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Taxation: State and Local

Ronald H. Jacobson

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Taxation: State and Local

Ronald H. Jacobson*

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I. INTRODUCTION

The *Survey* period produced important judicial developments pertaining to the income, property, and sales tax laws of Illinois and its various counties.¹ Additionally, the judiciary explained certain implications regarding the method for protesting state

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1. See *infra* notes 5-123 and accompanying text.

taxes.² The Illinois Supreme Court also affirmed broad powers of local taxing units located in Illinois.³ Finally, legislation passed during the *Survey* period may create new deductions and credits for both corporate and individual income taxpayers.⁴

II. INCOME TAXATION

A. Unitary Taxation

Under Illinois law, there are two methods corporations receiving interstate income may use to allocate that income among multiple taxing states.⁵ The first method, separate reporting, applies to a corporation conducting separate and distinct business activity in each taxing state.⁶ Using this approach, the income the corporation derives from each particular taxing state alone is used to compute the yearly taxable income upon which that state determines its tax.⁷ The second method of reporting, called unitary reporting, is employed when a corporation conducts integrated businesses in several states with the operations in each jurisdiction contributing to the income earned in other jurisdictions.⁸ Under the formula apportionment method of unitary reporting, Illinois totals the income of the entire unitary business and applies a formula to allocate a portion of that income to Illinois.⁹ This formula attempts to approximate the ratio between the corporation's activities in the taxing state and the taxpayer's activities throughout the country.¹⁰

The combined reporting method of formula apportionment must be applied when a unitary business is conducted by an associated group of affiliated corporations located in more than one state.¹¹ Combined reporting treats the entire conglomerate of corporations, referred to as the unitary business group, as a single taxpayer.¹² The state determines the total income of the unitary business group by combining the income reported by each group member for the taxable year. The state then applies an apportioning ratio to that total for a determination of the taxable income of the group mem-

2. See *infra* notes 124-59 and accompanying text.

3. See *infra* notes 160-94 and accompanying text.

4. See *infra* notes 195-235 and accompanying text.

5. *Citizens Utilities Company of Illinois v. The Department of Revenue*, 111 Ill. 2d 32, 39, 488 N.E.2d 984, 986 (1986).

6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.* at 40, 488 N.E.2d at 987.

10. *Id.*

11. *Id.*

12. *Id.*

ber operated in the taxing state.¹³ Combined reporting is intended to deter corporations from manipulating their income by shifting it to states with more favorable tax climates.¹⁴

In *Citizens Utilities Company of Illinois v. The Department of Revenue*,¹⁵ the Illinois Supreme Court concluded that public utilities qualifying as unitary businesses must use the combined reporting method of formula apportionment.¹⁶ Citizens Utilities Company ("Citizens"), a public utility, was one of twenty-four other corporate subsidiaries (the "Citizens Group") located throughout the United States which were wholly owned by a parent corporation. Although a member of the entire Citizens Group, Citizens operated only in Illinois.

In 1985, the Illinois Department of Revenue issued Citizens a notice of deficiency, stating that it was required to file unitary business returns for prior years in which it had filed separate state income tax returns.¹⁷ In response, Citizens contended that Illinois did not apply formula apportionment to public utilities. Furthermore, Citizens maintained that combined reporting subjected it to an unconstitutional tax on extraterritorial values.¹⁸

The Illinois Supreme Court concluded that the legislature, in enacting the Illinois Income Tax Act (the "Act"),¹⁹ included public utilities among those businesses subject to formula apportionment.²⁰ The court noted that while the Act was formulated to adopt most of the principles of the Multistate Tax Compact²¹ (the "MTC"), differences existed between the two.²² The MTC expressly exempted highly regulated businesses like public utilities from formula apportionment;²³ the Act did not. Insurance companies,²⁴ financial organizations,²⁵ and transportation services²⁶ were

13. *Id.*

14. *Id.* at 39, 488 N.E.2d at 986. See generally Dexter, *The Unitary Concept in State Income Taxation of Multistate-Multinational Businesses*, 10 URB. LAW 181 (1978) (setting forth the history and theory underlying the taxing of unitary businesses).

15. 111 Ill. 2d 32, 488 N.E.2d 984.

16. *Id.* at 54, 488 N.E.2d at 993.

17. *Id.*

18. *Id.* at 37-39, 46, 488 N.E.2d at 986, 989.

19. ILL. REV. STAT. ch. 120, para. 1-101 (1985).

20. *Citizens Utilities*, 111 Ill. 2d at 54, 488 N.E.2d at 993.

21. ILL. REV. STAT. ch. 120, para. 871 (1973) (repealed 1975).

22. *Citizens Utilities*, 111 Ill. 2d at 42, 488 N.E.2d at 988.

23. ILL. REV. STAT. ch. 120, para. 871 (1973) (repealed 1975). Both the MTC and the Uniform Division of Income Tax for Tax Purposes Act provide that a taxpayer who derives income from interstate and intrastate activities, "other than activity as a financial organization or public utility . . . , shall allocate and apportion his net income" *Id.*

24. ILL. REV. STAT. ch. 120, para. 3-304(b) (1985).

included in the Act as businesses subject to formula apportionment. The court thus determined it was proper to include public utilities in that list.²⁷

The court also decided that the combined method of reporting income did not subject Citizens to an unconstitutional tax on extra-territorial values.²⁸ Before a court will consider combined reporting to be a constitutional method of reporting income, the statute authorizing the disputed tax must meet two requirements. First, a minimal connection must exist between the interstate activities taxed and the taxing state to the extent that the out-of-state income reported by the business group is earned through business conducted within the taxing state.²⁹ Second, there must be a rational relationship between income attributed to the taxing state and values generated by the corporation within that state.³⁰ Noting that the members of the Citizens Group were functionally integrated, engaged in direct transfers of value, and achieved certain economies of scale³¹ under the group's form of organization, the court determined the requisite minimal connection was present.³² Fur-

25. *Id.* at para. 3-304(c).

26. *Id.* at para. 3-304(d).

27. *Citizens Utilities*, 111 Ill. 2d at 43, 488 N.E.2d at 988. Because public utilities are highly regulated businesses and the Act does not specifically exempt them from formula apportionment, the court stated that there was "no compelling reason to depart from the clear language of section 304 requiring formula apportionment for all unitary businesses, including public utilities." *Id.*

28. *Id.* at 54, 488 N.E.2d at 993.

29. *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 165-66 (1983).

30. *Id. Accord Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207, 221 (1980).

31. *See infra* note 32.

32. *Citizens Utilities*, 111 Ill. 2d at 47-52, 488 N.E.2d at 990-992. Functional integration has been equated with strong centralized management and control. *Container Corporation*, 463 U.S. at 165-66. In the Citizens Group, all finances and acquisitions, as well as most contracts carried on by the subsidiaries, were controlled by the parent. Further, all subsidiaries were wholly owned by the parent who employed the same officers for each in addition to an interlocking board of directors. These factors were considered by the court as evidence of functional integration. *Citizens Utilities*, 111 Ill. 2d at 48, 51, 488 N.E.2d at 990-991.

The court in *Citizens Utilities* noted that functional integration should not be considered an indispensable factor for identifying a unitary business. *Id.* at 51, 488 N.E.2d at 991. The Illinois Department of Revenue Regulations (the "Regulations") employ that factor only "to justify a conclusion that the operations of seemingly separate businesses . . . form a unitary one." ILL. DEPT. REV. REG. § 300-2(c)(1)(C) (proposed Dec. 29, 1981). The court further observed that the Regulation's definition of unitary business included public utilities, in which there is no diversification of activity among the entire unitary group. *Citizens Utilities*, 111 Ill. 2d at 51, 488 N.E.2d at 991 (citing ILL. DEPT. REV. REG. § 300-2(c)(1)(A) (proposed Dec. 29, 1981)).

The court concluded that direct transfers of value beyond that of the mere cash flow

thermore, because Citizens failed to rebut the presumed rational relationship, the court considered the method of combined reporting adopted by Illinois a proper method of formula apportionment.³³

To date, no widespread legal implications following from the court's opinion in *Citizens Utilities* are evident. The decision, however, adds public utilities to the list of businesses already subject to unitary reporting in Illinois,³⁴ while affirming the constitutionality of combined reporting.³⁵

B. Tax-Exempt Financing

The Illinois Development Finance Authority Act (the "Act")³⁶ empowers the Illinois Development Finance Authority (the "IDFA") to issue bonds to finance the construction and improve-

relating to passive investments, existed within the Citizen's Group. *Citizens Utilities*, 111 Ill. at 48, 50, 488 N.E.2d at 990-91. The court in *Citizens Utilities* supported this conclusion by noting that the group shared an inter-company account which was totally controlled by the parent. This account allowed the parent corporation to draw funds from one subsidiary and invest them in another in the form of interest-free loans. *Id.* at 48, 488 N.E.2d at 991. The flow of value inherent in the inter-company account of the Citizens group was not passive because both the borrowing and lending were controlled by the same management. The lender actively controlled how the loan proceeds were to be used. *Id.*

The court concluded that the economies of scale existing among the Citizens group were occasioned by certain reduced expenditures responsible for increasing the group's taxable income. *Id.* at 49, 488 N.E.2d at 991. This reduction resulted from the utilization of a pool of services into which each taxpayer of the group contributed. The pool enabled members to obtain various services at costs lower than those provided for on the open market, thus demonstrating economies of scale. *Id.*

33. *Citizens Utilities*, 111 Ill. 2d at 52-53, 488 N.E.2d at 992-93. *Accord Container Corporation*, 463 U.S. at 169-70. Citizens supported its contention that combined reporting was unconstitutional by asserting that combined reporting increased its tax liability by two-hundred and thirteen per cent over the amount determined by the use of separate accounting for years in question. *Citizens Utilities*, 111 Ill. 2d at 52-53, 488 N.E.2d at 992-93. The court responded that the appropriate concern was not the increase in taxes, but whether the taxpayer's business activity in Illinois contributed to income reported by the parent or other subsidiaries. *Id.* According to the court, that concern was confirmed by its determination that Citizens was engaged in a unitary business, warranting the use of formula apportionment. *Id.*

34. See *supra* notes 24-26 and accompanying text.

35. See *supra* note 16 and accompanying text. A minor issue in the case involved Citizen's reliance on now repealed Income Tax Informational Bulletin ("ITIB") 1975-1 for the proposition that combined reporting was no longer allowable under Illinois law. Although ITIB 1975-1 held that combined reporting was unauthorized, within eighty days from its issuance, ITIB 1975-2 alerted taxpayers to the continued validity of combined reporting in Illinois. The court denied Citizen's argument that the Department should be estopped from collecting the deficiency as figured by combined reporting. It reasoned that the eighty day retroactive effect would not have deprived Citizens of any due process. *Citizens Utilities*, 111 Ill. 2d at 44-46, 488 N.E.2d at 989.

36. ILL. REV. STAT. ch. 48, para. 850.01-.19 (1983).

ment of industrial projects for purposes of maintaining and improving the employment rate in Illinois.³⁷ The Act defines industrial projects to include ventures for use in a "commercial enterprise . . . [operating] as a . . . repair, overhaul or service facility"³⁸ One of the advantages of IDFA bond financing is its tax exempt status,³⁹ making the bonds an attractive investment. Subsequent to the appellate court's decision in *Illinois Development Finance Authority v. Bean*,⁴⁰ however, public utility projects located in Illinois may find themselves unable to qualify for IDFA tax-exempt bond financing.⁴¹

In *Bean*, the IDFA had decided that the Act authorized the provision of financing for public utilities by issuing tax exempt revenue bonds. The IDFA executive director,⁴² however, refused to effectuate the financing without a judicial determination that public utilities fell within the Act's definition of commercial enterprises.⁴³

In *Bean*, the Illinois Appellate Court for the First District held that the legislature had not regarded public utilities as commercial enterprises eligible for the IDFA financing.⁴⁴ As an initial matter, the court noted the Act's intentional coverage of only a limited category of businesses.⁴⁵ Because their highly regulated status distinguished public utilities from the listed businesses, the court did not consider them members of this limited category.⁴⁶ Thus, the court interpreted the exclusion of public utilities from the list of enterprises included in the Act as evidence of the legislature's in-

37. *Id.*

38. *Id.* at para. 850.03(c).

39. *Illinois Development Finance Authority v. Bean*, 138 Ill. App. 3d 401, 402, 485 N.E.2d 1202, 1204 (1st Dist. 1985).

40. 138 Ill. App. 3d 401, 485 N.E.2d 1202.

41. *Id.* at 409, 485 N.E.2d at 1208.

42. The IDFA executive director has the principle responsibility for ensuring the IDFA's compliance with its resolutions. *Id.* at 402, 485 N.E.2d at 1203.

43. *Id.* at 403, 485 N.E.2d at 1204. The actual issue at the appellate level was whether the trial court's grant of summary judgment favoring a disallowance of the financing was appropriate. *Id.* However, this determination required the appellate court to complete a full analysis of the authority of the IDFA to effectuate the disputed bond financing. *Id.* at 403-09, 485 N.E.2d at 1204-08.

44. *Id.* at 409, 485 N.E.2d at 1208.

45. *Id.* at 405, 485 N.E.2d at 1206. *Accord* *McDonald's Corp. v. DeVenney*, 415 So. 2d 1075, 1080 (Ala. 1982). The *Bean* court also addressed the IDFA argument that public utilities provide a "service" within the meaning of the statute. *Bean*, 138 Ill. App. 3d at 405-6, 485 N.E.2d at 1206. The court determined that the words "repair, overhaul or service facility" referred to facilities engaged in the repair, service or overhaul of equipment. *Id.* at 406, 485 N.E.2d at 1206. Accordingly, the court asserted that those three terms must be read in conjunction, not separately, to be given their proper meaning. *Id.*

46. *Bean*, 138 Ill. App. 3d at 405, 485 N.E.2d at 1206.

tent to deny them IDFA financing.⁴⁷

Tax-exempt financing for public utilities would permit them to obtain financing at lower interest rates. Because the interest cost is a factor used in setting public utility rates,⁴⁸ the decision in *Bean* could result in raising the cost of public utility services to the consumer.

C. Interest on Federally Guaranteed Bonds

Income received from obligations issued by the federal government is exempt from state and local taxation.⁴⁹ On the other hand, income received from obligations that are guaranteed but not issued by the federal government currently is subject to state and local taxation.⁵⁰ In *Rockford Life Insurance Co. v. The Department of Revenue*,⁵¹ the Illinois Supreme Court decided that income received from obligations issued by the Government National Mortgage Association ("Ginnie Mae") and similar institutions was subject to taxation by state and local taxing bodies.⁵² In assessing

47. *Id.* The court asserted that use of the term "utilities" in the Act as an example of "appurtenances and facilities incidental to a . . . commercial enterprise" supported its conclusion that utilities were not commercial enterprises for IDFA financing. *Id.* (citing ILL. REV. STAT. ch. 48, para. 850.03(c) (1983)). The court bolstered its conclusion with a discussion of the legislative history underlying amendments to the Act. *Bean*, 138 Ill. App. 3d at 408, 485 N.E.2d at 1207-08. See Senate Debates, 81st Ill. Gen. Assem., H.B. 821, at 198-99, June 25, 1980; H.B. 821, third reading at 16, June 26, 1980; House Debates, H.B. 821 at 33-35, June 30, 1980. See also W. Redmond, Recent Accomplishments of the General Assembly Designed to Improve Business, Economic and Employment Conditions in Illinois (Oct. 1980) (available in Loyola University of Chicago Law School Library). Because public utilities are captive within a state, are subject to regulated rate setting, enjoy a limited monopoly, and have been shown to make needed improvements regardless of the source of their financing, the court held that they had no need for IDFA financing. *Bean*, 138 Ill. App. 3d at 407, 409, 485 N.E.2d at 1207, 1208. The court held that the purpose of the IDFA Act — to create or retain industry in Illinois — would not be served by providing public utilities with IDFA financing. *Id.* at 408, 485 N.E.2d at 1208.

48. Public utility rates are regulated by the Illinois Commerce Commission. ILL. REV. STAT. ch. 111²/₃, para. 9-102 (1985).

49. *Rockford Life Insurance Co. v. The Department of Revenue*, 112 Ill. 2d 174, 492 N.E.2d 1278 (1986), *prob. juris. noted*, 55 U.S.L.W. 3335 (U.S. Nov. 10, 1986) (No. 86-251). See 31 U.S.C. § 3124(a) (1982).

50. *Rockford Life*, 112 Ill. 2d 174, 492 N.E.2d 1278.

51. 112 Ill. 2d 174, 492 N.E.2d 1278.

52. *Id.* at 177, 492 N.E.2d at 1279. The following three types of obligations were at issue in *Rockford Life*: (1) mortgage backed certificates guaranteed by the Government National Mortgage Association (12 U.S.C. § 1721(g) (1982)); (2) obligations guaranteed either under the New Communities Act of 1968 (42 U.S.C. § 3902 (1976)) or under the Urban Growth and New Community Development Act of 1970 (42 U.S.C. § 4514 (1982)); and (3) ship financing bonds guaranteed under the Merchant Marine Act of 1936 (46 U.S.C. § 1203(a) (1982)). For a description of the operations of the mortgage-backed

the taxable income of the Rockford Life Insurance Company ("Rockford"), the Illinois Department of Revenue (the "Department") included income derived from certain federally guaranteed obligations though the Department previously had not included income derived from those sources. Rockford disputed this inclusion, asserting that, because the securities were federal obligations governed by federal law, the income they yielded was exempt from state and local taxation.⁵³ In concluding that the Department's assessment was proper,⁵⁴ the court provided an analysis useful for determining when income received from a federal obligation will be considered exempt from state and local taxation.

Under federal law, "all stocks, bonds, Treasury notes, and other obligations of the United States shall be exempt from taxation by . . . State or municipal or local authority."⁵⁵ In its interpretation of this statute, the Supreme Court⁵⁶ held that only written, interest bearing obligations issued pursuant to congressional authorization were granted tax-exempt status.⁵⁷ The court in *Rockford Life* followed the Supreme Court's rationale in deciding that the obligations held by Rockford were subject to state and local taxation.⁵⁸ While the obligations enumerated in the statute pertain to the credit needs of the federal government,⁵⁹ the obligations Rockford held "reflect[ed] a[n] . . . intent [of the federal government] to attract private money into the credit markets by providing for government guarantees of the obligations."⁶⁰ Thus, because the government itself did not borrow on the obligations held by Rock-

security system, see *New York Guardian Mortgage Corp. v. Cleland*, 473 F. Supp. 409, 411 (S.D.N.Y. 1979).

53. *Rockford Life*, 112 Ill. 2d at 176, 492 N.E.2d at 1279.

54. *Id.* at 184, 492 N.E.2d at 1283.

55. 31 U.S.C. § 742 (1976). In referring to statutes concerning the tax exempt status of certain federal obligations, the court in *Rockford Life* noted that when Title 31 of the United States Code was reformulated in 1982, § 3701 was replaced by § 3124(a) without substantive change. *Rockford Life*, 112 Ill. 2d at 178, 492 N.E.2d at 1280 (citing 31 U.S.C. § 3124(a) (1982)). Thus, the court referred to cases addressing § 3701 in its determination that the obligations held by Rockford were subject to state and local taxation. *Rockford Life*, 112 Ill. 2d at 178-79, 492 N.E.2d at 1280 (citing *American Bank and Trust Co. v. Dallas County*, 463 U.S. 855, 859 (1983) and *Society for Savings v. Bowers*, 349 U.S. 143, 144 (1955)).

56. *Smith v. Davis*, 323 U.S. 111, 116-17 (1944).

57. *Id.*

58. *Rockford Life*, 112 Ill. 2d at 174, 492 N.E.2d at 1278.

59. *Id.* at 181, 492 N.E.2d at 1281.

60. *Id.* at 177, 492 N.E.2d at 1279. The court in *Rockford Life* also noted similarities in the obligations held by Rockford as opposed to federal obligations usually allowed tax-exempt status. *Id.* The obligations held by Rockford shared the following characteristics: (1) their issuance by private parties; (2) their guarantee by the full faith and credit of the United States Government; and (3) the fee paid to the United States for such guarantees.

ford, the court concluded that they did not represent "other obligations of the United States" within the meaning of the statute.⁶¹

The *Rockford Life* court also stated that the income received from the disputed obligations did not meet the constitutional requirement for exemption from state and local taxation.⁶² According to prior case law, the United States Constitution requires an obligation to include a binding promise by the United States to pay specified sums at certain dates in order to receive tax-exempt status.⁶³ The obligations Rockford held did not include a promise by the federal government to pay the principal and interest, but merely guaranteed their payment.⁶⁴ Thus, the government's guarantee did not qualify as a binding promise to pay because it would be required to pay the principal and interest only if the issuing body defaulted on the payments.⁶⁵ Accordingly, the obligations Rockford held did not qualify under the Constitution for exemption from state and local taxation.⁶⁶

The court in *Rockford Life* subjected income in the form of in-

Id. These similarities justified the court's application of its final determination in the suit to all three groups of obligations held by Rockford. *Id.* at 178, 492 N.E.2d at 1279.

61. *Id.* at 181, 492 N.E.2d at 1281. The *Rockford Life* court further supported its conclusion on the basis that Congress has the authority to provide a tax exemption for the obligations in question and has chosen not to do so. Rather, the court noted, Congress has only exempted the organizations issuing the obligations from taxation. *Id.* See 12 U.S.C. § 1723a(c)(1)(1976).

62. *Rockford Life*, 112 Ill. 2d at 181, 492 N.E.2d at 1281. *Accord* First National Bank v. Barrow County Board of Tax Assessors, 470 U.S. 583 (1985).

63. *Smith v. Davis*, 323 U.S. at 114-15. All instruments consistently held exempt from state and local taxation share the same characteristics. The obligations are written documents which bear interest, coupled by a binding promise of the United States to pay specified sums at specified dates. Further, each of the obligations carry specific congressional authorization which also pledges the full faith and credit of the United States as a guarantee of its promise to pay. *Id.*

64. *Rockford Life*, 112 Ill. 2d at 181, 492 N.E.2d at 1281.

65. *Id.*

66. *Id.* A secondary issue in *Rockford Life* pertained to whether the Department's change in policy favoring taxing bond interest required that it be equitably estopped from collecting the assessment disputed by Rockford. *Id.* at 176, 492 N.E.2d at 1279. Notwithstanding the usual elements of estoppel — a party's reasonable and detrimental reliance on the words or conduct of another — there is an additional requirement in estopping a governmental unit. *Hickey v. Illinois Central R.R. Co.*, 35 Ill. 2d 427, 448-49, 220 N.E.2d 415, 426-27 (1966), U.S. *cert. denied*, 386 U.S. 934 (1967). A public body can only be estopped if doing so would prevent fraud or injustice. *Id.* Rockford's argument depended on its reliance upon the previous Department policy of not assessing the interest on the disputed obligations. *Rockford Life*, 112 Ill. 2d at 185, 492 N.E.2d at 1283. The court, however, noted that Rockford had failed to prove the requisite fraud or injustice. The court likened the Department change in practice to the accepted State policy of reexamining a taxpayer's income tax return subsequent to approval. *Id.* This rationale justified the court's conclusion that the Department should not be estopped from including the interest in its assessment. *Id.* at 187, 492 N.E.2d at 1284. *Accord*

terest received on Ginnie Maes and similar obligations to state and local taxation: a view consistent with the conclusion reached by the administrative body of at least one other state during the *Survey* period.⁶⁷ The issue in *Rockford Life* soon will be entertained by the United States Supreme Court.⁶⁸

III. PROPERTY TAXATION

A. Charitable and Educational Exemptions

Tax exempt status is granted by the General Assembly pursuant to the Illinois Constitution.⁶⁹ Courts typically apply rules of strict construction to statutes granting property tax exemptions.⁷⁰ Thus, to exempt property from taxation, the taxpayer claiming the exemption has the burden of proving that his property falls within the terms of the relevant statute under which the exemption is claimed and that the statute itself is constitutionally authorized.⁷¹ The claimant must demonstrate clearly the exempt status of his property to meet the standard of proof in these circumstances.⁷²

The Illinois Constitution enables the General Assembly to exempt property used for charitable and educational purposes from property taxation.⁷³ In *Board of Certified Safety Professionals of the Americas, Inc. v. Johnson*,⁷⁴ the taxpayer disputed the Illinois Department of Revenue's determination that a parcel of land it had acquired was subject to state and local property taxes.⁷⁵ The Board of Certified Safety Professionals of the Americas, Inc. (the "Board") first argued that it was entitled to a property tax exemp-

People *ex rel.* Scott v. Chicago Thoroughbred Enterprises, Inc., 56 Ill. 2d 210, 306 N.E.2d 7 (1973).

67. John LaMontaine v. State Board of Equalization of the State of California, slip op. (Feb. 4, 1986) (LEXIS, States library, Cal file - CalSBE).

68. See *supra* note 49.

69. ILL. CONST. art. IX, § 6.

70. Coyne Electrical School v. Paschen, 12 Ill. 2d 387, 390, 146 N.E.2d 73, 75 (1957).

71. People *ex rel.* Kelly v. Avery Coonley School, 12 Ill. 2d 113, 115, 145 N.E.2d 80, 82 (1957).

72. *Id.*

73. ILL. CONST. art. IX, § 6. "The General Assembly by law may exempt from taxation only . . . property used exclusively for . . . school, religious, cemetery, and charitable purposes." *Id.*

74. 112 Ill. 2d 542, 494 N.E.2d 485 (1986). The taxpayer in *Safety Professionals* was a not-for-profit organization that issued certificates to those persons passing its driving examination. The taxpayer purchased land located in Illinois on which it constructed its corporate office. It then applied for a partial real estate exemption allowed at that time for property used for mechanical purposes. The Department of Revenue denied the exemption asserting that the statute authorizing it was unconstitutional. *Id.* at 543-44, 494 N.E.2d at 486-7.

75. *Id.* at 542, 494 N.E.2d at 486-7.

tion based on a statute providing an exemption for property used for mechanical purposes.⁷⁶ The Illinois Supreme Court, however, responded by declaring the statute unconstitutional, asserting that the constitution did not authorize a statute which exempted property used for mechanical purposes from property taxation.⁷⁷

The Board next argued that it should receive a property tax exemption because it used its property for charitable purposes.⁷⁸ To qualify under the charitable purposes exemption, the taxpayer must show that his organization benefits the public at large, reduces the burdens of the government, and derives its funds from public or private charity.⁷⁹ The Illinois Supreme Court in *Safety Professionals* determined that the Board did not meet any of these requirements. According to the court, the Board's activities directly benefited only the class of people it certified and not the general public.⁸⁰ The court also determined that the Board did not reduce any governmental burden because the government never sought to license or register safety professionals.⁸¹ The court concluded that the Board was not entitled to the charitable exemption because it derived its funds from examination and renewal fees, not from any form of charity.⁸²

The Board's final basis for asserting tax exempt status was the educational purposes classification.⁸³ According to the majority in *Safety Professionals*, prior case law⁸⁴ required courts to apply a two prong test in deciding whether property is used for educational purposes.⁸⁵ To receive the exemption, the taxpayer's organization must have been created by tax-exempt institutions and its activities must lessen substantially what would otherwise be a governmental function or obligation.⁸⁶ The Board failed to meet both prongs: the

76. *Id.* at 547, 494 N.E.2d at 488.

77. *Id.* at 543-44, 494 N.E.2d at 486-7. See ILL. REV. STAT. ch. 120, para. 500.10 (1985).

78. *Safety Professionals*, 112 Ill. 2d at 546, 494 N.E.2d at 488.

79. *Methodist Old Peoples Home v. Korzen*, 39 Ill. 2d 149, 156-58, 233 N.E.2d 537, 541-42 (1968).

80. *Safety Professionals*, 112 Ill. 2d at 546, 494 N.E.2d at 488. The court declared that if any public benefit was produced by the Board it was indirect. This determination was founded on the court's belief that the benefit rendered by the safety professionals would be performed by them regardless of the board's certification. *Id.*

81. *Id.* at 546-7, 494 N.E.2d at 488.

82. *Id.* at 546, 494 N.E.2d at 487.

83. *Id.* at 545, 494 N.E.2d at 487.

84. *Association of American Medical Colleges v. Lorenz*, 17 Ill. 2d 125, 160 N.E.2d 763 (1959).

85. *Safety Professionals*, 112 Ill. 2d at 546, 494 N.E.2d at 487-88.

86. *Id.*

entities that created it were not themselves tax-exempt⁸⁷ and, as previously noted, the Board's activities did not reduce any of the government's obligations.⁸⁸

In his dissent, Justice Clark first stated that the test for the exemption for property used for educational purposes should not focus on the ownership of the property, but rather the use of the property.⁸⁹ Accordingly, Justice Clark determined that the Board had been using its property in the same manner as taxpayers to whom the exemption had been granted.⁹⁰ The dissent also refused to accept the majority's position that, in order to qualify for an educational exemption from property taxation, the taxpayer must show that it provides "a course of study which substantially lessen[s] . . . [a governmental burden]."⁹¹ Thus, in Justice Clark's view, the Board should have been granted tax exempt status under the exemption for property used for educational purposes.⁹²

B. Condominium Assessment Classifications

The Cook County Real Property Assessment Classification Ordinance (the "Ordinance")⁹³ divides property located in Cook County into several classes depending upon the use of that property. Class two property includes "real estate used for residential purposes when improved with an apartment building of not more

87. *Id.* The Board was sponsored by four organizations: the American Society of Safety Engineers, the American Industrial Hygiene Association, the Systems Safety Society, and the Society of Fire Protection Engineers. *Id.* at 544, 494 N.E.2d at 487.

88. *Id.* at 546-47, 494 N.E.2d at 488. See also *supra* note 81 and accompanying text. The Board asserted the additional theory of denial of equal protection, arguing that it was similarly situated to other organizations which had been granted tax-exempt status. The court also rejected this argument because other tax-exempt organizations had been classified under constitutionally authorized statutory exceptions. Thus, the court concluded that the Board and those institutions were not similarly situated. *Safety Professionals*, 112 Ill. 2d at 548, 494 N.E.2d at 489.

89. *Safety Professionals*, 112 Ill. 2d at 550, 494 N.E.2d at 489 (Clark, J., dissenting).

90. *Id.* at 549, 494 N.E.2d at 489 (Clark, J., dissenting). "The Board, like the plaintiff in *American Medical Colleges*, utilizes its property to develop and improve educational standards in its field and curricula at various colleges and universities in Illinois, publishes newsletters, administers examinations and maintains a library." *Id.* (Clark J., dissenting) (citing *Association of American Medical Colleges v. Lorenz*, 17 Ill. 2d 125, 160 N.E.2d 763 (1959)).

91. *Safety Professionals*, 112 Ill. 2d at 549, N.E.2d at 489 (Clark, J., dissenting). Clark's view is consistent with the dissent in *American Medical Colleges*. In *American Medical Colleges*, the dissent stated that the requirement that a governmental obligation must be substantially lessened by the institution claiming the exemption was not incorporated into the majority opinion. *American Medical Colleges*, 17 Ill. 2d at 130, 160 N.E.2d at 766 (Hershey, J., dissenting).

92. *Safety Professionals*, 112 Ill. 2d at 549, N.E.2d at 489 (Clark, J., dissenting).

93. COOK COUNTY, ILL. ORDINANCE § 80-0-14 (Sept. 2, 1980).

than six living units or [a] residential condominium” and is assessed at sixteen percent of its market value under the Ordinance.⁹⁴ Class three property, which is assessed at thirty-three percent of its market value, includes all improved real estate used for residential purposes which is not considered class two property.⁹⁵ Thus, depending upon the use of their property, some owners of condominiums located in Cook County will be subject to an annual real estate assessment rate which is double that applied to other owners of like property.⁹⁶

In the case of *In re Application of Cook County Director v. Hunt*,⁹⁷ the Illinois Appellate Court for the First District held that whether condominium property was classified as class two or class three property depended on the owner’s use of that property.⁹⁸ In *Hunt*, the plaintiff represented owners of several twelve-unit condominium buildings located in Cook County. Each condominium owner rented, yet retained ownership of, all twelve condominium units located within his building. The Illinois Department of Revenue (the “Department”) assessed the condominiums as class three property, while the taxpayers maintained that the property should be properly classified as class two property. In affirming the trial court’s decision, the appellate court held that because the condominiums were held by the taxpayers for the production of income, the Ordinance mandated that they be assessed as class three properties.⁹⁹

The court interpreted the Ordinance by examining the legislative intent behind its enactment.¹⁰⁰ Initially, the court noted that, prior to the adoption of the Ordinance, all condominiums were assessed on the same basis as income-producing property.¹⁰¹ Thus, owners using their condominiums as residences were taxed at a much higher rate than single-family homeowners.¹⁰² In an attempt to

94. *Id.* The Ordinance states, in pertinent part: “Real estate used as a farm, or real estate used for residential purposes when improved with a house, or, an apartment building of not more than six living units, or residential condominium, a residential cooperative or a government-subsidized housing project, is required by statute to be assessed in the [second] category.” *Id.*

95. *Id.* The Ordinance defines real estate used for residential purposes as “any improvement or portion thereof occupied solely as a dwelling unit.” *Id.*

96. *In re Application of Cook County Collector v. Hunt*, 136 Ill. App. 3d 496, 483 N.E.2d 414 (1st Dist. 1985).

97. *Id.*

98. *Id.* at 500, 483 N.E.2d at 417.

99. *Id.*

100. *Id.* at 499, 483 N.E.2d at 416.

101. *Id.*

102. *Id.* at 500, 483 N.E.2d at 417.

eliminate this inequity, the legislature, in enacting the present Illinois Constitution in 1970, mandated that condominiums occupied by owners as residences for a minimum of six months during each year be assessed on the same basis as single family residences.¹⁰³ For this reason, condominiums used by their owners as residences were afforded lower assessment rates.¹⁰⁴

Relying on the history underlying the Ordinance, the court held that the appropriate property tax classification for a condominium depended on the owner's use of the property.¹⁰⁵ Thus, a residential condominium will qualify as class two property and will be assessed at sixteen percent of its market value.¹⁰⁶ On the other hand, a residential condominium which is held for the production of income must be assessed at thirty-three percent of its market value.¹⁰⁷

The court's interpretation of the Ordinance leaves unanswered at least one question: Are condominiums owned by a corporation and used by its employees for business purposes considered class two properties or class three properties? The court's opinion, which focuses on the use of the property,¹⁰⁸ does not provide a clear answer because the described condominiums cannot be classified as residential or income producing property in the usual sense.

IV. SALES TAXATION — USE TAX EXEMPTION

The Illinois Use Tax Act (the "Act")¹⁰⁹ exempts from Illinois use tax,¹¹⁰ machinery or equipment used primarily in the process of manufacturing or assembling tangible personal property for either wholesale or retail sale.¹¹¹ Consequently, businesses using machin-

103. ILL. REV. STAT. ch. 120, para. 501(c)-1 (1985).

104. *Hunt*, 136 Ill. App. 3d at 500, 483 N.E.2d at 417.

105. *See In re Application of Rosewell*, 120 Ill. App. 3d 369, 458 N.E.2d 121 (1st Dist. 1983). *See also supra* note 96 and accompanying text.

106. *Hunt*, 136 Ill. App. 3d at 499, 483 N.E.2d at 415.

107. *Id.* The *Hunt* court also noted that the taxpayers' objectives were to receive dual benefits from income-producing investment property and the lower taxation rates offered to single-family residence owners. Realizing that accepting the taxpayers' position would allow owners of apartments containing more than six units to convert their buildings into condominiums in order to take advantage of lower property taxes, the court further justified its interpretation of the Ordinance. *Id.* at 500, 483 N.E.2d at 417.

108. *See supra* note 105 and accompanying text.

109. ILL. REV. STAT. ch. 120, para. 439.3 (1985).

110. According to the title of the Use Tax Act, a use tax is a tax imposed on the privilege of using Illinois property acquired incident to the purchase of service from a serviceman. *Id.*

111. *Id.* The Act lists several definitions of "manufacturing" or "assembling" processes for purposes of claiming use tax exemptions. *Id.*

ery or equipment solely for offering a service are not entitled to the use tax exemption.¹¹² The majority of cases arising under the Act involve a dispute over whether the taxpayer is primarily engaged in manufacturing personal property or providing a service.¹¹³

In *Colorcraft Corporation, Inc. v. The Department of Revenue*,¹¹⁴ the Illinois Supreme Court held that a photofinishing business is a service occupation for purposes of the Act and is therefore not entitled to a use tax exemption on machinery purchased for use in its business.¹¹⁵ In *Colorcraft Corporation*, the taxpayer argued that it was entitled to a use tax exemption because its photofinishing operation was of a manufacturing nature.¹¹⁶ In rejecting this position, the court noted that a service business could be distinguished from a manufacturing business by analyzing the following factors: (1) the ratio between the bare cost of materials and the cost of labor used in the process of producing the item; (2) the purchaser's motivation behind selecting the particular company; and (3) whether the item rendered is unique to the original purchaser or standard stock.¹¹⁷ Initially, the supreme court rejected the appellate court's determination that Colorcraft Corporation, Inc. ("Colorcraft") was a manufacturer based on its allocation of more resources to material cost than to labor.¹¹⁸ The supreme court determined that

112. *Colorcraft Corp., Inc. v. The Department of Revenue*, 112 Ill. 2d 473, 483, 493 N.E.2d 1066, 1070 (1986).

113. *Id.*

114. 112 Ill. 2d 473, 493 N.E. 2d 1066.

115. *Id.* at 483, 493 N.E.2d at 1670. The record of the court disclosed that Colorcraft's film processing followed several mechanical steps. First, the customer brought undeveloped film to a dealer (e.g, a drug store). Colorcraft then picked up the film, sorted and marked it categorically, spliced it and produced color negatives. The negatives then were fed through an automatic printer along with photographic paper. Next, the negatives and the paper were put through a processor. Finally, the photographs were cut by machine, packaged and delivered back to the customer via the dealer. *Id.* at 477-78, 493 N.E.2d at 1067-68.

116. *Id.* at 480, 493 N.E.2d at 1069. The court also looked to the Department of Revenue Regulations (the "Regulations") in formulating its conclusion. *Id.* at 478, 493 N.E.2d at 1068. These regulations provide that persons engaged in the photofinishing business are conducting a service and should be taxed as such. 86 ILL. ADMIN. CODE tit. 86, § 130.2000 (1984). The court further buttressed its reliance on the Regulations by noting that they were enacted to coincide with the Retailers Occupation Tax Act (ILL. REV. STAT. ch. 120, para. 440 (1985)) and the Service Occupation Tax Act (ILL. REV. STAT. ch. 120, para. 439.101 (1985)). *Colorcraft Corporation*, 112 Ill. 2d at 479, 493 N.E.2d at 1068.

117. *Colorcraft Corporation*, 112 Ill. 2d at 483, 493 N.E.2d at 1070. *See generally*, *J.H. Walters & Co. v. Department of Revenue*, 44 Ill. 2d 95, 254 N.E.2d 485 (1969) (providing the framework for the requirements enumerated by the *Colorcraft* court in claiming the exemption).

118. *Colorcraft Corporation*, 112 Ill. 2d at 484, 493 N.E.2d at 1071.

the cost-sales ratio was not dispositive in determining whether Colorcraft conducted a manufacturing operation.¹¹⁹

Additionally, the Illinois Supreme Court relied on the appellate court's observations that Colorcraft's customers were motivated by the price, quality, and speed with which Colorcraft developed film.¹²⁰ According to the court, these qualities pertained to Colorcraft's expertise as a service-oriented business.¹²¹ The court, focusing on the pictures developed and not the roll of film being processed, concluded by noting that pictures typically were valuable only to their original purchaser.¹²² Accordingly, the court held that application of the tri-part test demonstrated that Colorcraft was engaged in a service occupation for purposes of the Act.¹²³

V. TAX PROTESTING

A. Property Tax

In general, an Illinois taxpayer who disputes the amount of his property tax assessment must pay the tax under protest and institute legal proceedings to obtain a refund of the amount allegedly overpaid.¹²⁴ This rule generally prohibits a taxpayer from disputing his tax assessment until he has paid the total amount of his assessment to the State.¹²⁵ Under a judicial exception to this rule, however, a taxpayer will be permitted to protest a tax before paying it when his tax assessments are so excessive they render the State's protest procedure inadequate.¹²⁶

In the 1973 case of *First National Bank and Trust Co. of Evans-*

119. *Id.*

120. *Id.* In support of its determination that the taxpayer conducted a sales operation, the appellate court stated that "a customer does not select . . . [Colorcraft] based on any special expertise possessed by the plaintiff; . . . the customer is motivated primarily by price; quality of the photographs and the speed with which the photographs are returned . . . are secondary considerations." *Colorcraft Corporation*, 136 Ill. App. 3d 217, 224, 482 N.E.2d 1038, 1043 (4th Dist. 1985), *rev'd*, 112 Ill. 2d 473, 493 N.E.2d 1066 (1986). In determining that Colorcraft engaged in a service occupation, the supreme court noted that the "fact that quality and speed are allegedly viewed by the consumer as secondary is immaterial." *Colorcraft Corporation*, 112 Ill. 2d at 484, 493 N.E.2d at 1071.

121. *Colorcraft Corporation*, 112 Ill. 2d at 484, 493 N.E.2d at 1071.

122. *Id.* at 485, 493 N.E.2d at 1071.

123. *Id.* See *supra* note 115. In reaching its decision, the court also noted its reliance on the Retailers Occupation Tax Act (ILL. REV. STAT. ch. 120, para. 440 (1985)), the Use Tax Act (ILL. REV. STAT. ch. 120, para. 439.1 (1985)), and the regulations promulgated by the Department of Revenue. (ILL. ADMIN. CODE tit. 86, § 130.2000 (1984)).

124. ILL. REV. STAT. ch. 120, para. 675 (1985).

125. *Lakey v. Pulaski Drainage District*, 4 Ill. 2d 72, 74, 122 N.E.2d 257, 259 (1954).

126. *Clarendon Associates v. Korzen*, 56 Ill. 2d 101, 108, 306 N.E.2d 299, 303 (1973).

ton v. Rosewell,¹²⁷ the Illinois Supreme Court decided that the inadequacy of the tax protesting remedy could not be measured by whether the assessed property produced sufficient income to pay the disputed tax.¹²⁸ The court in *First National* determined that this standard would encourage countless equitable actions by taxpayers.¹²⁹ The court was concerned that these challenges would forestall the payment of taxes and thus promote instability in local government finances.¹³⁰

Recently, the Illinois Appellate Court for the First District¹³¹ reaffirmed the *First National* court's position that the excessiveness exception to the usual method of tax protesting must be applied within a limited scope.¹³² In *Wolf v. Hynes*,¹³³ the taxpayer asserted that the taxes assessed on property he owned were highly excessive because the gross income he derived from his property for the tax year in question amounted to less than the tax.¹³⁴ Under these circumstances, the taxpayer argued that the judicial remedy of payment under protest would not be adequate and that the court should enjoin the Illinois Department of Revenue (the "Department") from collecting the tax prior to a judicial decision on the issue.¹³⁵

The taxpayer in *Wolf* relied on a previous Illinois Supreme Court decision¹³⁶ to support his assertion that his tax assessment was so excessive that it rendered the legal remedy of protesting the tax inadequate. The *Wolf* court, however, distinguished the two cases by noting that in the prior case the tax increase was twenty-five times the previous year's assessment, was predicated on non-existent property improvements, and was admitted to be excessive by the tax assessing officials involved.¹³⁷ Absent these factors, the court in *Wolf* required the taxpayer to use the proper legal remedy

127. 93 Ill. 2d 388, 444 N.E.2d 126 (1982), *cert. denied*, 464 U.S. 803 (1983).

128. *Id.*

129. *Id.* at 394, 444 N.E.2d at 129.

130. *Id.* The court reasoned that local government finances were largely derived from taxes. *Id.*

131. *Wolf v. Hynes*, 137 Ill. App. 3d 987, 485 N.E.2d 463 (1st Dist. 1985).

132. *Id.* at 992, 485 N.E.2d at 466 (citing *First National*, 93 Ill. 2d at 388, 444 N.E. 2d at 126).

133. 137 Ill. App. 3d 987, 485 N.E.2d 463.

134. *Id.* at 988, 485 N.E.2d at 464.

135. *Id.*

136. *Id.* (citing *Hoyne Savings and Loan Association v. Hare*, 60 Ill. 2d 84, 322 N.E.2d 833 (1974)).

137. *Wolf*, 137 Ill. App. 3d at 990, 485 N.E.2d at 465 (citing *Hoyne*, 60 Ill. 2d at 89, 322 N.E.2d at 836).

of paying the tax before protesting it.¹³⁸

The *Wolf* case reaffirms the view that an excessive tax, in and of itself, does not indicate that a taxpayer has no adequate legal remedy in protesting the tax.¹³⁹ Instead, a taxpayer must show that other factors exist before he can bypass the usual method for protesting Illinois property taxes.¹⁴⁰

B. Retaliatory Tax

The Illinois Insurance Code (the "Code")¹⁴¹ imposes a two per cent tax on the net taxable premium income¹⁴² of foreign or alien insurance companies¹⁴³ for the privilege of doing business in Illinois.¹⁴⁴ When an Illinois insurance company doing business in another state is taxed at a greater rate than the two percent privilege

138. *Wolf*, 137 Ill. App. 3d at 990, 485 N.E.2d at 465. A related issue in *Wolf* involved whether a court, in determining the adequacy of payment under protest, could consider a taxpayer's financial ability to pay the tax without violating the equal protection clause. *Id.* at 991, 483 N.E.2d at 466. A tax classification generally is deemed valid under the equal protection clause. *People v. Bales*, 108 Ill. 2d 182, 188, 488 N.E.2d 517, 520 (1985). The party challenging its constitutionality must set forth facts proving his assertion. *Illinois Pure Water Committee, Inc. v. Yoder*, 6 Ill. App. 3d 659, 660, 286 N.E. 2d 155, 156 (5th Dist. 1972). Moreover, absolute equality is not required in the area of taxation. *Mutual Tobacco Co. v. Halpin*, 414 Ill. 226, 234, 111 N.E.2d 155, 159 (1953). Equal protection considerations only prohibit tax classifications which are clearly unreasonable and arbitrary and which bear no reasonable relationship to a valid legislative purpose. *Fox v. Rosewell*, 55 Ill. App. 3d 860, 866, 371 N.E.2d 287, 292 (1975).

The court in *Wolf* asserted that the main purpose underlying the payment-under-protest remedy would not be served by "protract[ed] delays in the collection of taxes." *Wolf*, 137 Ill. App. 3d at 991, 485 N.E.2d at 466. Further, the court agreed with the *Hoyne* proposition that situations would arise where a taxpayer truly could not comply with the statutory remedy due to lack of finances. *Id.* (citing *Hoyne*, 60 Ill. 2d at 90, 322 N.E. 2d at 837). The *Wolf* court determined that a taxpayer's financial ability to pay the disputed taxes was reasonably related to whether the Illinois method for protesting taxes should be bypassed, and thus did not violate the equal protection clause. *Wolf*, 137 Ill. App. 3d at 991, 485 N.E.2d at 466.

139. See *supra* notes 127-30 and accompanying text.

140. See *supra* notes 136-38 and accompanying text.

141. ILL. REV. STAT. ch. 73, paras. 613 - 1065.724 (1985).

142. Net taxable premium income is defined as

"the gross taxable premium income reduced . . . by . . . the amount of premiums returned thereon which shall be limited to premiums returned during the preceding calendar year and shall not include the return of cash surrender values or death benefits on life policies . . . [and] dividends on such direct business that have been paid in cash, applied in reduction of premiums or left to accumulate to the credit of the policyholder or annuitants."

Id. at para. 1021(1)(a), (b) (1985).

143. A corporation that does business in one state though incorporated in another state is considered a foreign corporation with regard to the former state. BLACK'S LAW DICTIONARY 582 (5th ed. 1979).

144. ILL. REV. STAT. ch. 73, para. 1021(1) (1985).

tax imposed by Illinois on companies of that state doing business in Illinois, the tax rate of the foreign company's home state is adopted and applied to that company in lieu of the usual privilege tax.¹⁴⁵ This form of taxation is referred to as a retaliatory tax.¹⁴⁶

Another application of the retaliatory tax occurs when a foreign insurance company is required to pay the privilege tax and makes payment under protest into a segregated protest fund.¹⁴⁷ Upon doing so, the Insurance Code mandates that the company calculate its privilege tax as if it were zero.¹⁴⁸ Thus, the company is required to file a retaliatory tax return representing the full amount of the tax due for the taxable period.¹⁴⁹ This amount is the measure of tax liability, regardless of whether the protest of the privilege tax is successful.¹⁵⁰ Finally, the Code allows the State to take a portion of the protested payment equal to the amount of retaliatory tax from the protest fund and deposit it into the State General Revenue Fund.¹⁵¹

In *Metropolitan Life Insurance Company v. Washburn*,¹⁵² the Illinois Supreme Court interpreted the Code as not requiring a release of taxes from the protest fund into the General Revenue Fund when both the retaliatory and privilege taxes were paid under protest.¹⁵³ The court in *Metropolitan Life* determined that the sole purpose of the statute was to allow the release from the protest fund into the General Revenue Fund of an amount of money the taxpayer would owe in retaliatory taxes even when the protest of the privilege tax was upheld.¹⁵⁴ The court, however, noted that the statute and its legislative history did not address the further complication presented when the retaliatory tax also was paid under protest.¹⁵⁵ Thus, the court held that the circumstances in *Metropolitan Life* were not within the scope of the statute.¹⁵⁶ The court therefore, held that the Code does not order a transfer into the General Revenue Fund of the protested tax payments

145. *Id.* at para. 1056.

146. *Id.*

147. *Id.* at para. 1056.1(4).

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. 112 Ill. 2d 486, 493 N.E.2d 1071 (1986).

153. *Id.*

154. *Id.* at 492, 493 N.E.2d at 1074.

155. *Id.* at 492, 494, 493 N.E.2d at 1074, 1075. See House Debates, 82d Ill. Gen. Assem., H.B. 2945, at 54 (June 24, 1982).

156. *Metropolitan Life*, 112 Ill. 2d at 492, 493 N.E.2d at 1074.

when both taxes are protested.¹⁵⁷

In *Metropolitan Life*, the court relied on the Code's silence to hold that a release into the general revenue fund in the amount of protested retaliatory taxes was not mandated.¹⁵⁸ The court's interpretation of the Code appears proper as it is consistent with the treatment of the payment of privilege taxes under protest.¹⁵⁹

VII. LOCAL GOVERNMENT TAXING POWER

A. County Retention of Tax Penalty

The Revenue Act of 1939 (the "Act")¹⁶⁰ allows county authorities to collect real property taxes levied by the county and other local taxing units.¹⁶¹ The Act then requires the county collector to pay to each local unit the amount of taxes collected on its behalf.¹⁶² Additionally, the Act authorizes the county collector to collect and pay into the county treasury an interest penalty on the payment of delinquent property taxes levied by the county and other local taxing units.¹⁶³

The Illinois Constitution forbids any taxing body to pay a fee to a tax collector based on taxes paid and collected on behalf of itself and other taxing units.¹⁶⁴ Nevertheless, in *Village of Oak Lawn v. Rosewell*,¹⁶⁵ the Illinois Supreme Court upheld the Cook County practice of retaining, rather than sharing, the interest penalty on the payment of all delinquent taxes collected by the county on behalf of other local taxing units.¹⁶⁶ The court in *Village of Oak Lawn* held that the county's retention of interest was not equivalent to imposing an unconstitutional fee on the Village for the collection of taxes on its behalf.¹⁶⁷

The supreme court noted that its determination depended on whether the local taxing units were entitled to the interest collected

157. *Id.* at 494, 493 N.E.2d at 1075. The circuit court had refused to allow the contested transfer on the grounds that the disputed section of the Illinois Insurance Code violated due process. The supreme court vacated the circuit court's judgment of unconstitutionality. The supreme court reasoned that the disallowance of the transfer rendered a determination of constitutionality unnecessary. *Id.*

158. *See supra* notes 155-56 and accompanying text.

159. *Metropolitan Life*, 112 Ill. 2d at 488-89, 493 N.E.2d at 1072-73.

160. ILL. REV. STAT. ch. 120, para. 689 (1985).

161. *Id.*

162. *Id.*

163. *Id.* at para. 705.

164. ILL. CONST. art. VII, § 9(a).

165. 113 Ill. 2d 104, 497 N.E.2d 734 (1986).

166. *Id.* at 111-12, 497 N.E.2d at 738.

167. *Id.* at 110, 497 N.E.2d at 737.

on the delinquent tax payments.¹⁶⁸ The court interpreted the Act as appropriating the interest only to the county,¹⁶⁹ because the penalty fund created by the Act referred only to the county.¹⁷⁰ Thus, the local units could not complain of deprivation of interest to which they had no rightful claim.¹⁷¹ Rather, the taxpayer's delinquency in payment of the real estate taxes, not the county's retention of the interest penalty, caused the disputed loss in funds.¹⁷²

B. Taxation by Home Rule Units

A Home Rule Unit ("HRU") is either a municipality consisting of a population of twenty-five thousand or more individuals or a municipality that has elected to be an HRU through initiative and referendum.¹⁷³ The Illinois Constitution provides that an HRU may exercise the power to tax.¹⁷⁴ The Illinois General Assembly, however, may deny or limit an HRU's power to tax.¹⁷⁵

Conversely, the General Assembly cannot deny an HRU the

168. *Id.*

169. *Id.* The court held that the Act did not allocate the interest to any other local taxing units. *Id.*

170. *Id.* See ILL. REV. STAT. ch. 120 para. 705 (1985).

171. *Village of Oak Lawn*, 113 Ill. 2d at 109, 497 N.E.2d at 737. In *Board of Commissioners v. County of DuPage*, 107 Ill. App. 3d 409, 437 N.E.2d 923 (2nd Dist. 1982), *aff'd*, 96 Ill. 2d 378 (1983), the appellate court considered a constitutional challenge to a county's retention of interest. The interest in that case came from local tax revenues specifically owed certain taxing units. *Id.* at 417, 437 N.E.2d at 930. In *County of DuPage*, the court determined that the retention of interest was a fee constituting a deprivation by the county of the local units' use of money owed to them. *Id.*

172. *Village of Oak Lawn*, 113 Ill. 2d at 110, 497 N.E.2d at 737. The Village also asserted that the county's retention of the interest penalty violated equal protection. *Id.* A legislative classification will be upheld against an equal protection challenge if any set of facts reasonably can be conceived to sustain the classification. *Jacobs v. City of Chicago*, 53 Ill. 2d 421, 292 N.E.2d 401 (1973). The court in *Village of Oak Lawn* thus proceeded to find a rational basis for classifying the county separately from other local taxing units: the county was the only taxing unit sure to include every taxpayer within its jurisdiction. In contrast, the other local units' jurisdiction over the taxpayer depended upon that person's location within the county. *Village of Oak Lawn*, 113 Ill. 2d at 111, 497 N.E.2d at 738. Additionally, the court noted that in enacting the disputed statute, the legislature may have intended to forego extra expense and difficulty to the county in allocating which unit had jurisdiction to receive the interest and what portion thereof. *Id.* Therefore, the court concluded that the legislative classification allowing the county to retain the interest funds did not violate the local unit's equal protection. *Id.*

173. ILL. CONST. art. VII, § 6(a). Initiative refers to the power of the electorate to propose legislation to be acted upon by the legislature. BLACKS LAW DICTIONARY 705 (5th ed. 1979). Referendum means the reservation by the electorate of the right to have legislation passed by the legislature submitted to the electorate for approval or rejection. *Id.* at 1152.

174. ILL. CONST. art. VII, § 6(a).

175. *Id.* at § 6(g). A vote by three-fifths of the members of each house is required to deny or limit an HRU's power to tax. *Id.*

power to impose a certain tax if it allows the State to impose that same tax.¹⁷⁶ In addition, the Illinois State Constitution provides that all powers and functions of an HRU shall be construed liberally.¹⁷⁷

The Illinois Supreme Court decision in *Chicago Park District v. City of Chicago*¹⁷⁸ reaffirmed its prior view that the Illinois Constitution provides city governments with a broad taxing power via the HRU provisions.¹⁷⁹ In *Chicago*, the Chicago Park District (the "District") argued that the City of Chicago had exceeded its authority under the HRU provision of the Illinois Constitution by imposing a tax on the owner of any watercraft located within city limits and moored or docked for a fee.¹⁸⁰ The District also contended that the imposition of the tax represented an impermissible regulation of District operations by the City.¹⁸¹

The court held that the tax was a proper exercise of the City's HRU powers.¹⁸² The court noted that in prior cases it had prohibited an HRU from exercising its taxing power when such regulation infringed into areas over which the State intended to maintain exclusive control.¹⁸³ Those areas included the State's exclusive regulation of judicial¹⁸⁴ and educational systems.¹⁸⁵ In the present case, however, the court noted no indication that the State intended to maintain exclusive dominion over the harbors subjected to the mooring tax.¹⁸⁶

176. *Id.* at § 6(h).

177. *Id.* at § 6(m).

178. 111 Ill. 2d 7, 488 N.E.2d 968 (1986).

179. *Id.* at 11, 488 N.E.2d at 970. See ILL. CONST. art. VII, § 6(m).

180. *Chicago*, 111 Ill. 2d at 9, 488 N.E.2d at 969. Under the ordinance imposing the tax, the payee of the mooring fee is directly liable to the City for the tax. *Id.*

181. *Id.* at 10, 488 N.E.2d at 970.

182. *Id.* at 17, 488 N.E.2d at 973.

183. *Id.* at 11-13, 488 N.E.2d at 970-71.

184. *Ampersand, Inc. v. Finley*, 61 Ill. 2d 537, 338 N.E.2d 15 (1975). The Illinois Supreme Court in *Ampersand* held invalid a fee imposed by Cook County upon the filing of a case in one of its courts. The *Ampersand* court considered the fee an unconstitutional regulation of the Illinois' constitutionally protected judicial system. *Id.* at 542, 338 N.E.2d at 18.

185. *Board of Education of School District No. 150 v. City of Peoria*, 76 Ill. 2d 469, 394 N.E.2d 399 (1979). The Illinois Supreme Court in *Board of Education* struck down a city requirement that the School District collect a tax imposed on it by the City. The same scheme, however, was upheld when applied to the Park District. The requirement was held unconstitutional only when imposed on the School District because the state exercised plenary power over the Illinois Educational System. *Id.* at 476, 394 N.E.2d at 402-3.

186. *Chicago*, 111 Ill. 2d at 11, 488 N.E.2d at 970. The District argued that the legislature had intended the harbor affected by the tax to be excluded from city control. The District relied on provisions in the Illinois Revised Statute to support its position.

Emphasizing that the power to regulate and the power to tax are separate and distinct,¹⁸⁷ the court asserted that simultaneous regulation of the harbors by the State and the District did not prohibit the city from enacting a consumer tax on the use of those harbors.¹⁸⁸ In the court's view, this conclusion was consistent with the constitution's refusal to provide the State with complete dominion over the taxing power.¹⁸⁹

Finally, the court in *Chicago* dismissed the District's argument that the imposition of the tax on boatowners would reduce the demand for the mooring of boats, thereby limiting the District's ability to raise revenue.¹⁹⁰ The court determined that the issue of whether the tax was an unreasonable burden on the District was not within its discretion but instead was a matter for the legislature to decide.¹⁹¹ Under this analysis, a court should refrain from considering such an issue unless the tax is sufficiently arbitrary to constitute a regulation rather than a valid exercise of the taxing power.¹⁹²

Emphasizing that the decline in demand for the mooring of boats began significantly earlier than the imposition of the tax, the court concluded that it was proper to find that the mooring tax was not sufficiently arbitrary to warrant judicial scrutiny.¹⁹³ Recalling that the Illinois General Assembly may limit or deny the power to tax, the court noted that "the legislature may prevent or rectify any hardships which the plaintiffs envisage, should they occur".¹⁹⁴

Id. (citing ILL. REV. STAT. ch. 19, para. 71 (1985) (title to Lake Michigan is held in trust for the benefit of the people of Illinois; the Department of Transportation has complete jurisdiction over public bodies of water located in Illinois and over the construction of any moor or dock upon those waters)). Nevertheless, the court in *Chicago* found that these statutes provided no evidence that the State intended to maintain total control over the harbors. *Chicago*, 111 Ill. 2d at 11, 488 N.E.2d at 970.

187. *Chicago*, 111 Ill. 2d at 13, 488 N.E.2d at 971.

188. *Id.* See *Town of Cicero v. Fox Valley Trotting Club, Inc.*, 65 Ill. 2d 10, 17, 357 N.E.2d 1118, 1120-21 (1976). In *Fox Valley*, the court upheld the town's taxation on horse racing despite the existence of an extensive statutory plan providing for the regulation of the horse racing industry in Illinois. *Id.* at 16, 357 N.E.2d at 1120.

189. *Chicago*, 111 Ill. 2d at 14, 488 N.E.2d at 971. See ILL. CONST. art. VII, § 6(h).

190. *Chicago*, 111 Ill. 2d at 15-16, 488 N.E.2d at 972.

191. *Id.* at 16, 488 N.E.2d at 972. Accord *Fox v. Standard Oil Co.*, 294 U.S. 87, 99-100 (1935).

192. *Chicago*, 111 Ill. 2d at 16, 488 N.E.2d at 972.

193. *Id.*

194. *Id.* at 17, 488 N.E.2d at 973. (citing *City of Evanston v. County of Cook*, 53 Ill. 2d 312, 319, 291 N.E.2d 823, 827 (1972)). The District furthered its argument that the tax was improper by noting that its mooring fees were not ordinary commercial transactions, but rather a legislatively authorized method of retiring its harbor revenue bonds. *Chicago*, 111 Ill. 2d at 15, 488 N.E.2d at 972. The court observed that a classification as

VII. RECENT TAX LEGISLATION

A. Tax Credits

1. High Impact Business Credit

The recently enacted Illinois "High Impact Business Act" (the "Act")¹⁹⁵ authorizes the Illinois Department of Commerce and Community Affairs (the "Department") to allocate specified tax benefits to qualified businesses for the purpose of improving the economy in certain areas of the State.¹⁹⁶ To qualify for a credit under the Act, the business must be designated as high impact, located in a federally designated Foreign Trade Zone,¹⁹⁷ and invest in a certain type of property.¹⁹⁸ A business will be characterized as high impact if investment in the business will increase per capita income, reverse the loss of jobs, decrease the unemployment rate and the poverty level, or beneficially affect other economic indicators.¹⁹⁹

In addition, the property in which the business invests must be depreciable property under the Internal Revenue Code and located in a federally designated Foreign Trade Zone.²⁰⁰ Depreciable property generally means property which is used in a trade or business or held for the production of income.²⁰¹ Further, the property for which the credit is claimed must be acquired by purchase.²⁰² This purchase may not be made between family members or related corporate taxpayers.²⁰³

either an ordinary transaction or a legislatively authorized one did not defeat the ability of an HRU to impose the disputed tax. *Id.*

195. 1986 Ill. Leg. Serv. 84-769 (West).

196. ILL. REV. STAT. ch. 67½, para. 609.1; ch. 120, para. 2-201(j) (1985).

197. ILL. REV. STAT. ch. 67½, para. 609.1(2) (1985). A federally designated foreign trade zone is a zone established in states wherein component parts for certain products initially may be imported duty free, such duty being postponed until the finished product enters the larger American market. BLACKS LAW DICTIONARY 583 (5th ed. 1979). The credit, however, will not apply to property placed within an Enterprise Zone pursuant to the Illinois Enterprise Zone Act. *See* ILL. REV. STAT. ch. 120, para. 2-201(h), (j) (1985).

198. *See infra* notes 200-03 and accompanying text.

199. ILL. REV. STAT. ch. 67½, para. 609.1(3) (1985).

200. ILL. REV. STAT. ch. 120, para. 2-201(j)(1) (1985). *See* I.R.C. §§ 167, 168 (1985). "Three year property" as defined by the Code is precluded from receiving the credit. Generally, this is property having a present life, for depreciation purposes, of four years or less, or property which is used in connection with research or experimentation. *See* I.R.C. § 168(c)(2)(A) (1985).

201. I.R.C. §§ 167, 168 (1985).

202. ILL. REV. STAT. ch. 120, para. 2-201(j)(2)(c) (1985). The Act adopts the definition of "acquired by purchase" employed by the Internal Revenue Code. I.R.C. § 179(d)(2) (1985).

203. I.R.C. § 179(d)(2) (1985).

If a business meets all of these requirements, it qualifies for a tax benefit in the form of an investment tax credit.²⁰⁴ When the taxpayer invests in qualifying property, one-half of one percent of the basis of such property is allowed as a credit against the income tax imposed upon that taxpayer in Illinois.²⁰⁵ The credit is available only in the taxable year in which the property is placed in service.²⁰⁶ Further, the credit is allowed only to the extent it does not reduce a taxpayer's current income tax liability below zero.²⁰⁷

Finally, the Act contains a recapture provision. If property ceases to be qualified within forty-eight months after being placed in service, or the situs of the property is moved outside of Illinois within that same time period, the taxes due for that taxable year will be increased.²⁰⁸ This increase is calculated by recomputing the investment tax credit without including the basis of the now unqualified property.²⁰⁹ The recomputed credit then is subtracted from the previously credited amount; the difference representing the tax increase.²¹⁰

2. Personal Property Tax Replacement Income Tax Credit

During the *Survey* period, the legislature converted the deduction allowed to corporations, partnerships, and trusts for the Personal Property Tax Replacement Income Tax ("PPTRIT")²¹¹ into a tax credit.²¹² The credit is computed by multiplying the PPTRIT by the appropriate fraction determined under the Illinois apportionment factor provisions.²¹³ If no fraction needs to be applied under those provisions, the amount of the credit is equivalent to the PPTRIT. In either instance, the product of this factoring then

204. ILL. REV. STAT. ch. 120, para. 2-201(j)(1) (1985).

205. *Id.* Illinois imposes separate income tax rates on individuals and corporations. These rates are measured by calculating a taxpayer's net income and applying that figure to varying rates. *See* ILL. REV. STAT. ch. 120, para. 2-201(a), (b) (1985).

206. ILL. REV. STAT. ch. 120, para. 2-201(j)(1) (1985).

207. *Id.*

208. *Id.* at para. 2-201(j)(6). The Act borrows the definition of "placed in service" from the Internal Revenue Code. *Id.* *See generally* I.R.C. § 46 (1985).

209. ILL. REV. STAT. ch. 120, para. 2-201(j)(6) (1985).

210. *Id.* at para. 2-201(j)(6)(ii). The Act determines the basis of qualified property using the same method employed to compute the depreciation deduction for federal income tax purposes. *Id.* at para. 2-201(j)(3).

211. The PPTRIT is applied to every corporation (including Subchapter S corporations), partnership, and trust for each taxable year ending after June 30, 1979. The tax is imposed on the privilege of receiving income in or as a resident of Illinois and is in addition to the usual income tax imposed. *Id.* at para. 2-201(c).

212. *Id.* at para. 2-201(k).

213. *Id.* *See id.* at paras. 2-201(c), (d), 3-304. *See infra* notes 232-34 and accompanying text.

is multiplied by the appropriate income tax rate.²¹⁴

Any credit unused in the year computed can be carried back to each of the three taxable years preceding the year the credit arose.²¹⁵ The credit also may be carried forward to each of the fifteen taxable years, in successive order, following the year of computation continuing until it is fully used.²¹⁶ The credit, however, must first be applied to the earliest year for which there was a tax liability.²¹⁷

B. *Deductions for Net Operating Loss*

Effective for tax years ending on or after December 31, 1986, the Illinois Income Tax Act (the "Act")²¹⁸ is amended to provide a deduction for a net operating loss carry-over or carry-back.²¹⁹ The loss may be carried back to prior years or over to future years in the same manner as a federal net operating loss. The net operating loss provision is only applied to corporations, trusts, and estates.²²⁰

Illinois enacted the new law to ensure that such losses are deducted only once for Illinois income tax purposes.²²¹ Thus, in order to prevent the double deduction of net operating loss carry-backs and carry-overs, amendment of the original Act was necessary.²²² In computing loss deductions under the current form of the Act, the amount of any net operating loss, other than net operating losses carried forward from a taxable period prior to December 31, 1986, can be carried over or back.²²³ This change was required because the starting point of the calculation of Illinois base income is federal taxable income. This starting point, for corporations, trusts and estates, would have included any federal loss carry-over or carry-back to that year from all other taxable years.²²⁴

C. *Miscellaneous Legislation*

The Illinois legislature recently has added to the number of de-

214. ILL. REV. STAT. ch. 120, para. 2-201(k) (1985). See *id.* at para. 2-201(a), (b).

215. *Id.* at para. 2-201(k).

216. *Id.*

217. *Id.*

218. *Id.* at paras. 2-201 to 15-501.

219. *Id.* at para. 2-207.

220. *Id.* See *id.* para. 2-203.

221. J. Truskowski, *Recent Changes to the Illinois Income Tax Act*, 29 I.S.B.A. TAX TRENDS 1 (Feb. 1986).

222. *Id.*

223. *Id.*

224. *Id.*

ductions allowed for financial institutions doing business in Illinois. State income tax deductions are now allowed for interest expenses which are not allowed as deductions for certain federal tax purposes.²²⁵ In computing the Illinois base income of a qualified corporation, federal taxable income is modified by allowing those Illinois corporations to deduct interest expenses which are not deductible under federal law.²²⁶ The deduction is only applicable to tax years ending on or after September 19, 1985.²²⁷

Also, the Illinois Real Estate Transfer Tax Act (the "Act")²²⁸ imposes a tax on the transfer of a beneficial interest in real property that is the subject of a land trust and is represented by a trust document filed for recordation.²²⁹ The tax is imposed at a rate of twenty-five cents for each five hundred dollar value or fraction thereof stated in the declaration.²³⁰ The tax, however, does not apply to trust documents executed before 1986 but recorded after August 25, 1986.²³¹

Finally, effective for taxable years beginning on or after January 1, 1987, the formula for apportioning the business income of non-residents to Illinois has been amended.²³² Formerly, this formula was based on the three factors of property, payroll, and sales, all of which were weighted equally.²³³ The recent change employs the same three factors, but doubles the weight given to the sales factor in computing taxable income.²³⁴

VIII. CONCLUSION

A majority of the case law produced during the *Survey* period was resolved in favor of taxation. Most tax benefits originated from explicit statutory recognition. Thus, the general rule that all income is taxable unless specifically excepted to²³⁵ was followed judiciously.

225. ILL. REV. STAT. ch. 120, para. 2-203(b)(2)(J) (1985).

226. *Id.* See I.R.C. § 291(a)(3) (1985).

227. ILL. REV. STAT. ch. 120, para. 2-203 (1985).

228. *Id.* at paras. 1001 - 1003.1.

229. *Id.* at para. 1003.

230. *Id.*

231. ILL. REV. STAT. ch. 120, para. 1004(a) (Supp. 1986).

232. *Id.*

233. ILL. REV. STAT. ch. 120, para. 3-304 (1985).

234. ILL. REV. STAT. ch. 120, para. 1004(a) (Supp. 1986).

235. Treas. Reg. 31.61-1(a) (1986).

