meant to prevent homeowners from being overburdened by property taxes. Some of these programs provide property tax credits and others provide relief from income taxes. The state had a limited income tax-based circuit breaker program for senior citizens until 2012. Some opponents of the sales tax expansion are worried about overall tax burden in the state, particularly given high property taxes. A renewed circuit breaker program could help offset those concerns and at the same time provide significant relief to low-income households.

Support local governments

Like the state, local governments could similarly use new revenues from the sales tax on consumer services to improve their long-term financial condition. Fiscally responsible options for local governments include increasing budgetary reserves to the level recommended by the Government Finance Officers Association (approximately two months of expenditures for smaller governments) or increasing contributions to unfunded pensions. Local governments might also consider using additional sales tax revenues as a source to relieve their reliance on property tax revenues, or to fund property tax abatement for residents.



PROVIDE EXPERTISE AND OVERSIGHT FOR IMPLEMENTATION AND EVALUATE PERFORMANCE AND USE OF THE EXPANDED TAX

The analysis and recommendations provided in this report would help ensure that any expansion of the sales tax to consumer services will a) withstand judicial scrutiny; b) be sufficient to help improve the financial condition and sustainability of the state, local governments, and transit agencies; and c) fulfill the promise to residents to improve public services. However, no tax policy has a set it and forget it approach. The legislature can take intentional steps to evaluate the effectiveness of a more modern tax and the investments made with incremental proceeds.

Effectively modernizing the sales tax so that it applies to a broad, uniform base of consumer services, provides reasonable exemptions that minimize economic distortions, and improves the fairness of the tax system will require clear legislative intent and considerable care for administrative complexity. Hard-working public servants throughout Illinois who will develop the rules and administer the tax will need support and assistance from experienced professionals and subject matter experts. Therefore, to support the implementation process, the state should create an independent advisory panel. Panel responsibilities should be well-defined, and members should include tax policy professionals from organizations such as the University of Chicago Center for Municipal Finance, the University of Illinois Government Finance Research Center, and the Taxpayers Federation of Illinois, and be chaired by a relevant government body such as the Commission on Government Forecasting and Accountability.

In addition to overseeing implementation, the panel members should be held accountable for producing specific deliverables including annual reports that update the legislature on implementation progress, revenue generation, principle alignment, and equity concerns. Based on their findings, the panel should have the authority to make recommendations related to the structure of the sales tax and future modernization needs.

NEXT STEPS

Today, despite past setbacks, there are still opportunities to align Illinois' tax system with the realities of the 21st-century economy, introduce greater progressivity, reduce burdens on low-income households, support local communities statewide, ensure the competitiveness of Illinois businesses, and achieve the state's legal and administrative objectives. The policy considerations and principles outlined in this report offer important guidance for the state to make progress addressing this urgent revenue and tax policy challenge. Ultimately, success will require commitment to bold, thoughtful action and a sustainable fiscal future.

When the legislature makes the important decision to move forward to modernize the state's sales tax, several technical and practical considerations will need to be addressed. Useful next steps would include state action to:

1. Establish and convene the independent advisory panel.
2. Determine what form the service tax itself should take in consultation with IDOR.
Three main options exist:
 - ▷ Extending the sales tax to a defined list of services
 - ▷ Extending the sales tax to all services and specifying exemptions
 - ▷ Establishing distinct excise taxes for broadly defined categories and establishing a uniform administration provision
3. Charge IDOR with developing an implementation plan that includes the time required to reach full compliance and revenue projections for interim fiscal years, including anticipated allocations to the state, counties, municipalities, and the RTA.



ENDNOTES

1. Tax Foundation and Taxpayers' Federation of Illinois, "Illinois Illustrated: A Visual Guide to Taxes and the Economy," 2015, <https://illinoistax.org/wp-content/uploads/2018/06/IL-chart-book-final.pdf>.
2. Jared Walczak, "Modernizing State Sales Taxes: A Policymaker's Guide," Tax Foundation, September 5, 2024, <https://taxfoundation.org/wp-content/uploads/2024/09/FF845.pdf>.
3. Commission on Government Forecasting and Accountability, "Sales Taxes in Illinois," May 2010, <https://cgfa.ilga.gov/Upload/2010mayilsalestax.pdf>.
4. Commission on Government Forecasting and Accountability.
5. "Regional Transportation Authority Act," Pub. L. No. 70 ILCS 3615, Illinois Compiled Statutes (n.d.), <https://www.ilga.gov/legislation/ilcs/ilcs5.asp?ActID=984&ChapterID=15>.
6. "Downstate Public Transportation Act," Pub. L. No. 30 ILCS 740, Illinois Compiled Statutes (n.d.), <https://www.ilga.gov/legislation/ilcs/ilcs5.asp?ActID=565&ChapterID=7>.
7. Jared Walczak, "State and Local Sales Tax Rates, 2024," Tax Foundation, February 6, 2024, <https://taxfoundation.org/data/all/state/2024-sales-taxes/>.
8. Illinois Department of Revenue, "MyTax Illinois Tax Rate Finder," Accessed January 23, 2025, <https://mytax.illinois.gov>.
9. Federation of Tax Administrators, "Sales Taxation of Services," 2017, <https://taxadmin.org/sales-taxation-of-services>.
10. Governor's Office of Management and Budget, "Illinois State Budget Fiscal Year 2025," February 21, 2024, <https://budget.illinois.gov/content/dam/soi/en/web/budget/documents/budget-book/FY2025-budget/Fiscal-Year-2025-Operating-Budget.pdf>.
11. Analysis of Illinois Comptroller data.
12. Matthew McGough et al., "How Has U.S. Spending on Healthcare Changed over Time?," Peterson-KFF Health System Tracker, December 20, 2024, <https://www.healthsystemtracker.org/chart-collection/u-s-spending-healthcare-changed-time/>.
13. Walczak, "Modernizing State Sales Taxes."
14. Sophia Wedeen, "High Housing Costs Are Consuming Household Incomes," Joint Center for Housing Studies, June 12, 2024, <https://www.jchs.harvard.edu/blog/high-housing-costs-are-consuming-household-incomes>.
15. Walczak, "Modernizing State Sales Taxes."
16. Andrey Yushkov, Jared Walczak, and Katherine Loughead, "2025 State Tax Competitiveness Index" (Tax Foundation, October 31, 2024), https://taxfoundation.org/wp-content/uploads/2024/10/TF_25_STCI_10-30.pdf.
17. Chicago Metropolitan Agency for Planning, "Plan of Action for Regional Transit," December 2023, https://cmap.illinois.gov/wp-content/uploads/Plan-of-Action-for-Regional-Transit_Dec2023.pdf.

18. Chicago Metropolitan Agency for Planning, "C3: Overview of Key Sales Tax Recommendations," September 26, 2023, https://cmap.illinois.gov/wp-content/uploads/PART_recommendations-c3-sales-tax.pdf.
19. Arloc Sherman, Danilo Trisi, and Josephine Cureton, "A Guide to Statistics on Historical Trends in Income Inequality" (Washington, D.C.: Center for Budget and Policy Priorities, December 11, 2024), https://www.cbpp.org/sites/default/files/atoms/files/11-28-11pov_0.pdf.
20. U.S. Bureau of Labor Statistics, "Table 1101. Quintiles of Income before Taxes: Annual Expenditure Means, Shares, Standard Errors, and Relative Standard Errors, Consumer Expenditure Surveys, 2022," September 2023, <https://www.bls.gov/cex/tables/calendar-year/mean-item-share-average-standard-error/cu-income-quintiles-before-taxes-2022.pdf>.
21. Mark Zandi and Bernard Yarros, "Macroeconomic Impact of Home and Community-Based Services Expansion," Moody's Analytics, 2021.
22. Walczak, "Modernizing State Sales Taxes."
23. Benjamin Russo, "An Efficiency Analysis of Proposed State and Local Sales Tax Reforms," *Southern Economic Journal* 72, no. 2 (October 2005): 443–62, <https://doi.org/10.1002/j.2325-8012.2005.tb00712.x>.
24. "Amusement Taxes in Illinois," Amazon, accessed February 1, 2025, <https://www.amazon.com/gp/help/customer/display.html?nodeId=T0pNmeuNwSC96gs8Hb>.
25. Patrick Fleenor and Andrew Chamberlain, "Tax Pyramiding: The Economic Consequences of Gross Receipts Taxes (Special Report No. 147)," Tax Foundation, December 4, 2006, <https://taxfoundation.org/research/all/state/tax-pyramiding-economic-consequences-gross-receipts-taxes>.
26. Michael Mazerov, "Expanding Sales Taxation of Services: Options and Issues," Center for Budget and Policy Priorities, July 2009, <https://www.cbpp.org/sites/default/files/atoms/files/8-10-09sfp.pdf>.
27. Jared Walczak, "State Sales Tax Breadth and Reliance, Fiscal Year 2022," Tax Foundation, July 23, 2024, <https://taxfoundation.org/data/all/state/sales-tax-revenue-reliance-breadth/>.
28. Iowa Department of Revenue, "Retail Sales and Use Tax Annual Report Fiscal Year 2015," December 2015, https://revenue.iowa.gov/sites/default/files/idr/Annual%20Sales%20%26%20Use%20%20Report%20FY%202015_0.pdf.
29. Iowa Department of Revenue, "Iowa Tax Rate History," accessed December 10, 2024, <https://revenue.iowa.gov/resources/law-policy-information/iowa-tax-rate-history>.
30. Iowa Department of Revenue, "Taxation of Specified Digital Products, Software, and Related Services," accessed December 13, 2024, <https://revenue.iowa.gov/taxes/tax-guidance/sales-use-excise-tax/taxation-specified-digital-products-software-and-related-services>.
31. Kentucky Department of Revenue, "Kentucky Sales Tax Facts," June 2024, <https://www.legis.iowa.gov/docs/publications/IP/256370.pdf>.
32. Walczak, "Modernizing State Sales Taxes."



THE CIVIC FEDERATION

RESEARCH • INFORMATION • ACTION

EST. 1894

The Civic Federation is an independent, nonpartisan government research organization that provides robust and objective fiscal analysis, recommendations, and oversight for the benefit of civic and business leaders, the media, and the general public in Chicago and the State of Illinois.

Visit civicfed.org for more information.



Chicago Metropolitan Agency for Planning

The Chicago Metropolitan Agency for Planning is the region's comprehensive planning organization. The agency and its partners developed and are now implementing ON TO 2050, a long-range plan to help the 7 counties and 284 communities of northeastern Illinois implement strategies that address transportation, housing, economic development, open space, the environment, and other quality-of-life issues.

Visit cmap.illinois.gov for more information.

CTBA | Center For Tax and Budget Accountability

Social and economic justice through data-driven policy.

The Center for Tax and Budget Accountability is a nonprofit, nonpartisan research organization committed to advancing social and economic justice for all through evidence-based, best practice public policy solutions that are sustainable over time. Our evidence-based research has helped generate fundamental changes in education, healthcare, housing, economic development, and tax policies in Illinois and nationwide.

Visit ctbaonline.org for more information.

ILEPI

ILLINOIS ECONOMIC POLICY INSTITUTE

The Illinois Economic Policy Institute is a nonprofit, nonpartisan research organization that uses advanced statistics and the latest forecasting models to promote economic growth for businesses and working families.

Visit illinoisepi.org for more information.