

2015

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Recommended Citation

Anton DirnbergerII, & John Harig, *Grand Chapter, Order of the Eastern Star of the State of Illinois v. Topinka: Court Upholds, but Suggests Change in, Bed Tax Law*, 46 Loy. U. Chi. L.J. 1059 (2015).

Available at: <http://lawcommons.luc.edu/lucj/vol46/iss4/8>

Recent Development

Grand Chapter, Order of the Eastern Star of the State of Illinois v. Topinka: Court Upholds, but Suggests Change in, Bed Tax Law

Anton Dirnberger II and John Harig***

Under Illinois law, the Department of Public Aid (“the Department”) is charged with enforcing a Nursing Home Licensing Fee. The law states in relevant part:

Every nursing home provider shall pay to [the Department] on or before September 10, December 10, March 10, and June 10, a fee in the amount of \$1.50 for each licensed nursing bed day for the calendar quarter in which the payment is due.¹

While taxes like this bed tax² are commonplace in the medical industry, the Illinois Supreme Court was recently faced with deciding whether these taxes should be enforced against providers who do not participate in Medicaid or other government-funded programs. In *Grand Chapter, Order of the Eastern Star of State of the Illinois v. Topinka*, the Illinois Supreme Court upheld the constitutionality of the bed tax under the state constitution’s uniformity clause, but suggested that the state legislature rethink the bed tax application.³ While the unanimous holding utilizes doctrinal reasoning, its message to the legislature highlights the potential need for review of the bed tax policy.

The plaintiff, Grand Chapter, Order of the Eastern Star of the State of

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1. 305 ILL. COMP. STAT. 5/5E-10 (2012).

2. See *Crocker v. Finley*, 459 N.E.2d 1346, 1350 (Ill. App. Ct. 1984) (providing that, although a statute may describe a charge as a “fee,” the statute involves a tax where it is charged for the raising of general revenues and not in exchange for the rendering of a particular service).

3. *Grand Chapter, Order of the Eastern Star of the State of Ill. v. Topinka*, 25 N.E.3d 621, 626–27 (Ill. 2015).

Illinois (“Grand Chapter”), is an Illinois fraternal organization registered as a not-for-profit corporation.⁴ Additionally, it is tax-exempt under section 501(c)(10) of the federal Internal Revenue Code.⁵ Grand Chapter owns and operates the Eastern Star Home (“Eastern Star”), a nursing home in Macon, Illinois.⁶ The Department licensed Eastern Star and permits it to enter into Life Care contracts with nursing home clients under the Life Care Facilities Act.⁷ Life Care contracts require an entrance fee and include personal, nursing, or medical care in addition to the residency arrangement.⁸ Under Life Care contracts, a Life Care facility must promise to provide a range of services for at least one year, typically for life, in exchange for the entrance fee, which is paid in addition to or in lieu of a regular periodic payment.⁹ Between May and October 2002, the Department sent letters to Grand Chapter demanding that it pay the bed tax required by section 5E-10 of the Illinois Public Aid Code.¹⁰ In its October letter, the Department claimed that Grand Chapter was delinquent in its payment of the bed tax since 1993 and that it now owed the Department \$482,123 in back fees and penalties.¹¹ Grand Chapter paid the fees under protest and filed a declaratory action seeking to have the bed tax declared unconstitutional under the uniformity clause¹² of the Illinois Constitution.¹³

In its complaint, Grand Chapter explained that it only accepts admission from those nursing home clients that either pay a monthly fee or surrender all their present and future assets to Eastern Star in exchange for lifetime care.¹⁴ Grand Chapter emphasized that it does not apply for or accept any government funding or subsidies and that it mandates that its residents relinquish receipt of any government aid prior to entering Eastern Star.¹⁵ As a result, argued Grand Chapter, neither Eastern Star nor its residents participate in the Medicaid program.¹⁶ Grand Chapter further argued that, because the bed tax’s

4. *Id.* at 622.

5. 26 U.S.C. § 501(c)(10) (2012); *Grand Chapter*, 25 N.E.3d at 622.

6. *Grand Chapter*, 25 N.E.3d at 622.

7. Life Care Facilities Act, 210 ILL. COMP. STAT. 40/1 (2012).

8. EVAN PONDER, ILL. DEP’T OF PUB. HEALTH, LIFE CARE PROGRAM UPDATE 1 (2012), available at http://www.idph.state.il.us/pdf/Life_Care_Update.pdf.

9. *Id.*

10. *Grand Chapter*, 25 N.E.3d at 622.

11. *Id.*

12. ILL. CONST. art. IX, § 2 (stating, in relevant part, “[i]n any law classifying the subjects or objects of non-property taxes or fees, the classes shall be taxed uniformly”).

13. *Grand Chapter*, 25 N.E.3d at 622.

14. *Id.* at 622–23.

15. *Id.* at 623.

16. *Id.*

principal purpose is to fund Medicaid-related expenditures that are not paid to Eastern Star, the enforcement of the bed tax is unconstitutional.¹⁷

In response, the State contended that the bed tax does not solely fund Medicaid-related programs.¹⁸ In fact, the Department is required by statute to deposit all the revenue from the bed tax into the Long-Term Care Provider Fund.¹⁹ This fund is used for several purposes, many of which, the State asserted, “benefit or are precipitated” by the operation of nursing homes including Eastern Star.²⁰ As a result, the State argued that it is reasonable to include Eastern Star in the class of “every nursing home.”²¹ In opposition, Grand Chapter continued to claim that the bed tax exists solely to fund the reimbursement of nursing homes that charge the state through the Medicaid program.²² Because Eastern Star did not participate or intend to participate in Medicaid or any other government program, Grand Chapter stated “[t]here is no conceivable benefit to Eastern Star . . . and there is no conceivable way that Eastern Star contributes to the problem [that the bed tax intended to remedy].”²³

Both parties filed for summary judgment.²⁴ Following a hearing, the circuit court granted Grand Chapter’s motion for summary judgment, thereby declaring the bed tax unconstitutional under the uniformity clause of the Illinois Constitution,²⁵ which states that, “[i]n any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subject and objects within each class shall be taxed uniformly.”²⁶ Under established precedent, in order to survive scrutiny under the uniformity clause, a non-property tax classification must be based on a real and substantial difference between the people taxed and those not taxed, and bear some reasonable relationship to the object of the legislation or to public policy.²⁷ Because Grand Chapter did not dispute the absence of a real and

17. *Id.*

18. *Id.*

19. *See* 305 ILL. COMP. STAT. 5/5B-8 (2012) (creating the Long-Term Care Provider Fund); *see also id.* at 5/5E-10 (mandating that “[a]ll fees received by the Illinois Department under [the bed tax] shall be deposited into the Long-Term Care Provider Fund”).

20. *Grand Chapter*, 25 N.E.3d at 623.

21. *Id.*; *see* 305 ILL. COMP. STAT. 5/5E-10 (classifying the object of the bed tax as “every nursing home”).

22. *Grand Chapter*, 25 N.E.3d at 623.

23. *Id.*

24. *Id.*

25. *Id.*

26. *See* ILL. CONST. art. IX, § 2 (quoting the relevant language of the uniformity clause).

27. *See* *Arangold Corp. v. Zehnder*, 787 N.E.2d 786, 793 (Ill. 2003) (detailing the burden of proof applicable when upholding a tax classification under the uniformity clause).

substantial difference between people taxed and not taxed, the circuit court evaluated each party's argument with regards to the second requirement: whether "every nursing home" bears some reasonable relationship to the object of the legislation or public policy.²⁸ According to the circuit court, the Long-Term Care Provider Fund is not used for general administrative purposes or paying any expenses that Eastern Star precipitated.²⁹ As a result, the circuit court held that the sole purpose of the bed tax is to provide for Medicaid reimbursement, which does not bear a reasonable relationship to Eastern Star because the organization operates on a considerable deficit and does not use any Medicaid funds.³⁰ Because the circuit court's order invalidated a state statute, the appeal was sent directly to the Illinois Supreme Court.³¹

The supreme court reversed the circuit court's judgment in a unanimous decision.³² Writing for the supreme court, Justice Thomas found two fatal flaws in the argument advanced by the lower court.³³ First, Justice Thomas noted that the bed tax's purpose is not solely limited to funding Medicaid-related costs.³⁴ Rather, he stressed that the Long-Term Care Provider Fund pays for the administrative expenses of the Department and its agents.³⁵ Moreover, that same fund provides financial support for the enforcement of Illinois' nursing home standards, the expansion of home- and community-based services, the support of a nursing home ombudsman program, and the funding of Illinois' General Obligation Bond Retirement and Interest Fund.³⁶ Taking the statutory language into account, Justice Thomas concluded that revenue from the bed tax has a much broader purpose than simply funding the Medicaid program.³⁷ As a result, the supreme court determined that the purpose of the nursing home bed tax are more expansive than did the circuit court.

The second fatal flaw that Justice Thomas highlighted was the conclusion that a taxpayer cannot be required to pay a tax for which he or she "receives no direct, reciprocal, and proportionate benefit."³⁸ The

28. *Grand Chapter*, 25 N.E.3d at 624.

29. *Id.*

30. *Id.*

31. ILL. S. CT. R. 302(a)(1).

32. *Grand Chapter*, 25 N.E.3d at 627.

33. *Id.* at 624.

34. *Id.*

35. *Id.* at 624–25; see 305 ILL. COMP. STAT. 5/5B-8 (2012) (outlining proper disbursements from the Long-Term Care Provider Fund).

36. 305 ILL. COMP. STAT. 5/5B-8.

37. *Grand Chapter*, 25 N.E.3d at 625.

38. *Id.*

circuit court argued that a taxpayer could not be forced to pay a tax that exists to fund a benefit that the taxpayer does not receive, or fix a problem that the taxpayer did not cause.³⁹ However, Justice Thomas pointed out that the supreme court has never mandated equal reciprocity between the payment of a tax and the benefit the taxpayer receives.⁴⁰ In fact, Justice Thomas cited precedent, which held that “[n]othing is more familiar in taxation than the imposition of a tax upon a class or upon individuals who enjoy no direct benefit from its expenditure, and who are not responsible for the condition to be remedied.”⁴¹ From such precedent the supreme court has affirmed time and again that a tax may be enforced on a class, even when the class does not derive a benefit from it.⁴² Justice Thomas emphasized that the uniformity clause does not require perfect reciprocity between the payment and benefit, but rather only that the taxing classification bears some reasonable relationship to the object or purpose of the tax.⁴³

With these two fatal flaws identified, Justice Thomas addressed the taxing classification at issue: whether “every nursing home” bears some reasonable relationship to the object of the legislation or public policy.⁴⁴ Contrary to the circuit court’s decision, the supreme court held that it does. Because the object of the bed tax is not solely Medicaid reimbursement, but rather several purposes that the Long-Term Care Provider Fund is meant to address, the supreme court concluded that the circuit court’s reasoning fell short.

Justice Thomas then addressed whether there is a reasonable relationship between the collection of the bed tax from every nursing home, including Eastern Star, and Illinois’s need to financially support the obligations of the Long-Term Care Provider Fund.⁴⁵ He stated that such a relationship clearly exists.⁴⁶ First, Justice Thomas noted that every nursing home is licensed pursuant to various permits issued by the Department, which receives approximately \$2 million from the Long-Term Care Provider fund annually.⁴⁷ Second, he pointed out that every nursing home in Illinois operates within an industry whose oversight

39. *Id.*

40. *Id.*

41. *Arangold Corp. v. Zehnder*, 787 N.E.2d 786, 792 (Ill. 2003) (quoting *Carmichael v. S. Coal & Coke Co.*, 301 U.S. 495, 521–22 (1937)).

42. *See Empress Casino Joliet Corp. v. Giannoulis*, 896 N.E.2d 277, 285–86 (Ill. 2008) (“[A] tax may imposed upon a class even though the class enjoys no benefit from the tax.”).

43. *Grand Chapter*, 25 N.E.3d at 625.

44. *Id.* at 626.

45. *Id.*

46. *Id.*

47. *Id.*

and enforcement of regulations is partially financed by the Long-Term Care Provider Fund.⁴⁸ Lastly, Justice Thomas stated that every nursing home benefits or has an interest in ensuring that Illinois's bond obligations remain funded, and the bed tax revenue that is deposited into the Long-Term Care Provider fund can be used for such a purpose.⁴⁹ Therefore, Justice Thomas concluded that the collection of the bed tax is constitutional under the uniformity clause, thereby reversing the circuit court's decision.⁵⁰

However, even after reaching the supreme court's holding, Justice Thomas commented on the nature of the bed tax, stating "the mere fact that a tax is permissible does not necessarily mean it is wise."⁵¹ Justice Thomas recognized the charitable work that Eastern Star provides by furnishing private nursing home care, often to low-income citizens at rates considerably below market value, resulting in substantial financial loss.⁵² Furthermore, Justice Thomas underscored the fact that Eastern Star's business plan alleviated the burden on the Illinois Medicaid system.⁵³ Taking this into account, Justice Thomas urged the Illinois legislature to reevaluate the bed tax and to reconsider whether charitable organizations, like Eastern Star, should be included in the taxing classification.⁵⁴ Justice Thomas reminded the legislature that "[e]xemption to charitable, educational and religious organizations is bottomed upon the fact that they render service to the State, for which reason they are relieved of certain burdens of taxation."⁵⁵ Because Eastern Star's particular operation is assisting both low-income individuals and Illinois taxpayers, Justice Thomas recommended that the Illinois legislature consider relieving Eastern Star and similar organizations from such burdens of taxation.⁵⁶

Despite the supreme court's strong urgings that the Illinois legislature amend the enforcement of the Nursing Home Licensing Fee so that non-profit nursing homes like Eastern Star are exempt from the bed tax, *Grand Chapter* ultimately demonstrates that non-profit nursing homes will not find relief in the judicial system. Rather, their remedy, if any,

48. *Id.* at 626–27; see 305 ILL. COMP. STAT. 5/5B-8 (2012) (detailing the allowable disbursements of the Long-Term Care Provider Fund).

49. *Grand Chapter*, 25 N.E.3d at 627.

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.* (quoting *In re Estate of Schureman*, 133 N.E.2d 7, 11 (Ill. 1956)).

56. *Id.*

will be had through legislation or regulation.

In the past, such legislative efforts have proven unsuccessful. For instance, in 2012, the federal government approved Illinois' nursing home bed tax increase, which raised the bed tax by \$6.07 per resident per day.⁵⁷ While the Illinois government claimed that much of the tax would be returned to the nursing homes through the Medicaid program, non-profit nursing homes that typically serve few or no Medicaid clients spoke out against the increase.⁵⁸ Although non-profit nursing home stakeholders voiced their criticisms, the increase remained.

Grand Chapter could also potentially have consequences beyond requiring Illinois non-profit nursing homes to pay the bed tax. In reaching his conclusion, Justice Thomas noted that no person paying tax is guaranteed a benefit, though there must be some relation between what is paid and what is received.⁵⁹ There is thus potential that the Court's holding in *Grand Chapter* could extend beyond the bed tax realm.

57. Kevin Kolus, *In Face of Fiscal Meltdown, Illinois Funds Nursing Home Safety*, LONG-TERM LIVING (Jan. 30, 2012), <http://www.ltlmagazine.com/blogs/kevin-kolus/face-fiscal-meltdown-illinois-funds-nursing-home-safety>.

58. *Id.*

59. *Grand Chapter*, 25 N.E.3d at 625.