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Pritzker's tax plan: Closing corporate tax loopholes, or 'the best way to shoot yourself in the foot?'

By Ryan Ori and Lauren Zumbach - Chicago Tribune | - Feb 19, 2021

Kyle Beringer-Kalamay, left, and Wade Marton speak at State Optical's factory on Feb. 19, 2021 in Vernon Hills. (Stacey Wescott / Chicago Tribune)

Gov. J.B. Pritzker wants to close $932 million of what he called "corporate tax loopholes" to help Illinois balance its budget after the fiscal ruins of COVID-19, but the controversial proposal comes as cities and states gear up to attract jobs and strengthen an economy battered by the pandemic.

Trade groups spoke out against Pritzker's plan after it was announced Wednesday, saying businesses are struggling even without new costs.

Real estate experts said Pritzker's proposal to phase out or eliminate some tax breaks could add a hurdle at an unprecedented moment, when swathes of corporations are rethinking their space needs.

"Raising taxes during a pandemic is the best way to shoot yourself in the foot, when it comes to attracting jobs," said John H. Boyd, principal of The Boyd Co., a corporate site selection consulting firm. "It's ill-timed and shortsighted."

The biggest chunk of the additional revenue Pritzker is seeking would come from a proposal to limit to $100,000 the amount of net operating losses a company can deduct from its tax liability, so the amount due the state would be higher.

Other changes would eliminate business tax incentives adopted just two years ago, including the repeal of the state's corporate franchise tax and a sales tax exemption for manufacturers.

All of Pritzker's proposals would take effect for the fiscal year that begins July 1.

Gov J.B. Pritzker gives a press briefing at the drive-thru COVID-19 vaccination location at the Lake County Fairgrounds on Jan. 27, 2021, in Grayslake. (Stacey Wescott / Chicago Tribune)

Among Pritzker's proposed changes is one that would undo tax incentives adopted in 2019, including a policy that would have given contractors income tax credits for some construction jobs. Reversing that policy, which was set to go into effect this year, will save the state $16 million, Pritzker said.

Tom Cuculich, executive director of the Chicagoland Associated General Contractors, said the move is shortsighted.

“We’re hitting a COVID pause on new construction projects, and we think it’s going to take a year or two to get us back to where we were,” he said.

“We need incentives, rather than taking away tools that would make construction projects viable,” said Cuculich, whose organization represents more than 10,000 employees of general contractors, subcontractors and suppliers in the greater Chicago area, including some in Wisconsin and Indiana.

Losing any competitive edge could slow efforts to return downtown Chicago’s economy to pre-pandemic levels, and it also could hinder the state’s ability to add manufacturing jobs amid intense competition with neighboring states such as Indiana and Wisconsin, according to opponents of Pritzker’s plan. Eliminating tax breaks could add another burden to small businesses such as bars, restaurants and boutique shops already on the brink, say trade groups representing retailers and manufacturers.

“When you look at what other states are doing, reducing taxes, reducing regulations, Illinois is going in the opposite direction,” said Mark Denzler, president and CEO of the Illinois Manufacturers’ Association.

Boyd said his Princeton, N.J.-based site selection firm is the busiest it’s been in its 45 years, even though commercial real estate leasing has slowed to a crawl during the pandemic.

“That sounds counterintuitive, but companies are very intensely planning for when there’s a new normal,” Boyd said. “There’s going to be tremendous displacement in the commercial real estate market.”

With many office employees working remotely, companies are taking a closer look at where they should be located, as well as studying costs such as rent and taxes, he said.

“The notion of corporate mobility is on the front burner for companies,” Boyd said. “Corporate relocation is historically rare, and now it’s becoming more common.”

During the pandemic, tech firms Oracle and Hewlett Packard Enterprise and the world’s largest commercial real estate brokerage, CBRE, have announced headquarters moves from California to cities in Texas.

Wall Street behemoth Goldman Sachs is reportedly looking to move a business unit to Florida, where several financial firms have shifted jobs from New York.

In January, liquor maker Beam Suntory announced its headquarters is moving from Chicago to New York.

Some experts give Pritzker's administration high marks for its efforts to compete for jobs, and the first-term governor — a billionaire heir to the Hyatt Hotels fortune — is no stranger to corporate boardrooms. He's also a longtime technology investor and booster of Chicago startups.

But Pritzker's options for solving a budget shortfall are limited.

Voters rejected his proposal to replace the state's flax tax rate with a graduated-rate income tax, and an across-the-board increase in income taxes wouldn't be popular at a time when many people are hurting financially, said Therese McGuire, professor of strategy at Northwestern University's Kellogg School of Management.

Chicago benefited from corporate relocations during a more than decadelong economic boom that brought a wave of headquarters to downtown from the suburbs and other states, including McDonald's, Kraft Heinz and Conagra Brands.

The Chicago area always scores well in key areas including its central location, universities, skilled workforce, public transportation and airports.

But local and state shortcomings have become more pronounced as the economy has slowed, corporate and real estate experts say.

Even before the pandemic, several Chicago developers said they were looking for investments in other cities because of expected Cook County property tax increases and concerns about ongoing local and state fiscal issues.

"Right now, tough choices have to be made at the local and state levels," said industrial site selection expert Bradley Migdal of Cushman & Wakefield. "At the end of the day, Gov. Pritzker is the state's chief business development officer. Governors can play a huge role in relocations.

"The governor needs to realize that he's not just competing against Missouri, Indiana and Wisconsin for jobs. He's competing against the entire United States."

Tax policies such as limiting net operating losses to $100,000 per year or doing away with accelerated-depreciation tax breaks on purchases of new equipment could be deciding factors when comparing otherwise comparable cities or states, Migdal said.

"Illinois has a lot of great advantages, but as site selectors we look at the lowest embedded costs to locate somewhere," Migdal said. "We don't just look at one-time incentives. We look at long-term costs. You don't want to take away anything that's an advantage for Illinois."

While some Chicago-area businesses said parts of Pritzker's would be easy to stomach, other proposals could raise costs at a time when they are already suffering steep losses.

Pritzker's proposal would cap the amount that retailers get to keep from sales taxes they collect, meant to reimburse some of the cost of collecting those taxes, at $1,000 a month. That change would bring the state $73 million and local governments $55 million.

Under current state rules, retailers keep 1.75% of the sales taxes they collect.

According to the state, only retailers with monthly sales above $500,000 would be affected by the new limit.

"This is not closing a loophole, this is an unfair penalty the state wants to put on restaurants," said Donnie Madia, partner at One Off Hospitality Group, whose concepts include The Publican, Avec and Big Star. The Chicago company closed another restaurant, Blackbird, during the pandemic after more than 22 years in business.

Of the 45 states that have a sales tax, 18 don't provide any vendor discount and some that offer retailers a larger share than Illinois limit the amount they can collect each month, according to the Federation of Tax Administrators.

Even under the current rules, restaurants and shops, many of which are now cashless, pay an average of 2.25% plus 10 cents on every credit-card transaction, which is more than the tax break they receive, Madia said.

"We already have an extremely difficult tax system in Illinois and now it's going to make it even more difficult for operators," Madia said. "And it comes at the world's worst time, during a pandemic."

Another proposed change, capping the amount of net operating losses corporations can deduct from taxable income to $100,000 a year for each of the next three years, starting in the 2022 fiscal year, would bring in $314 million for the state and $21 million in local taxes. About 80% of Illinois companies with losses would not be affected, according to the state.

That would hurt businesses with large losses, but those tend to be bigger companies with more resources that may see the change as a short-term impact worth waiting out, said John Gallemore, associate professor of accounting at University of Chicago's Booth School of Business.

Another proposed change would limit accelerated depreciation that can be claimed on state tax filings, allowed under a 2017 federal tax change, bringing in an estimated $214 million for the state and $14 million for local governments.

The upshot could be that companies invest less in assets like machinery and equipment, Gallemore said.

Accelerated depreciation was “very valuable” to State Optical Co., a Vernon Hills-based eyewear maker with about 200 employees, when it acquired American Optical, an eyewear company with lots of machinery in 2019.

Scott Shapiro, CEO of State Optical, at the company's factory on Feb. 19, 2021, in Vernon Hills. State Optical is the largest eyewear manufacturer in North America. (Stacey Wescott / Chicago Tribune)

Still, when it comes to smaller-scale, ongoing investments in the factory, CEO Scott Shapiro called it a “nice to have, not a have to have,” unless the federal government adopted a similar change.

“The company is going to continue investing in growth whether or not we can get that tax advantage,” he said.

Pritzker’s proposal also would reverse the repeal, which had only just begun, of Illinois’ corporate franchise tax, a tax on any company doing business in Illinois. The tax is complicated to comply with and most states don’t charge one, McGuire said. The state estimates it will bring in $30 million.

Another proposal gets rid of a sales tax exemption on items like oils, lubricants and coolants manufacturers use to make goods.

Experts are skeptical the proposed changes would lead companies to leave the state.

“I’m sure there are firms that see some of these taxes as a true nuisance and they really will move to Indiana,” Northwestern’s McGuire said. “But broadly, for the overall economy, I don’t think this is what might be driving people out of Illinois.”

Matt Schrimpf, president of family-owned HWRT Oil Co., said he is considering moving the Hartford-based company’s headquarters in Madison County across the border into Missouri after 89 years in Illinois.

He’s more concerned about the state’s financial issues and higher costs than Pritzker’s budget proposals.

“It’s getting harder and harder on businesses. When you start doing business in Arkansas and Indiana, you start putting a number on things and seeing how much less expensive it is to do business,” he said.

Bob Buchsbaum, CEO of Blick Art Materials, on the other hand, said he understands the state’s need to fund services like education and supports “sharing in that pain.” The provision capping retailers’ sales tax discounts would have only a “modest” effect on his business, he said.

Blick Art Materials CEO Bob Buchsbaum inside his Lincoln Park store on Feb. 19, 2021. He said the company has five stores in the Chicago area, and has survived thanks to online sales. (Abel Uribe / Chicago Tribune)

The art supply retailer, which has its headquarters, distribution center and five retail stores in Illinois, also has about 60 stores in other states.

“This isn’t going to cause us to pick up and move out of the state,” he said. “No one likes tax increases, you never want to hear it, but this is an Illinois company and we support, broadly, the concept of the things he’s trying to do.”