



TAXING LEASE RECEIPTS: NEW HOME RULE REVENUE STREAM?

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BACKGROUND

- The financially distressed state of many municipalities has left them looking for additional revenue sources in order to be able to continue to provide essential services.
- Given the crash in the housing market, many municipalities have an increasing number of rental properties, with some municipalities having an equal number of rentals and owner occupied homes or even more rentals than owner occupied homes.



WHAT IS THE LAW?

- Article VII, §6(a) of the Illinois Constitution provides that “Except as limited by this section, a home rule unit may exercise any power and perform any function pertaining to its government and affairs including, but not limited to, the power to...tax.”
 - Thus, home rule units are given broad authority to enact tax ordinances for taxable events within their territorial boundaries.



WHAT IS THE LAW?

- However, a home rule unit shall have only the power that the General Assembly may provide by law...to license for revenue or impose taxes upon or measured by income or earnings or upon occupations.
- “Occupational Tax” is one that in practical effect imposes a tax on a given occupation or the provider of particular services.
 - “Services” has been broadly defined as including all “sales” transactions other than sales of tangible property.



WHAT IS THE LAW?

- Factors that affect whether a home rule unit is imposing an impermissible tax on occupations are:
 - 1. Whether it regulates and controls a given occupation;
 - 2. Imposes a tax for the privilege in engaging in a given occupation, trade, or profession; or
 - 3. Imposes a tax on the privilege of engaging in the business of selling services.



WHAT IS THE LAW?

- 65 ILCS 5/8-11-6a provides that a home rule municipality is pre-empted from levying certain taxes (ex. occupation taxes). However, this “does not pre-empt any home rule imposed tax such as the following:...(5) a tax, however measured, on lease receipts”...



THE LAW PUT INTO CONTEXT

- Clearly, the law provides that a municipality cannot tax the occupation of being a landlord.
- Additionally, could the receipt of rent be deemed the “selling” of the “service” of providing the use of realty, which would also be beyond the taxing power of a municipality?
- But...by enacting 65 ILCS 5/8-11-6a, has the Illinois legislature expressly or impliedly authorized municipalities to tax the transfer of money between lessee and lessor, similar to the tax imposed upon the flows of money from a buyer to a seller?
- Note that the sales tax, however, is a tax on the occupation of a retailer allowed to be passed on.



HAS SUCH A TAX BEEN IMPOSED BEFORE...ANYWHERE?

- Not in Illinois, as far as we know
- But a similar tax has been imposed by Mesa, Arizona for a number of years: a 1.75% tax on the gross income generated from the rental or lease of any real property within the city.
- Exempt from this tax are persons renting out less than two residential units (apartments, houses, trailer lots, etc.) within the state (not only in the city).
- However, if the person rents out one or more units of commercial property subject to the tax, then he/she is subject to taxation on all residential properties being rented out, even if it is only one.



MESA, AZ MUNICIPAL CODE 5-10-445

- The Mesa ordinance considers payments made by the lessee, to or on behalf of the lessor, for property taxes, repairs, or improvements to be included as part of the taxable gross income.
- Additionally, charges for utilities, telecommunications, pet fees, or maintenance are also considered part of the taxable gross income
- A decision was rendered by a municipal hearing officer that a person cannot avoid the tax by “leasing” to a family member without signing a written lease, so long as the “lessee” pays the property taxes and similar expenses associated with the property



COULD THIS BE DONE IN HOME RULE MUNICIPALITIES IN ILLINOIS? REASONABLE MINDS DISAGREE.

- Does an express exception of something in a statute that prohibits a list of other things constitute an implicit authorization to do that excepted thing?
- Is the answer to this question, in the area of municipal taxation, made any clearer by Illinois' rather extensive home rule powers?
- Given the general requirement that the legislature must indicate when something is beyond home rule power, is there a benefit of the doubt to be given in favor of the legality of a municipal tax on rental income from real estate within its borders?



SOME PROS OF ENACTING THIS TYPE OF ORDINANCE

○ Pros

- Potentially huge amount of revenue generated, especially if the municipality has a large amount of rentals (Mesa, AZ reports approximately \$1.5 million a month on its privilege taxes—one of City's largest revenue sources)
- Might help to incentivizes more real estate being owned than rented, leading to better maintenance and neighborhood stability



SOME CONS OF ENACTING THIS TYPE OF ORDINANCE

○ Cons

- New to Illinois, so undoubtedly will be legally challenged
- Substantial pushback expected from Realtors, Landlords, and anti-tax advocates
- Would require that the collection process be managed and overseen, meaning more responsibilities for existing overworked staff or the hiring of new staff or independent contractors (spending money to make money)
- Could make the municipality seem less business-friendly and cause some businesses to move out or not move in
- Might discourage responsible investors from rehabbing and renting vacant residential properties



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- On the table for discussion...

