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Legislative Note

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LEGISLATIVE NOTE

PUBLIC ACT 78-1250: IS THE ATTEMPTED EXEMPTION VALID

Taxation of personal property has long been a source of frustration for both the government and the taxpayer. This article deals with a possible problem in the most recent attempt of the General Assembly to further reduce the ad valorem taxation of personal property. As will be evident later, this action by the General Assembly is certain to produce litigation on the validity of exempting trustees and other fiduciaries within the limited context of the act without a provision for replacing the revenue lost. This article attempts to examine problem areas of the legislation and present a plausible and persuasive case for holding the act to be a clarification of prior legislation and not a totally new exemption. In order to fully understand the distinction drawn and the act's vulnerability to attack without a revenue replacement provision, it is mandatory to review the General Assembly's past efforts to exempt certain property from taxation and the court's construction of those attempts.

PUBLIC ACT 78-1250

By letter dated September 7, 1974, Governor Daniel Walker allowed House Bill 2049 to become law without his signature.¹ Although it is relatively short in length, H.B. 2049 is certain to produce litigation as to its validity under the 1970 Illinois Constitution.

H.B. 2049 enacted as Public Act 78-1250 adds a new exemption to the steadily decreasing personal property tax. The Act amends Chapter 120 by adding paragraph 500.21b which exempts property held "by a trustee, guardian, conservator, executor, administrator or other fiduciary to the extent held for the exclusive benefit of a natural person." This amendment was apparently brought about by the Illinois Supreme Court's interpretation of Article IX-A of the 1870 Illinois Constitution, which was adopted by referendum in November of 1970. Prior to the adoption of article IX-A, all personal property owned by individuals within the state was taxed. Each household was given an exemption for their household furnishings and one automobile.²

1. This method of approving legislation is provided for pursuant to article IV, section 9(b) of the Illinois Constitution of 1970. It has been little used by the current Governor.

2. ILL. REV. STAT. ch. 120, § 499 (1939).

Chapter 120 §§ 528, et. seq., requires the taxpayer to inventory his non-exempt personal property each year. This inventory is to be filed with the local assessor between April 1 and June 1 each year. After the inventory is filed, the assessor is then required to assess the value of the property and enter that assessment upon his records. The assessor must then deliver the books to the local collector, either a town collector or in his absence the county collector, who then issues the tax bills. A taxpayer, if he objects to the assessment, must proceed to pay the tax under protest. Notice of payment under protest is given to the collector. Thereafter the taxpayer must file a petition with the circuit court of the county where the payment was made naming as defendants the collector and other related local officials. Thereafter, the hearing proceeds as in other civil hearings and judgment rendered accordingly.

ARTICLE IX-A OF THE 1870 ILLINOIS CONSTITUTION

Article IX-A of the 1870 Illinois Constitution, adopted in November of 1970, prohibited the taxation of personal property by valuation as to individuals. Appearing on the referendum ballot with the proposal was a brief explanation of the intent of the proposal. That explanation stated: "The amendment would abolish the personal property tax by valuation levied against individuals. It would not affect the same tax levied against corporations and other entities not considered in law to be individuals."³

Prior to submission of the amendment to referendum, both the House and Senate set forth their intent as to the meaning of the word "individuals." Their expressed feeling was that

[I]t was the intention of the General Assembly to abolish the *ad valorem* taxation of personal property owned by a natural person or two or more natural persons, and that by the use of the phrase 'as to individuals' this General Assembly intended to mean a natural person, or two or more natural persons as joint tenants or tenants in common.⁴

The validity of article IX-A was put in question in *Lake Shore Auto-Parts v. Korzen*.⁵ The plaintiffs in that case sought to have the amendment set aside on fourteenth amendment equal protection grounds. The Illinois Supreme Court was called upon to first decide the meaning of the word "individual" and then to decide the equal protection question. Through a review of both the explanation of the amendment printed on the ballot and Senate Joint Resolution No. 67, the court found that the amendment applied to natural persons either individually or as tenants in common or joint tenants.⁶

3. Senate Journal, May 29, 1970, p. 149. The amendment itself read:
[N]otwithstanding any other provision of this Constitution, the taxation of personal property by valuation is prohibited as to individuals.

4. S.J. No. 67, Senate Journal May 29, 1970, p. 149.

5. *Lake Shore Auto Parts v. Korzen*, 49 Ill. 2d 137, 373 N.E.2d 592 (1971).

6. *Id.* at 148, 373 N.E.2d at 597.

So finding, the court proceeded in its review of article IX-A to determine whether or not the discrimination that resulted from its enactment was valid. The test formulated by the court was one based upon a rational differentiation or classification of similar situations in the promotion of a valid state policy. Two threshold questions were therefore raised. Was the differentiation between personal property of natural persons and "non-natural" persons rational? Once that was determined, was that differentiation furthering a permissible state policy?⁷

In answering the first question, the court found that the amendment classified property not according to its characteristics or its use, but solely according to its ownership.⁸ As such, the court felt that, absent a clear purpose behind the classification, the amendment was arbitrary. The court, in seeking to find such a purpose, found that any argument raised as to the effectiveness and uniformity of enforcement of the tax could be equally raised with respect to property owned by individuals or other non-individuals. Additionally, the court found that the only apparent desire of the General Assembly was to free one set of taxpayers from the personal property tax.⁹ That desire, absent a rational relationship to the measure taken, was not sufficient to pass the requirements of the fourteenth amendment.

On further appeal, the United States Supreme Court reversed the finding of discrimination and remanded the cause to the Illinois Supreme Court.¹⁰ On remand, the Illinois Supreme Court, in extrapolating on the areas still subject to the tax, stated that "trustees and other fiduciaries, whether corporate or not, do not own property as natural persons, and they were not exempted from taxation by article IX-A."¹¹ Therefore article IX-A of the 1870 Illinois Constitution, through judicial construction has been held not to exempt "trustees and other fiduciaries." Article IX, section 5(b) of the Illinois Constitution of 1970 provides that any ad valorem personal property tax abolished on or before its effective date shall not be reinstated.

ARTICLE IX, SECTION 5(C) OF THE 1970 ILLINOIS CONSTITUTION

Article IX, section 5(c) of the Illinois Constitution of 1970 provides:

7. *Id.* at 150, 373 N.E.2d at 599.

8. *Id.* at 151, 373 N.E.2d at 599.

9. *Id.*

10. *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356 (1973). In reversing the Illinois Supreme Court, the Court examined a long line of cases dealing with the permissible limits of state discrimination in its taxing power. The primary reason for reversal was the failure of the plaintiff's to overcome the presumption of reasonableness of Article IX-A. Indeed, the court felt that the state had established a "rational relation to a state policy by a showing of the lack of uniformity of enforcement of the tax as to persons. At the same time, the Court noted, the enforcement of the taxes as to corporations was nearly uniform.

11. *Lake Shore Auto Parts v. Korzen*, 54 Ill. 2d 237, 239, 296 N.E.2d 324, 343 (1973).

On or before January 1, 1979, the General Assembly by law shall abolish all *ad valorem* personal property taxes and concurrently therewith and thereafter shall replace all revenue lost by units of local government and school districts as a result of the abolition of *ad valorem* personal property taxes subsequent to January 2, 1971.

The Illinois Supreme Court has considered this provision in *Elk Grove Engineering v. Korzen*.¹² The Court had before it for the first time the question of the construction of article IX, section 5. The act in question in *Elk Grove* had attempted to exempt from taxation all personal property of a person used entirely for farm purposes. Article IX, section 5, provides the enabling power for the General Assembly to tax personal property. Section 5(a) provides for the classification of property by valuation. It also empowers the General Assembly to abolish the tax on any or all property and to levy taxes in lieu of the personal property tax. It was argued by the defendants that the classification of the property was by its use, not its ownership.¹³ Section 5(c), they argued, referred to classes of ownership, while section 5(a) referred to classes of use.¹⁴ Therefore, since the exemption was based on the class of use, the mandate of revenue replacement did not apply.

Plaintiff on appeal argued that the question of whether section 5(a) or 5(c) was binding was best determined by looking to the constitutional convention. Upon examination, they argued that the convention, when it used the term "classes", meant classes of taxpayers.¹⁵ So that under either 5(a) or 5(c), the term refers to the taxpayer and not necessarily to the use to which he puts the property.¹⁶

Agreeing with that contention, the court determined that 5(c) included 5(a). 5(a), the court found, provided only the authority for the legislature to value, assess and abolish taxation on personal property.¹⁷ 5(c) limited the procedure by which the legislature could abolish *ad valorem* taxation and also mandated the abolition. The mandate, therefore, is two fold: abolish by 1979 and replace when abolishing.

At issue in the *Elk Grove* case was whether or not an exemption or deduction was equivalent to an abolition so as to bring the measure under the provision. The court, stating first that an exemption or deduction has the same practical effect as an abolition, ruled that exemptions granted to individuals and deductions given to reduce property values both come under the provision.¹⁸ Therefore any such exemption or deduction, if enacted sub-

12. 55 Ill. 2d 393, 304 N.E.2d 65 (1973).

13. *Id.* at 397, 304 N.E.2d at 70.

14. *Id.*

15. *Id.* at 399, 304 N.E.2d at 71.

16. *Id.*

17. *Id.* at 406, 304 N.E.2d at 72.

18. *Id.* at 406, 304 N.E.2d at 72.

sequent to the effective date of article IX, section 5(c), must be accompanied by a replacement tax on the class thereby exempted.¹⁹

PUBLIC ACT 1250 DISTINGUISHED

Elk Grove coupled with *Lake Shore Auto Parts* therefore creates a dilemma for the courts in construing Public Act 1250 and for trustees and other fiduciaries in performing their duties. The Act appears to be an attempt by the General Assembly to clarify its intent in drafting and submitting article IX-A to the voters. The Illinois Supreme Court, in interpreting that provision, has excluded trustees and other fiduciaries from article IX-A. In enacting Public Act 1250 the General Assembly is attempting to place them within the prohibition. The question that surely will arise is whether or not their attempt is an abolition of the personal property tax on a class of people other than that covered by article IX-A. Under *Elk Grove*, that interpretation could easily be justified.

Like *Elk Grove*, it could reasonably be argued that the attempted exemption is an abolition of the personal property tax on a class of people subsequent to the effective date of the 1970 constitution. The act involved in *Elk Grove* attempted substantially the same thing. Since both acts have effective dates subsequent to the effective date of the 1970 constitution, *Elk Grove* would seem to require that P.A. 1250 be ruled unconstitutional. Under such an interpretation trustees and other fiduciaries would still be subject to the personal property tax on property they hold in their respective capacities.

A persuasive case could also be made to hold the Act to be a clarification. In his dissent to *Lake Shore Auto Parts*,²⁰ Justice Goldenhersh presents two situations which provide a sound basis for holding P.A. 1250 to be a clarification. First, the use of trustees, long held to be a valid and effective way to dispose of property, would be curtailed. Property, while exempt when held by an individual, would be subject to tax on transfer to a trustee, even though the beneficial interest remained in the individual owner.²¹ The second situation that proves troublesome to Justice Goldenhersh is that of decedents' estates. While the testator lives, the property is not taxable. Once letters of administration issue, it would be taxable. Upon distribution it would again be exempted.²² Again, no rational basis exists for the non-exemption. The use of the property remains the same.

With a rational basis for exempting trustees and other fiduciaries from the personal property tax within the limited context of the Act, it would ap-

19. *Id.*

20. 54 Ill. 2d 237, 239, 296 N.E.2d 324, 343 (1973).

21. *Id.*

22. *Id.* at 240, 296 N.E.2d at 343.

pear that the court could distinguish *Elk Grove* from a case challenging P.A. 1250. The exemptions and deductions challenged in *Elk Grove* were not directly tied to the Revenue Act prior to the effective date of the 1970 constitution. Instead, they were attempts to create new exemptions and deductions not previously considered. P.A. 1250 does not suffer that defect. Instead, it is tied directly to the adoption of article IX-A and the interpretation given to it by the court in *Lake Shore Auto Parts*.

The court, in construing the Act, should give great weight to this distinction. Absent the adoption of article IX, section 5(c), there would be no question of the Act's validity. By considering the fact that the Act appears to be in direct response to *Lake Shore Auto Parts*' holding, the court should give less weight to the fact that the effective date of the legislation is subsequent to the 1970 Constitution. Instead, it should focus its concern on the rationale of having trustees and other fiduciaries exempted. In so viewing the Act, it would appear that article IX, section 5(c) is inapplicable.

In *Secco v. Chicago Transit Authority*,²³ Justice Robson speaking for a unanimous court said: "Our courts have held that if the language of a statute admits of two constructions, one of which makes the enactment mischievous, if not absurd, and the other renders it reasonable and wholesome, the construction leading to an absurd result should be avoided." Such a construction is appropriate here. Additionally, in a report sent to registered voters before the referendum on article IX-A, the legislature said that they believed "That personal property which is owned by or held in a fiduciary capacity for the benefit of natural persons is exempted from taxes."²⁴ The court in *Lake Shore Auto Parts* ignored that belief.

CONCLUSION

The validity of Public Act 1250 will certainly be put before the court. While *Elk Grove* would seem to require that the court invalidate the Act, for the reasons given, this writer believes that a case under the Act could be easily distinguished. The court, when put to the test, must ultimately balance the harm done by not exempting trustees and other fiduciaries against the lost revenue caused by the exemption. In striking that balance, the court should pay close attention to Justice Goldenhersh's dissent.

C. RONALD COOK

23. 2 Ill. App. 2d 239, 246, 119 N.E.2d 471, 475 (1954).

24. Letter from Daniel Walker to the Members of the House of Representatives, 78th General Assembly, September 7, 1974.

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