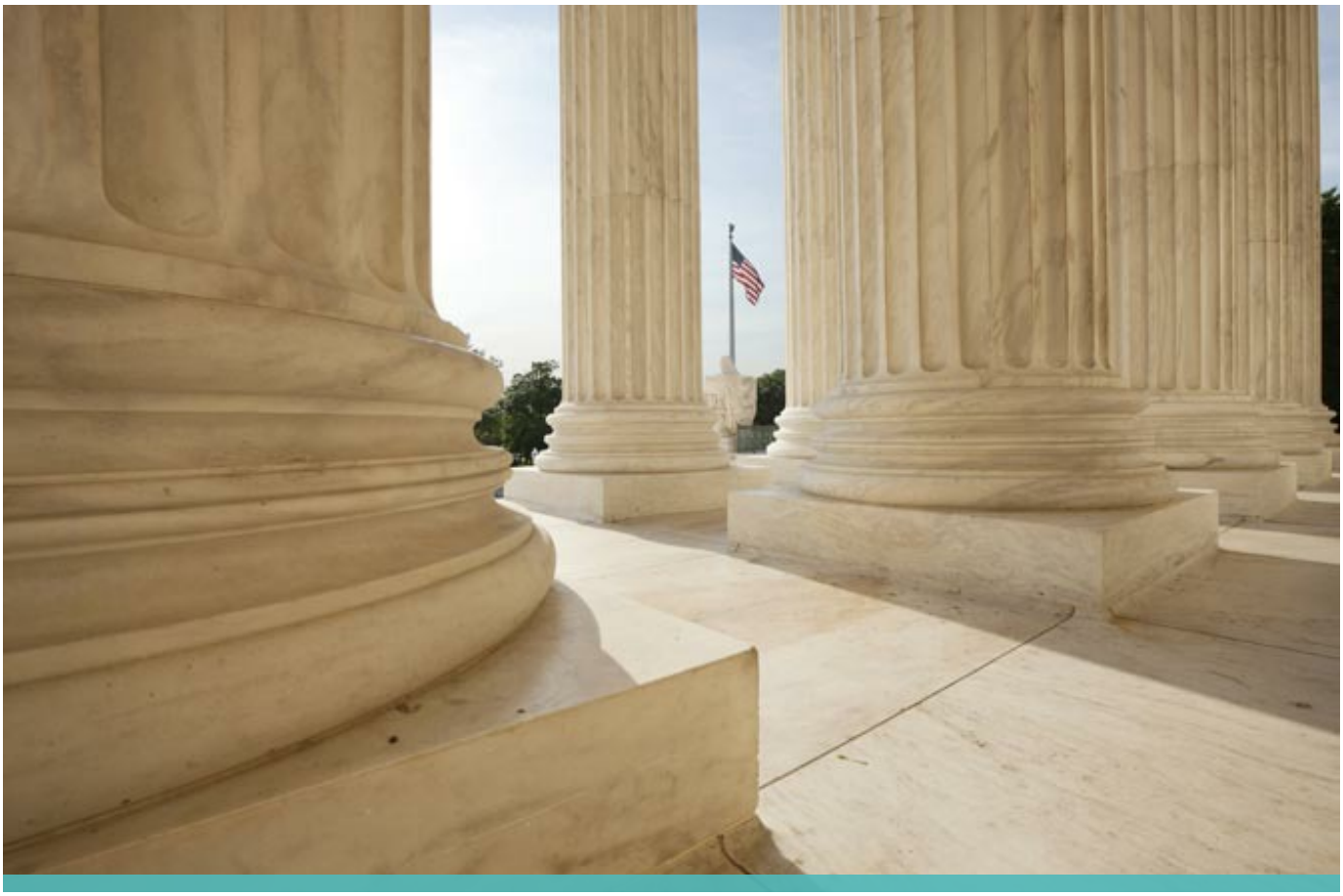
Illinois: State Supreme Court determines that Chicago's tax on suburban car rentals is unconstitutional



David M. Kall | Thursday, February 2, 2017

In the case *The Hertz Corporation v. The City of Chicago*, the Illinois Supreme Court reversed the lower court's conclusion, thus holding that the Personal Property Lease Transaction Tax that the Windy City imposes on suburban vehicle rental agencies located within three miles of Chicago's borders is unconstitutional.

Background

In May 2011, 0fficials issued Ruling 11, which established that as of July 1, 2011, Chicago's Department of Revenue (Department) would hold suburban rental agencies responsible for paying the Personal Property Lease Transaction Tax, in the absence of written proof that the lessee was exempt from paying the tax. Exemption was available if the lessee used the vehicle outside the City of Chicago. Without written proof, the default assumption was that a customer who is a resident of Chicago would be driving the vehicle there, and that a non-resident lessee would be using the vehicle outside of the city.

Ruling 11, an amendment to a 1992 ordinance, applied the tax to car rental companies specifically, whereas the original ordinance levied a tax on the general lease, rental or privilege of personal property in Chicago. The ordinance imposed the tax obligation on the lessee of the property.

Ruling 11 addressed other related matters as well, such as conditions upon which audits would occur, notification lead times, and a safe harbor provision for suburban rental companies in lieu of maintaining records.

When Ruling 11 took effect, Enterprise Leasing Company of Chicago (Enterprise) requested guidance from the Department as to whether its current lease agreement, which advised renters that they would be obligated to pay the city tax if they used the vehicle primarily in Chicago, was sufficient to provide an exemption from the tax. The Department's response was that the language was not sufficient to satisfy exemption, because the lease agreement did not require a renter to expressly inform Enterprise whether he intended to use the car primarily in Chicago.

The lawsuit

In two separately filed lawsuits, Enterprise and the Hertz Corporation (Hertz) sued the City of Chicago and the City comptroller. Both plaintiffs sought a declaration that the tax violated various clauses in the state and federal constitutions, including due process and commerce clause violations, and an injunction to prevent Chicago from enforcing the tax obligation. The court consolidated the suits and granted summary judgment in the plaintiffs' favor, agreeing that Ruling 11 violated due process and commerce clause, and that it violated the Illinois Constitution's home rule provision, because it was an exercise of improper extraterritorial taxing authority. This stemmed from the fact that the lease transaction takes beyond the city of Chicago's borders.

The appellate court reversed the circuit court's holding, so plaintiffs took their case to the state's high court.

In the Illinois Supreme Court

The Supreme Court first considered the home rule argument, which permits a "home rule unit" to exercise "any power and perform any function pertaining to its government and affairs including, but not limited to, the power to regulate for the protection of the public health, safety, morals and welfare; to license; to tax; and to incur debt." However, the court noted that home rule authority is not unlimited, pointing to previous case law determining that home rule units may not extend their home rule powers, such as the taxing power, beyond their borders unless expressly authorized by the General Assembly.

The plaintiffs supported their position with the following:

- The lease transactions at issue occur entirely outside the borders of Chicago;
- The lease is negotiated and signed outside of Chicago; and
- The leased vehicle is delivered to the customer outside of Chicago.

For these reasons, the plaintiffs asserted, Ruling 11 unlawfully requires them to act as the City's tax collectors when no part of the rental transaction occurs within Chicago. On the other hand, the City contended that the tax is one on the privilege of using property in Chicago; once that tax is paid, taxpayer is entitled to use the property an unlimited number of times within the taxing jurisdiction.

The Supreme Court rejected the City's claims, underscoring the crux of the issue:

> "[W]hether Chicago improperly extended its home rule power to tax beyond its borders by requiring plaintiffs to collect the tax from vehicle lessees who state their intention to use the vehicle at least 50 [percent] of the time in Chicago."

Declaring that it does not matter whether the taxed commodity is services or personal property usage, the Court answered this question affirmatively. It observed that tax is imposed on a renter's stated intent as to future use, or absent a statement of intent, on a presumption of use based on Chicago residency. That conclusive presumption of taxability based on residency has nothing to do with use of the rental vehicles, because there is no evidence of where the lessee actually drove the vehicle. Without an actual connection to Chicago, the tax under Ruling 11 amounts to one on transactions that take place wholly outside the city's borders. Because the Illinois Constitution limits the extraterritorial exercise of home rule powers to those enacted by the legislature, Ruling 11 exceeds the scope of Chicago's home rule authority, and is therefore an improper exercise of its home rule powers.

In light of this holding, the court did not address the other arguments.

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Team member bio