Personal Property Taxes - Lehnhausen v. Lake Shore Auto Parts Co.

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By a referendum vote in November, 1970, the people of Illinois adopted the following amendment to the Constitution of 1870:

Article IX-A

Section I. Notwithstanding any other provision of this Constitution, the taxation of personal property by valuation is prohibited as to individuals.¹

The official explanation which appeared on the referendum ballot stated that the amendment would abolish the ad valorem personal property tax levy against individuals, but the same tax levied against corporations and other entities not considered individuals would not be affected. Later in the session, the General Assembly adopted a resolution² further clarifying the legislature's intent that the effect of Article IX-A would be to "abolish the ad valorem taxation of personal property owned by a natural person or by two or more natural persons. . . ."³

A subsequent action was brought by a Cook County corporation, in which the trial court held that the provisions of the Revenue Act of 1939⁴ as amended by Article IX-A violated the equal protection clause of the fourteenth amendment. The decision was appealed to the Illinois Supreme Court, which held that it is the discrimination against corporations produced by Article IX-A itself that violates the equal protection clause and therefore Article IX-A must fall.⁵ The United States Supreme Court reversed, reiterating the long-established doctrine that states may exercise wide latitude in classifying for purposes of taxation without violating the

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¹ This amendment, the manner of its presentation to Illinois voters, and the schedule of effectiveness are contained in Senate Joint Resolution 30. State of Illinois, S. JOUR., 76th G.A., 3476 (June 30, 1969).
⁴ ILL. REV. STAT. ch. 120, §§ 482 et seq. (1971).

In reviewing state taxing schemes, the Supreme Court has consistently adhered to the principle that deference to the wisdom of the state legislature should be given as long as the tax classification is based upon a rational foundation and is not palpably arbitrary.7 In *Bell's Gap R.R. Co. v. Pennsylvania*,8 an 1890 case, the Court upheld a Pennsylvania tax statute against an equal protection attack. The doctrine enunciated in that decision retains its vitality in 1973: “[T]he Fourteenth Amendment was not intended to compel the State to adopt an iron rule of equal taxation.”9 The Court indicated that the equal protection clause would not prohibit a state from adjusting its tax system in any way the people and the legislature chose, so long as distinctions made among those who should bear the burden of taxation were reasonably and properly enacted.10

Fifty years later, in *Madden v. Kentucky*,11 the Court restated the principle that the fourteenth amendment requires “no iron rule of equality” in state taxation schemes. *Madden* was a case challenging the validity of

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6. Even though Illinois adopted a new constitution in 1970, the effect of this amendment to the revenue article of the 1870 constitution carries over to the present. Thus, a decision on the constitutionality of Article IX-A was not moot in 1973. Article IX, sec. 5(c) of the present constitution states that the General Assembly shall abolish all ad valorem personal property taxes on or before January 1, 1979, and “thereafter shall replace all revenue lost . . . as a result of the abolition of ad valorem personal property taxes subsequent to January 1, 1971. Such revenue shall be replaced by imposing statewide taxes, other than ad valorem taxes on real estate, solely on those classes relieved of the burden of paying ad valorem personal property taxes because of the abolition of such taxes subsequent to January 2, 1971.” The effective date of Article IX-A was January 1, 1971. Thus, because individuals were relieved of the burden of paying ad valorem personal property taxes prior to January 2, 1971, “replacement taxes” can be imposed upon corporations only.


9. Id. at 237.

10. Id.

11. 309 U.S. 83 (1940).
an ad valorem tax on bank deposits imposing a higher tax rate on deposits outside the state than upon those in state banks. Upholding the tax classification, the Court said the passing of fifty years since its decision in *Bell's Gap* had served to "underscore the wisdom" of the recognition that wide areas of discretion are necessary for a state to formulate sound tax policies.  

In 1959, the Supreme Court reviewed an Ohio tax law which exempted from ad valorem tax merchandise owned by nonresidents placed in Ohio warehouses for storage purposes only, but did not exempt like merchandise stored and owned by residents. The Court referred again to the "no iron rule of equality" doctrine:

The States have a very wide discretion in the laying of their taxes. . . . Of course, the States, in the exercise of their taxing power, are subject to the Equal Protection Clause of the Fourteenth Amendment. *But that clause imposes no iron rule of equality,* prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation.

There are many other decisions that have relied upon the doctrine that state tax classifications violate the equal protection clause only where it can clearly be shown that the state had no reasonable, justifiable basis for making a distinction between taxpayers. The argument has been made that even though a state has great leeway in delineating classes upon which a tax will fall, a distinction between corporations and individuals does not provide such a basis. However, the validity of such a distinction was upheld by the Court in *Flint v. Stone Tracy Co.* The Court reasoned that these distinctions are supported by the significant differences between corporate and non-corporate entities. Among the benefits which inure to corporations, wrote the Court, are "[t]he continuity of the business, without interruption by death or dissolution," the ease of transferring property interests through shares of stock, managerial control by a board of directors, and the general absence of individual liability.

12. *Id.* at 88.
14. *Id.* at 526 (emphasis added).
17. *Id.* at 161.
18. *Id.* at 162.
Although the line of cases discussed above would seem to make clear that the classification struck down by the Illinois court in Lake Shore did not violate the equal protection clause, a 1928 Supreme Court decision held that if the character of the owner was the only distinction between parties paying the tax and those exempt from it, then the tax classification would violate the equal protection clause. Quaker City Cab Co. v. Pennsylvania involved a tax on gross receipts imposed upon foreign or domestic corporations operating taxicabs, but not upon individuals or partnerships in the same type of business. Since the tax was imposed only because the owner of a company happened to be a corporation, the Court felt there was no "real" or "substantial" difference between the classes. Thus, the Pennsylvania statute in issue was stricken as arbitrary and unjustifiable under the equal protection clause. Mr. Justice Brandeis dissented, stating that the Flint decision had shown there is a real and not a specious or fanciful distinction between incorporated and unincorporated businesses.

Lake Shore had argued that the Quaker City doctrine should control the Illinois question, and the state supreme court agreed. The Illinois court also viewed the nature of the tax, as well as the nature of the thing taxed, as a vital factor in its decision.

On review, the Supreme Court placed no importance whatsoever upon the difference in types of taxes. But faced with the disparities between Quaker City and later decisions, the Court simply chose to dismiss

20. Id. at 403-12.
22. Lake Shore Auto Parts Co. v. Korzen, 49 Ill. 2d 137, 149, 273 N.E.2d 592, 598 (1971). The court apparently discussed the nature of a tax in order to distinguish Thorpe v. Mahin, 43 Ill. 2d 36, 250 N.E.2d 633 (1969). Thorpe upheld a newly-enacted state income tax which imposed a higher tax rate upon corporations than individuals. The problem in Thorpe, though, was that the then-effective constitution contained a provision prohibiting classification of property for taxation purposes. A prior decision, Bachrach v. Nelson, 349 Ill. 579, 182 N.E. 909 (1932) invalidated an income tax because the court considered income to be property, and therefore all property (income) had to be taxed equally. To nullify the Bachrach holding, Thorpe stated "the tax in question is not a property tax and therefore does not come within the limitations . . . our constitution imposes on property taxes." 43 Ill. 2d at 42, 250 N.E.2d at 636. Lake Shore was rendered consistent with Thorpe by emphasizing the importance of the nature of the tax. That is, since the tax was to be levied against corporate property rather than income, the classification was improper.
Quaker City as a "relic of a bygone era."24 This dismissal amounts to a sub silentio overruling of that case.

The law now seems clear. Quaker City was the one potential obstacle faced by states in their tax treatment of corporations. Removing this obstacle, the Court has implicitly recognized the revenue-raising problems states must cope with and the necessity of using a wide range of tax plans to solve them.

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24. 41 U.S.L.W. at 4292.