

## A Presumption of Taxability Cannot Save an Extraterritorial Tax

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In this article, the authors discuss the Illinois Supreme Court's decision in *Hertz Corp. v. City of Chicago*, in which the court held that Chicago's ruling on the property lease transaction tax was simply extraterritorial overreach by the city. The decision, the authors write, reiterates that only by state legislation can a home rule municipality in Illinois apply its taxing powers beyond its borders.

### Introduction

Like many states, Illinois has a constitutional prohibition on extraterritorial municipal taxation.<sup>1</sup> This means that municipalities in Illinois cannot extend their taxing powers outside their borders without specific state legislative approval. This restriction on extraterritorial exercises of municipal taxing power includes taxes imposed by home rule

<sup>1</sup> *Commercial National Bank of Chicago v. City of Chicago*, 89 Ill. 2d 45 (1982).

municipalities in Illinois,<sup>2</sup> including Chicago.<sup>3</sup> Although this has been long-standing law, the Illinois Supreme Court recently had to address this issue again in a case involving whether Chicago could extend its taxing powers to short-term vehicle rental transactions occurring 2 miles beyond its corporate borders. In *Hertz Corp. v. City of Chicago*,<sup>4</sup> the tax at issue was Chicago's personal property lease transaction tax. The city applied this tax to vehicle rentals occurring within 3 miles of the city when a Chicago resident rented the vehicle. This extraterritorial extension of the city's taxing jurisdiction was based on a presumption created by Personal Property Lease Transaction Tax Second Amended Ruling 11 (Ruling 11), an administrative ruling promulgated by the city's director of revenue. Under Ruling 11, a person with a Chicago address on his driver's license who rented a vehicle in the city's suburbs would be presumed to use the vehicle at least 50 percent of the time in the city. Thus, these rentals were deemed taxable in the city unless the lessor could prove such city use did not occur. The circuit court found the ruling unconstitutional as an extraterritorial extension of the tax under the Illinois Constitution, as well as exceeding the scope of the lease transaction tax ordinance and violating the due process and commerce clauses of the U.S. Constitution.<sup>5</sup> However, the appellate court reversed the decision, finding the city's actions allowable under the law.

<sup>2</sup> A home rule municipality is a municipality in Illinois that has been granted broad powers over its own government and affairs, including broad taxing powers, under the Illinois Constitution. Ill. Const. 1970, Article VII, section 6(a).

<sup>3</sup> This extraterritorial restriction on taxing power is similar to the U.S. Constitution's due process and commerce clauses restrictions on extraterritorial taxation. See, e.g., *American Oil Co. v. Neil*, 380 U.S. 451 (1965); *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977); and *MeadWestvaco Corp. v. Illinois Department of Revenue*, 533 U.S. 16 (2008).

<sup>4</sup> 2017 IL 119945.

<sup>5</sup> *Hertz Corp. v. City of Chicago*, 2017 IL 119945.

The Illinois Supreme Court unanimously reversed the appellate court's decision, holding that Ruling 11 violated the Illinois Constitution because of its extraterritorial effect.<sup>6</sup> In doing so, the supreme court rejected the idea that the presumption of taxability created by Ruling 11 somehow gave the city the extraterritorial power to regulate and tax a lease transaction occurring outside its borders.<sup>7</sup> In other words, *Hertz* plainly stands for the proposition that an administrative presumption of future taxability cannot save an extraterritorial tax.

### Illinois's Prohibition on the Exercise of Extraterritorial Municipal Jurisdiction

The Illinois Constitution allows a home rule unit to exercise "any power and perform any function pertaining to its government affairs including [. . .] the power to [. . .] tax."<sup>8</sup> Yet while this grants broad taxing powers to a home rule municipality, Illinois courts have made it clear that it also restricts that power to matters within the home rule municipality's corporate boundaries and does not grant extraterritorial jurisdiction to a home rule municipality.<sup>9</sup> "It is now axiomatic that home rule units like defendant have no jurisdiction beyond their corporate limits except what is expressly granted by the legislature."<sup>10</sup>

Notably, the limits on extending municipal power beyond its borders have been well established by the Illinois Supreme Court for over 150 years. In *Strauss v. Town of Pontiac*,<sup>11</sup> Pontiac attempted to prohibit the sale of spirits and beer within a 3-mile extension of the town's borders.

<sup>6</sup> *Id.*

<sup>7</sup> The Illinois Supreme Court did not address the due process or commerce clause arguments because it held that Ruling 11 violated the extraterritorial limitations provision of the Illinois Constitution and therefore did not have to address those issues.

<sup>8</sup> Ill. Const. 1970, Article IV, section 6(a).

<sup>9</sup> *City of Carbondale v. Van Natta*, 61 Ill. 2d 483, 485 (1975) (Article VII, section 6(a) does not "confer extraterritorial sovereign or governmental powers" on a home rule unit); and *Harris Bank of Roselle v. Village of Mettawa*, 243 Ill. App. 3d 103, 117 (1993) ("If a municipality wishes to enact and enforce extraterritorial regulations, it must act under the color of a specific, express grant of statutory authority").

<sup>10</sup> *Seigles Inc. v. City of St. Charles*, 365 Ill. App. 3d 431, 434 (2006); see also *Village of Orland Hills v. Citizens Utility Co. of Illinois*, 347 Ill. App. 3d 504, 520 (2004) ("A municipality, whether home rule or non-home-rule, may exercise authority outside its boundaries only when the state legislature grants it such authority").

<sup>11</sup> 40 Ill. 301 (1866).

The *Strauss* court invalidated this attempt to regulate such extraterritorial activities, holding, "We are not able to find in [the state charter] any authority to pass that portion of the ordinance which forbids the sale of spirits or beer outside the corporate limits and within three miles thereof." It added that "it cannot be contended that a town can give its ordinances an extraterritorial effect except so far as it may be clearly authorized to do so by the legislature."<sup>12</sup> Almost a century later, in

*Dean Milk Co. v. City of Elgin*,<sup>13</sup> the supreme court continued applying this prohibition on extraterritorial municipal power by holding that the city of Chicago's attempted regulation of a milk plant located outside the city because the plant sold to persons within the city was an improper extraterritorial exercise of municipal power.

Similarly, regarding municipal home rule taxation, in 1982 the supreme court struck down the extraterritorial imposition of a tax by a home rule municipality. In *Commercial National Bank of Chicago v. City of Chicago*,<sup>14</sup> the court considered the constitutionality of Chicago's home rule service tax ordinance that imposed a tax on a purchaser who purchased services outside the city but used the services in the city at a rate of 1 percent of the purchase price of the service. The service tax ordinance required the collection of the tax by the non-Chicago seller on the sale of a service outside the city if the use of the service (as defined in the ordinance) occurred in the city.<sup>15</sup> The crucial question raised in *Commercial National Bank* was whether a non-Chicago seller that engaged in business in the city on other sales could be forced to collect this service tax on these non-city sales of services when no part of the service or transaction occurred in Chicago. In that case, the supreme court unanimously held that the city did not have the extraterritorial taxing power to impose tax collection responsibilities on the non-city seller. In doing so, the court found that the tax was "a clear attempt by the city of

<sup>12</sup> *Id.* at 302.

<sup>13</sup> 405 Ill. 204, 207-08 (1950).

<sup>14</sup> 89 Ill. 2d 45 (1982).

<sup>15</sup> *Id.*

Chicago to give extraterritorial effect to its ordinance and to tax services that have no connection with the taxing city.”<sup>16</sup> The court explained, “In our judgment, Chicago’s imposition of tax liability or tax-collection duties upon nonresident purchasers and sellers of services performed outside the city is incompatible with the intent of the drafters of our constitution as determined in *Van Natta*.”<sup>17</sup>

Simply put, the *Commercial National Bank* court held that forcing a non-Chicago seller to collect the service tax even when no part of the transaction or activities by the seller regarding the service occurred in the city had violated Article VII, section 6(a) of the Illinois Constitution by giving the tax an extraterritorial effect.<sup>18</sup> A “home rule municipality is prohibited from forcing sellers to collect taxes that are not rendered and nor performed within that municipality’s borders”<sup>19</sup> since “home rule units [like Chicago] do not possess extraterritorial governmental powers.”<sup>20</sup>

More recently, in *Seigles v. City of St. Charles*,<sup>21</sup> another extraterritorial home rule municipal sales tax was struck down, this time by the appellate court. In *Seigles*, the city of St. Charles assessed a lumber sales tax against lumberyard owners in St. Charles by imposing the sales tax on the sale of lumber “distributed from a location within” St. Charles.<sup>22</sup> The tax was therefore imposed on sales that occurred at Seigles’s sales office outside St. Charles, in Hampshire, Illinois, when the lumber was delivered from the Seigles lumberyard in St. Charles. Even if the lumber was sold outside St. Charles and delivered to customers outside St. Charles, the tax was applied to the sale.

St. Charles argued that its lumber sales tax was proper because it applied to the distribution of lumber from the city rather than the sales of lumber in Hampshire. Seigles challenged that the tax as an extraterritorial tax on its sales occurring

from its Hampshire office. The appellate court, citing *Commercial National Bank*, found that the tax was keyed to sales and that because the tax was on sales occurring outside St. Charles and was based on the sales price of such lumber sold outside St. Charles, it had an extraterritorial effect. As a result, the court held that the tax violated the extraterritorial restrictions on home rule taxing power under the Illinois Constitution.<sup>23</sup>

### Hertz Background

The city of Chicago, the defendant in *Hertz*, possesses broad home rule taxing powers under the Illinois Constitution. Under this power, the city has for decades imposed a lease transaction tax on leases or rentals of personal property occurring in the city and on the privilege of using personal property in the city that was leased or rented outside the city.<sup>24</sup> This tax obligation is on the lessee of the property, and under the tax ordinance, the lease or rental is deemed to take place at the location where possession or delivery of the property in question occurs.<sup>25</sup> Notably, a lessee is exempt from the lease transaction tax if more than 50 percent of the use of the property occurs outside the city.<sup>26</sup> A lessor must collect the tax from the lessee on taxable lease transactions and is subject to the tax’s regulatory requirements and penalty provisions.<sup>27</sup> If the lessor fails to collect the lease transaction tax due, the lessee must file a return and pay the tax due directly to the city.

The plaintiffs — Hertz Corp. and Enterprise Leasing Co. of Chicago — rent vehicles for short-term periods at car rental locations both in Chicago and the city’s suburbs throughout northeastern Illinois and northwest Indiana to city and non-city residents. The rental transactions take place where the rental agreements are consummated by the parties and transfers of vehicles to the lessees occur.<sup>28</sup> The plaintiffs do not track where the vehicles are used

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 78.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 78.

<sup>20</sup> *Id.* at 77.

<sup>21</sup> 365 Ill. App. 3d 431 (2006).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> Chicago Municipal Code section 3-32-030(A)

<sup>25</sup> *Id.* at section 3-32-030 (C).

<sup>26</sup> *Id.* at section 3-32-050(A)(1).

<sup>27</sup> *Id.* at section 3-32-070.

<sup>28</sup> *Hertz Corp.*, 2017 IL 119945, para. 21.

nor do they require that information from their lessees after possession is returned.<sup>29</sup> For rentals taking place in the city, the plaintiffs collected city lease transaction tax.<sup>30</sup> For rentals occurring outside the city, the plaintiffs did not collect lease transaction tax. That latter point is the reason for their challenge to Ruling 11.

After the failure of two previous attempts by the Chicago Director of Revenue to draft a ruling that could legally extend its taxing power to short-term car rentals in the city's suburbs, Ruling 11, issued May 2011, was the third attempt to promulgate a ruling to impose the lease transaction tax on short-term car rental transactions occurring outside the city.<sup>31</sup> The ruling expanded the tax to "suburban short-term vehicle rental locations within three miles of the City's borders."<sup>32</sup> Sections 3 and 4 of the ruling elaborated that any suburban car rental company within this 3-mile zone that did business in the city was subject to tax collection responsibilities and the document creation/retention and penalty provisions of the tax. Further, these companies were also subject to audit by the city DOR. The ruling stated that unless the lessor had documents to prove the lessee would not use the rental vehicle in the city, the department would presume a lessee with a Chicago address on his or her driver's license would use the vehicle 50 percent or more in the city, thus triggering the lease transaction tax. Therefore, for those rentals, a suburban rental company was subject to the lease transaction tax and was required to collect or account for the tax, regardless of whether any actual use of the vehicle occurred in the city. A safe harbor provision in the ruling allowed a suburban rental company operating within this

3-mile area, in lieu of maintaining records and collecting tax, to assume that 25 percent of its Chicago resident rental charges would be taxable and then pay the lease transaction tax based on that 25 percent amount.<sup>33</sup>

### The Procedural History of Hertz

Hertz and Enterprise<sup>34</sup> separately challenged Ruling 11 as being unauthorized by law and unconstitutional under the Illinois and U.S. constitutions. Enterprise filed a motion for preliminary injunction, and the city filed a motion to dismiss its complaint.<sup>35</sup> The circuit court denied the city's motion and granted Enterprise's motion for preliminary injunction.<sup>36</sup>

Enterprise thereafter moved for summary judgment and a permanent injunction. Hertz joined the motion, and the cases were ultimately consolidated.<sup>37</sup> The circuit court granted Enterprise's motion for summary judgment and a permanent injunction against Ruling 11, declaring the ruling facially unconstitutional as violating the extraterritorial limitations of the Illinois Constitution, violating the due process and commerce clauses of the U.S. Constitution, and illegally exceeding the scope of the lease transaction tax ordinance.<sup>38</sup> On appeal, the appellate court reversed the circuit court's decision, finding that the tax was a use tax and that use of the vehicle in the city was taxable under the plain language of the ordinance.<sup>39</sup> The appellate court held that Ruling 11 was not an extraterritorial exercise of municipal power, because it simply imposed the tax on "use" in the city.<sup>40</sup> In reaching this conclusion, the court sidestepped whether the city had the extraterritorial power to extend its taxing and regulatory jurisdiction outside the city to require a suburban rental car company to collect such tax

<sup>29</sup> See Enterprise's Petition for Leave to Appeal to the Supreme Court at 6.

<sup>30</sup> See *Id.* n.1.

<sup>31</sup> The original Ruling No. 11, promulgated in 2008, attempted to tax short-term car rental transactions occurring in the counties of Cook, Kane, Lake, McHenry, DuPage, and Will. This was ultimately challenged and then withdrawn by the city. Ruling No. 11 was amended in 2009 to eliminate references to specific counties. It continued to impose the lease transaction tax on short-term car rental transactions occurring solely outside Chicago, but it reserved the right to increase the area outside the city limits on which the tax may be imposed. That ruling was also withdrawn by the city after challenge.

<sup>32</sup> See City of Chicago Department of Revenue Personal Property Lease Transaction Tax Ruling 11 (Apr. 2011).

<sup>33</sup> *Id.* at section 5.

<sup>34</sup> Kaminski was one of the attorneys representing Enterprise in the lawsuit.

<sup>35</sup> *Id.* at para. 9.

<sup>36</sup> *Id.*

<sup>37</sup> *Hertz Corp.*, 2017 IL 119945, para. 8.

<sup>38</sup> *Id.*

<sup>39</sup> *Hertz Corp. v. City of Chicago*, 2015 IL App (1st) 123210, para. 21.

<sup>40</sup> *Id.* at para. 31.

on non-Chicago rentals before or whether any use in the city occurred. Rather, the court focused solely on the possible future use of the vehicle in the city and the fact that the plaintiffs did business in the city regarding other rental transactions. As to the tax collection, document retention, and other regulatory requirements that Ruling 11 imposed on suburban car rental companies for non-Chicago rentals, the appellate court disposed of those concerns by simply stating they were not “undue burdens” and could be avoided by the rental companies by merely paying the 25 percent safe harbor tax.<sup>41</sup> In essence, the appellate court found that because the rental companies had locations in the city (and thus did business in the city regarding other rentals), this was enough for the city to extend its taxing jurisdiction to these companies’ rental activities outside the city, even if those rentals had no connection with the city other than a possible future use in the city of the rental vehicle. Regarding the extraterritorial effect of the administrative presumption in Ruling 11 through its expansion of the taxing powers of the city to non-Chicago rental transactions, the appellate court again ignored this extraterritorial exercise of power and justified the presumption by saying that “reason and human experience allows for a presumption.”<sup>42</sup>

The appellate court found that Ruling 11 did not exceed the ordinance’s scope, because it taxed only the use of the rental vehicle in the city, which was allowed by the lease transaction tax ordinance, once more sidestepping the extraterritorial issue. As to the due process transactional nexus argument, the appellate court reiterated established law that the due process clause requires a definite link between the object of the tax and the taxing jurisdiction to uphold a tax (and not merely a connection to the actor it seeks to tax).<sup>43</sup> However, rather than applying this law and deciding whether the city had sufficient nexus over these suburban rentals based on the mere presumption of future use, the appellate court made the unusual finding that the rented vehicle’s possible future use in the city is not only

sufficient for due process nexus, but also sufficient to deprive the plaintiffs of standing to even challenge the tax on those grounds.<sup>44</sup>

Both Hertz and Enterprise petitioned the Illinois Supreme Court for leave to appeal the appellate court’s decision. The court granted the plaintiffs’ petitions for leave to appeal and the cases were consolidated for review.<sup>45</sup> Thereafter, the Taxpayer Federation of Illinois and the Illinois Chamber of Commerce filed amicus briefs in the supreme court on behalf of Hertz and Enterprise arguing that the appellate court decision would create chaos by broadly expanding municipal taxing power to activities occurring outside their corporate limits and be a major departure from past precedent.

### The Illinois Supreme Court’s Decision

The primary issue on appeal to the Illinois Supreme Court was whether Ruling 11 was an extraterritorial exercise of home rule power in violation of the Illinois Constitution, when it extended the city’s lease transaction tax to car rental transactions occurring solely outside the city, and thus required non-Chicago car rental companies to collect the tax, create or retain records, and be subject to audit (as well as penalties) on such non-Chicago rentals, simply because they rented vehicles to persons with a Chicago addresses on their driver’s licenses. Unlike previous cases before the court, no delivery or use of the property had actually occurred in the city, and the entire transaction — from entering the agreement to the transfer of possession of the property — occurred outside the city. The court was asked to decide whether the city, through Ruling 11, could assert its tax jurisdiction over these exclusively non-Chicago car rental transactions.

The plaintiffs also argued that the due process clause of both the Illinois and U.S. constitutions prohibited the extraterritorial imposition of a tax obligation on transactions or activities occurring outside the city when no delivery or other activity in the city by the lessor, made certain a taxable event in the city,

<sup>41</sup> *Id.* at para. 37 and 38.

<sup>42</sup> *Id.* at para. 40.

<sup>43</sup> *Hertz Corp.*, 2017 IL 119945, para. 49.

<sup>44</sup> *Hertz Corp.*, 2015 IL App. (1st) 123210, para. 31.

<sup>45</sup> Ill. S. Ct. R. 315 (eff. Mar. 15, 2016).

had occurred.<sup>46</sup> Lastly, the plaintiffs challenged whether Ruling 11 expanded the scope of the lease transaction tax ordinance in violation of Illinois law.<sup>47</sup>

In its ruling, the supreme court addressed only the extraterritorial question under the Illinois Constitution. It held that the ruling did indeed violate the Illinois Constitution since it had an extraterritorial effect. As a result the court declined to decide the other issues raised.<sup>48</sup>

In its analysis of Ruling 11, the Illinois Supreme Court found that through Ruling 11 the city did not seek to tax actual use of rental vehicles in Chicago, “but in fact, the tax is imposed on stated intent as to future use or on a conclusive presumption of use based on Chicago residency, absent a statement of intent.”<sup>49</sup> In other words, Ruling 11 tries to tax possible future use in the city and not actual use in the city. Therefore, when the tax was being applied, there was no connection with the city at all. The court held that “absent an actual connection to Chicago, the City’s tax under Ruling 11 amounts to a tax on transaction that take place wholly outside Chicago’s borders.”<sup>50</sup> And here “at most, there is only a tenuous connection between the City and the taxed transaction.”<sup>51</sup> Consequently, the court concluded that Ruling 11 was an improper extraterritorial exercise of municipal power.

### Specific Arguments

As to the specific arguments raised by the plaintiffs and the city, the court addressed them as discussed below.

As previously mentioned, the plaintiffs’ main argument was that Ruling 11 was an extraterritorial exercise of home rule power under

the Illinois Constitution. They relied on numerous decisions on the limitations of home rule power, including *Commercial National Bank v. City of Chicago*, noting that case as being directly on point. The city tried to distinguish *Commercial National Bank* and argued that the Illinois Supreme Court decision of *Mulligan v. Dunne* should control. The supreme court agreed that *Commercial National Bank* controls.

The Hertz plaintiffs emphasized that as in their case, in *Commercial National Bank* Chicago improperly tried to impose a tax on transactions occurring outside the city. The *Commercial National Bank* court was faced with a city service tax in which a non-Chicago seller of a service (that engaged in business in the city) had the burden of collecting and remitting the service tax to the city for services performed solely outside the city when the buyer purchased the service for use in the city. The plaintiff in *Commercial National Bank* challenged the legality of the tax, arguing that the city tax, without express legislative approval, was an extraterritorial exercise of taxing power in that it imposed its taxing power outside the city to require a non-Chicago seller to collect and account for the Chicago tax. The *Commercial National Bank* court agreed and found that the city service tax violated the Illinois Constitution since it had an extraterritorial effect of requiring the collection of a tax by a non-Chicago seller on services solely performed outside the city. Because of this, the plaintiffs in *Hertz* argued *Commercial National Bank* was essentially on all fours with the case at hand.

The city on the other hand argued that *Commercial National Bank* should not be applied, because the tax at issue in that case was a service tax and the tax at issue in *Hertz* was a lease use tax. Moreover, it argued, Ruling 11 applied only to city residents who rent vehicles outside the city. The court dismissed both arguments. Regarding the alleged difference between taxes on services and leases, the court found “no meaningful distinction” between the two about whether the city is applying its jurisdiction extraterritorially.<sup>52</sup> Likewise, regarding whether Ruling 11 applied only to non-Chicago rentals to Chicago residents,

<sup>46</sup> See, e.g., *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 345 and 346 (1954); *Allied-Signal Inc.*, 504 U.S. 768, 778 (1992); *National Geographic Society v. State Board of Equalization*, 16 Cal. 3d 637, 649–50 (1976), *aff’d* 430 U.S. 551 (1977); *Irwin Industrial Tool Co. v. Illinois Department of Revenue*, 238 Ill. 2d 332 at 342 (2010); and *Montgomery Ward & Co. v. State Board of Equalization*, 78 Cal. Rptr. 373, 379–80 (Cal. App. 1969).

<sup>47</sup> See, e.g., *Van’s Material Co. v. Department of Revenue*, 131 Ill. 2d 196 (1989).

<sup>48</sup> *Hertz Corp.*, 2017 IL 119945, para. 31.

<sup>49</sup> *Id.* at para. 30.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at para. 27.

<sup>52</sup> *Id.* at para. 24.

again the supreme court found that irrelevant, stating, “The City cites no authority for the proposition that mere residence in a taxing jurisdiction gives that jurisdiction the ability to impose taxes on the resident regardless of whether the taxed property or activity is connected to the taxing entity.”<sup>53</sup>

The court also rejected the city’s assertion that *Mulligan v. Dunne* should control rather than *Commercial National Bank*.<sup>54</sup> In *Mulligan*, Cook County imposed a tax on the retail sale of all alcoholic beverages in the county.<sup>55</sup> Wholesalers were obligated to collect this tax when they sold such alcoholic beverages to retailers within the county. The *Mulligan* court held that an out-of-county wholesaler selling to retailers within the county could be required to collect the county tax.<sup>56</sup> The supreme court in *Hertz* noted, however, that with *Mulligan* and the other cases cited by the city, “the tax was levied on sales of tangible personal property that took place within the borders of the taxing jurisdiction.”<sup>57</sup> Moreover, the court said, “the cases relied on by the city involved a tangible connection to the taxing jurisdiction either through delivery of the taxed items into the taxing entity or through sale of the taxed items inside the borders of the taxing jurisdiction.”<sup>58</sup> As a result, the court found *Mulligan* and the other cases cited easily distinguishable.

The city also tried to argue that the court should apply federal due process case law in its analysis of the extraterritorial limits of the Illinois Constitution. The city cited *Irwin Industrial Tool Co. v. Department of Revenue*<sup>59</sup> and *First Access Material Handling v. Wish* as authority for the proposition that it is not a violation of the due process clause to impose a use tax on property used in the city.<sup>60</sup> While first noting the significant factual differences between those cases and the

case at hand (both dealt with actual use in the city, and not possible or presumed use), and rather than go into any more analysis, the court summarily rejected the city’s due process argument as it relates to the extraterritorial limits of the Illinois Constitution, stating that there is “no authority for equating the concepts of due process and home rule authority under the Illinois Constitution.”<sup>61</sup>

Lastly, the city argued that *Evanston v. Create* supports its argument that Ruling 11 is valid.<sup>62</sup> In *Create*, a city ordinance imposed specific conditions on every residential lease of real property within Evanston. The plaintiffs in *Create* argued that the ordinance had an extraterritorial effect, because contracting parties were located outside the city.<sup>63</sup> The *Create* court rejected the argument, finding that the ordinance only regulated leases of property within Evanston’s borders, so there was no extraterritorial exercise. As a result, the *Hertz* supreme court rejected any reliance on *Create* noting that the decision in *Create* dealt with the actual use of property, saying “in contrast, the City’s use tax [lease transaction tax] is imposed not on actual use within the City’s borders, but only presumed use.”<sup>64</sup>

### Analysis of Supreme Court Decision

The *Hertz* decision was the first ruling by the Illinois Supreme Court on extraterritorial municipal taxation in over 30 years. As in *Commercial National Bank*, the *Hertz* court applied its established precedent that municipal taxing power cannot be applied in an extraterritorial fashion. Equally important, the supreme court rebuffed the use of a presumption to bootstrap taxing power over transactions outside the city’s jurisdiction. Therefore, even though the appellate court suggested that a possible future use was sufficient to give the city this expanded power over a non-Chicago car rental, the supreme court determined that this was simply extraterritorial overreach by the city.

<sup>53</sup> *Id.* at para. 25.

<sup>54</sup> *Id.* at para. 19.

<sup>55</sup> *Mulligan v. Dunne*, 61 Ill. 2d 544, (1975).

<sup>56</sup> *Id.*

<sup>57</sup> *Hertz Corp.*, 2017 IL 119945, para. 26.

<sup>58</sup> *Id.* at para. 27.

<sup>59</sup> *Irwin Industrial*, 238 Ill. 2d at 332 (2010).

<sup>60</sup> *First Access Material Handling v. Wish*, 297 Ill. App. 3d 396 (1998).

<sup>61</sup> *Hertz Corp.*, 2017 IL 119945, para. 24.

<sup>62</sup> *City of Evanston v. Create Inc.*, 85 Ill. 2d 101 (1981).

<sup>63</sup> *Hertz Corp.*, 2017 IL 119945, para. 29.

<sup>64</sup> *Id.*

Further, while the *Hertz* decision did not address the due process transactional nexus argument raised by the plaintiffs, and although the decision clearly suggests that the limits on municipal extraterritorial tax powers are more stringent than the limits imposed by the due process clause of the U.S. Constitution, that does not mean the court's holding is not relevant in a broader context. Limits on extraterritorial municipal taxation are similar to the transactional nexus limits imposed on sales and use taxes by the due process clause and commerce clause of the U.S. Constitution in that there must be some actual sale or use activity taking place in a taxing jurisdiction to create nexus to tax such sale or use.<sup>65</sup> In *Hertz*, the city tried to extend its taxing jurisdiction beyond its borders for transactions over which it had no tax nexus. Therefore, this absence of transactional nexus may also violate the federal due process and commerce clauses, as noted in the circuit court decision. Consequently, future due process or commerce clause cases may cite the *Hertz* decision's analysis — that the residence of the parties is not enough by itself to justify a tax on a transaction or use. Rather, some part of the transaction or use must “actually” occur in a jurisdiction before a taxing body can seek to impose its tax on such transaction or use.

### Conclusion

Limits on municipal extraterritorial taxation are still alive and well in Illinois. The Illinois Supreme Court has once again declared that only by state legislation can a home rule municipality in Illinois apply its taxing powers beyond that municipality's borders. And, in that regard, a municipality cannot unilaterally give itself extraterritorial taxing power by creating a presumption of taxability for transactions or activities occurring outside its borders and then use that presumption to impose its tax jurisdiction over those transactions or activities. ■

<sup>65</sup> See, e.g., *American Oil Co. v. Neil*, 380 U.S. at 451; see also *Miller Brothers*, 347 U.S. at 340.

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