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DOUBLE TAXATION OF PARTNERSHIP INCOME IN ILLINOIS

Continental Illinois National Bank & Trust Co. v. Zagel

78 Ill. 2d 387, 401 N.E.2d 491 (1979)

A state's power to tax is inherently broad,¹ subject only to state and federal constitutional restraints.² One of the lesser known state constitutional limitations on a state's taxing power consists of the unfavorable treatment generally accorded to "double taxation."³ Essentially, double taxation results where a second tax is imposed on something that is already subject to tax.⁴ In a few states, double taxation is expressly prohibited.⁵ In most states, double taxation is judicially disfavored, unless its imposition is accompanied by a clear legislative intent.⁶ Upon finding double taxation, courts will generally

1. *International Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 444-45 (1944) ("The power to tax 'is an incident of sovereignty, and is coextensive with that to which it is an incident. All subjects over which the sovereign powers of a state extends, are objects of taxation. . . .'). See also *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522 (1959); *Shaffer v. Carter*, 252 U.S. 37 (1920). See generally E. STIMSON, *JURISDICTION & POWER OF TAXATION* (1933); 2 T. COOLEY, *CONSTITUTIONAL LIMITATIONS* 986-1107 (8th ed. 1927).

2. *E.g.*, *Providence Bank v. Billings*, 29 U.S. (4 Pet.) 514 (1830).

Challenges to state taxes under the federal constitution are generally made under the equal protection clause and the privileges and immunities clause. A state tax will be found unconstitutional under the equal protection clause only if it is based on a classification that is arbitrary and capricious. So long as the tax's classification is found to have a rational basis, it will not be found violative of the equal protection clause. See, *e.g.*, *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522 (1959). See also Sholley, *Equal Protection in Tax Legislation*, 24 VA. L. REV. 229 (1938). A state tax will be found unconstitutional under the privileges and immunities clause if it discriminates against citizens of another state. See, *e.g.*, *Toomer v. Witsell*, 334 U.S. 385 (1948). See also Lomen, *Privileges and Immunities under the Fourteenth Amendment*, 18 WASH. L. REV. 120, 129-34 (1943).

A state's power to tax is also subject to such restraints as may be imposed by its own constitution. *E.g.*, *Lane County v. Oregon*, 74 U.S. (7 Wall) 71 (1868). Such limitations vary among the states. See generally Morrow, *State Constitutional Limitations on the Taxing Authority of State Legislatures*, 9 NAT. TAX J. 126 (1956).

3. The United States Constitution does not prohibit double taxation by a state. *E.g.*, *Baker v. Drusedow*, 263 U.S. 137 (1923). To be found in violation of the federal constitution, a state's imposition of double taxation must be shown to be arbitrary and capricious under the equal protection clause. *Id.* at 142. See note 2 *supra*.

4. Double taxation actually consists of the concurrence of four elements. Two taxes must be imposed 1) by the same unit of state government, 2) for the same purpose, 3) over the same time period and 4) the objects of the two taxes—the persons, property, or privileges taxed—must partially overlap. *E.g.*, *Federated Mutual Implement Hardware Ins. Co. v. Commissioner*, 266 F.2d 66 (8th Cir. 1959); T. COOLEY, *THE LAW OF TAXATION* § 223 (4th ed. 1924) [hereinafter cited as COOLEY]. The elements of double taxation are further discussed in the text accompanying notes 62-93 *infra*.

5. *E.g.*, IDAHO CONST. art. 7, § 5. See note 93 *infra* for a compilation of authorities.

6. See, *e.g.*, *Old Colony Trust Co. v. Commissioner*, 346 Mass. 667, 195 N.E.2d 332 (1964).

construe one of the two taxes involved in such a manner as to eliminate the double imposition of tax.⁷

Prior to 1979, Illinois followed the vast majority of states and the federal government in treating a partnership⁸ as a "conduit" for purposes of the state's general income tax.⁹ Under this approach, partnership income is deemed to flow through the partnership to the individual partners.¹⁰ No income tax is levied on the partnership itself; instead, each partner's share of partnership income is treated as his own income, which is then subject to tax.¹¹ In 1979, the Illinois legislature enacted an additional income tax on partnerships themselves.¹² Because the legislature left intact the conduit provision of the state's general income tax, partnership income became subject to two income taxes: the new tax at the partnership level and the general income tax at the individual partner level.

Relying on an express state constitutional ban against double taxation of an individual's income,¹³ a local partnership challenged the new tax¹⁴ in *Continental Illinois National Bank & Trust Co. v. Zagel*.¹⁵ The Illinois Supreme Court rejected the claim that the partnership income tax resulted in double taxation of the individual partners' income. As the sole ground for its decision, the court distinguished a partnership

See note 62 *infra* for other state authorities. *See also* *Tennessee v. Whitworth*, 117 U.S. 129, 137 (1886). *See generally* COOLEY, *supra* note 4, §§ 223, 224.

7. *See, e.g.*, *Old Colony Trust Co. v. Commissioner*, 346 Mass. 667, 195 N.E.2d 332 (1964).

8. For income tax purposes, a "'partnership' includes a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation or venture is carried on. . . ." ILL. REV. STAT. ch. 120, § 15-1501(a)(16) (1979). *See also* I.R.C. §§ 761(a), 7701(a)(2). The Uniform Partnership Act, § 6(1) similarly defines a partnership as an association of two or more persons to carry on as co-owners a business for profit. ILL. REV. STAT. ch. 106½, § 6(1) (1979). The existence of a partnership fundamentally depends on the parties' intent. *See, e.g.*, *Commissioner v. Culbertson*, 337 U.S. 733 (1949); *Peck v. Peck*, 16 Ill. 2d 268, 157 N.E.2d 249 (1959). *See also* 6 J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 35.03 (1975 rev. ed.).

9. ILL. REV. STAT. ch. 120, § 2-205(b) (1977) (amended 1979); I.R.C. § 701. *See* note 113 *infra* for a compilation of similar state statutes.

10. *See, e.g.*, *United States v. Bayse*, 410 U.S. 441 (1973). *See generally* A. ARONSOHN, PARTNERSHIPS AND INCOME TAXES (PLI 1966).

11. *E.g.*, ILL. REV. STAT. ch. 120, § 2-205(b) (1977) (amended 1979).

12. Personal Property Tax Replacement Income Tax Act, P.A. 81-1st Sp. Sess.-I, § 2(c), 1979 Ill. Laws 4925 (1979). The partnership income tax was one of four taxes enacted to replace the state's personal property tax. For details of the other three taxes enacted, *see* note 146 *infra*. For details of the circumstances surrounding the replacement of the state's personal property tax, *see* text accompanying notes 140-43 *infra*.

13. ILL. CONST. art. IX, § 3(a). *See* note 141 *infra* for the text of this provision.

14. The validity of the other taxes enacted to replace the state's personal property tax was also challenged in what became a consolidated action. *See* note 146 *infra*. The issues raised with respect to these other taxes are not discussed in this case comment.

15. 78 Ill. 2d 387, 401 N.E.2d 491 (1979).

from its partners.¹⁶ By viewing the partnership income tax as falling on the income of a separate legal entity as distinguished from the general income tax which falls on the income of the individual partners, the court precluded a finding of double taxation. The dissent argued that the income of a partnership was also the income of the individual partners so that the new tax, together with the general income tax, resulted in double taxation.¹⁷

This case comment will examine the *Zagel* court's treatment of the double taxation issue. The law of double taxation will be presented and applied to Illinois' partnership and general income taxes to analyze and expand upon the court's finding that no double taxation resulted. The analysis will confirm that the key factor in determining the double taxation issue is whether the income of a partnership is to be deemed the partnership's or the individual partners'. After reviewing the court's basis for its decision that partnership income should be deemed the partnership's and finding it lacking in substantive merit, the case comment will conclude that the rationale underlying the widely accepted conduit approach represents the better view. If the partnership income tax is then viewed as a second tax on the income of the individual partners, double taxation results. Surprisingly, the new tax came within an exception to the state's constitutional ban against double income taxation¹⁸ so that a finding of double taxation would not have precluded the court from upholding the new tax. However, this exception was overlooked in the decision.

CLASSIFICATION OF TAXES

Double taxation involves an overlap in the things that are subject to two particular taxes.¹⁹ The "thing" subject to a given tax is termed the tax's "object" and it is generally classified in terms of persons, property or privileges.²⁰ When the issue of double taxation arises, it is first necessary to establish the objects of the two taxes in question.²¹ Once the objects of the two taxes are established, it can then be determined if

16. *Id.* at 407, 401 N.E.2d at 501.

17. *Id.* at 415-16, 401 N.E.2d at 505-06 (Clark, J., concurring in part and dissenting in part).

18. ILL. CONST. art. IX, § 5(c). The text of this section appears in note 142 *infra*.

19. An overlap between the objects of the two taxes at issue is but one of the four elements of double taxation. For an explanation and discussion of the four elements, see text accompanying notes 62-93 *infra*.

20. See J. HELLERSTEIN & W. HELLERSTEIN, *STATE & LOCAL TAXATION* 27 (4th ed. 1978) [hereinafter cited as HELLERSTEIN]; Peairs, *General Principles of Taxation: An Initial Survey*, 6 TAX L. REV. 267, 292 (1951); COOLEY, *supra* note 4, § 38.

21. See, e.g., *Educational Films Corp. v. Ward*, 282 U.S. 379 (1931); *Dawson v. Kentucky Dist. & Whse. Co.*, 255 U.S. 288 (1921).

an overlap between them exists. Establishing the object of a tax is largely a matter of statutory interpretation in light of the general characteristics that taxes which are imposed on persons, property or privileges exhibit.²²

Taxes on Persons

Taxes on persons are termed capitation or poll taxes. These taxes are levies of a fixed amount imposed on all persons, or a selected group of persons, within the taxing jurisdiction.²³ These taxes are levied without regard to a person's property, income or other circumstances.²⁴ A state tax of \$1.00 per year on all inhabitants between the ages of twenty-one and sixty is typical of such taxes.²⁵ Poll taxes were popular during the early history of this country although they have long since fallen into disuse.²⁶

Taxes on Property

Taxes on real and personal property are commonly termed property taxes. These taxes are imposed on property itself²⁷ within the taxing jurisdiction and are generally measured by a specified percentage of the property's value.²⁸ The taxes are typically imposed once a year.²⁹ Perhaps the most familiar type of property tax is a tax on real estate.³⁰

Some property taxes are measured by a percentage of the income derived from the property subject to tax. This method of measuring property taxes is generally used where the value of the property would be otherwise difficult to determine. Although the tax is measured on the basis of the income derived from the property, the object of the tax is nevertheless considered to be the income-producing property itself.³¹ In *Redfield v. Fisher*,³² the Oregon Supreme Court found that a tax

22. *Id.*

23. *See* *Breedlove v. Suttles*, 302 U.S. 277 (1937). *See also* COOLEY, *supra* note 4, § 40.

24. 302 U.S. at 281.

25. *Id.* at 282.

26. *See* SEGILMAN, *ESSAYS IN TAXATION* 16-17 (10th ed. 1931).

27. *See, e.g.*, ILL. REV. STAT. ch. 120, § 499 (1979). *See also* *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 314 (1937); *Dawson v. Kentucky Dist. & Whse. Co.*, 255 U.S. 288, 293-94 (1921); COOLEY, *supra* note 4, § 39.

28. *See, e.g.*, ILL. REV. STAT. ch. 120, §§ 501, 502 (1979); *see also* Cooley, *supra* note 4, § 39.

29. *See, e.g.*, ILL. REV. STAT. ch. 120, § 508(a) (1979).

30. *See, e.g.*, ILL. REV. STAT. ch. 120, §§ 482-811 (1979).

31. *See, e.g.*, *Great Northern Ry. Co. v. Minnesota*, 278 U.S. 503 (1929) (a tax on the in-state trackage of railroads measured by a percentage of a railroad's income is a property tax). *See also* *Shaffer v. Carter*, 252 U.S. 37 (1920) (a tax on oil and gas production measured by a percentage of income derived is a tax in lieu of a property tax). *See generally* COOLEY, *supra* note 4, § 46.

32. 135 Or. 180, 292 P. 813 (1930), *cert. denied*, 284 U.S. 617 (1931).

measured by 5% of the income derived from stocks, bonds and other intangible personal property had as its object the intangible personal property itself.

Taxes on Privileges

Privileges represent the residual category for objects of taxation.³³ The category includes all those acts, transactions or privileges that are subject to tax.³⁴ These acts, transactions or privileges are typically numerous and varied.³⁵ A privilege tax generally accrues only upon the exercise of the specified privilege or the occurrence of the specified act.³⁶ Thus, an income tax accrues upon the earning of income³⁷ and a

33. Commentators are not in perfect agreement on the terminology of this category of objects of taxes. Some term this category "excise taxes" while others differentiate between income taxes and excise taxes. Compare HELLERSTEIN, *supra* note 20, at 29 with COOLEY, *supra* note 4, § 38.

34. See Peairs, *General Principles of Taxation: An Initial Survey*, 6 TAX. L. REV. 267, 292 (1951); COOLEY, *supra* note 4, §§ 42-47.

35. In Illinois, the following acts, transactions or privileges are subject to tax: privilege of earning income, ILL. REV. STAT. ch. 120, §§ 1-101 to 17-1701 (1979); transfer of property at death, *id.* §§ 375-404; privilege of operating motor vehicles on state highways, *id.* §§ 417-434; privilege of using tangible personal property in the state purchased at retail from a retailer, *id.* §§ 439.1-22; privilege of carrying on a retail business, *id.* §§ 440-453; privilege of engaging in a cigarette sales business at retail and wholesale, *id.* §§ 453.1-30; privilege of using cigarettes, *id.* §§ 453.31-67; privilege of carrying on a message transmission business, *id.* §§ 467.1-15; privilege of carrying on a gas distribution business, *id.* §§ 467.16-30; privilege of carrying on an electricity generation and distribution business, *id.* §§ 468-481a; privilege of operating coin-operated amusement devices, *id.* §§ 481b.1-.16; privilege of carrying on a hotel business, *id.* §§ 481b.31-40; privilege of transferring title to real estate, *id.* §§ 1001-1008; privilege of conducting bingo games, *id.* §§ 1101-1107.

See generally COOLEY, *supra* note 4, §§ 45, 1670-1718.

36. See HELLERSTEIN, *supra* note 20, at 29; COOLEY, *supra* note 4, § 45.

37. See, e.g., *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 314 (1937).

At one time, there was a split among state courts concerning the object of an income tax. The seminal case for the view that the object of an income tax is property was *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895). In *Pollock*, the United States Supreme Court interpreted a federal income tax that included income from property as a tax on property itself. The Court held that this property tax violated the requirement in article 1, section 2 of the United States Constitution that federal taxes be equally apportioned among the states on the basis of population. *Id.* at 442. The *Pollock* decision prompted the passage of the sixteenth amendment authorizing the imposition of a non-apportioned federal income tax in 1913.

When states began enacting income taxes during the first half of this century, their constitutionality was challenged. Interpreting these taxes as property taxes provided courts with a vehicle for bringing income taxes within state constitutional taxing frameworks that were largely property tax oriented. A few state supreme courts took this approach. See, e.g., *In re Opinion of the Justices*, 220 Mass. 613, 108 N.E. 570 (1915). The majority of state supreme courts viewed income taxes as privilege or excise taxes. See, e.g., *Ludlow-Saylor Wire Co. v. Wollbrinck*, 275 Mo. 339, 205 S.W. 196 (1918). The cases are collected in Annot., 11 A.L.R. 313 (1921); Annot., 70 A.L.R. 468 (1931); Annot., 71 A.L.R. 1226 (1931); Annot., 97 A.L.R. 1488 (1935).

In *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937), the United States Supreme Court abandoned its view of an income tax as a tax on property and adopted the view that it is a privilege tax. *Id.* at 314-15. This is now the established view. See W. NEWHOUSE, *CONSTITUTIONAL UNIFORMITY AND EQUALITY IN STATE TAXATION* 743-60 (1959) [hereinafter referred to as NEWHOUSE].

For a comprehensive discussion of this controversy, see NEWHOUSE, *supra*, at 690-766.

business occupation tax accrues when one engages in the occupation subject to tax.³⁸

Income taxes are generally measured by a percentage of net income, *i.e.*, total income received less related expenses and other adjustments.³⁹ In contrast, business occupation taxes are generally measured as a percentage of the total or gross income obtained from the taxed occupation, without any adjustments.⁴⁰ Other privilege taxes are generally also measured as a percentage of the gross amount of money transferred in the taxed transaction.⁴¹

In establishing the object of a particular tax, courts look beyond the relevant statutory language and consider the tax's operation and effect.⁴² In *Dawson v. Kentucky Distilleries and Warehouse Co.*,⁴³ the United States Supreme Court examined a fifty-cent per gallon tax on whiskey withdrawn from bond or transferred to another state. The tax was described statutorily as an occupation tax: it was ostensibly imposed on the privilege of engaging in the business of manufacturing or storing whiskey.⁴⁴ The Court rejected the statute's characterization of the tax, noting that the tax did not accrue during the manufacture or storage of the whiskey but only upon its removal from bond or transfer to another state.⁴⁵ Finding the object of the tax to be the whiskey itself, the Court concluded that the tax was actually a property tax.⁴⁶ By conducting this type of operative analysis of a tax's statutory language, the true objects of the two taxes alleged to result in double taxation can be established and the determination made whether double taxation has occurred.

38. *See, e.g.*, ILL. REV. STAT. ch. 120, §§ 440-453 (1979) (Retailers' Occupation Tax); *Central Television Service, Inc. v. Isaacs*, 27 Ill. 2d 420, 189 N.E.2d 333 (1963) (Retailers' Occupation Tax is not a tax on the privilege of buying or upon the individual sale, but is a tax on the occupation of selling at retail). For a compilation of other business occupations that are taxed in Illinois, *see* note 35 *supra*.

39. *E.g.*, ILL. REV. STAT. ch. 120, §§ 2-201(b), 202-204 (1979). *See also* COOLEY, *supra* note 4, § 49. *See generally* STATE TAX HANDBOOK (CCH Oct. 1, 1980).

40. *E.g.*, ILL. REV. STAT. ch. 120, §§ 440-453 (1979) (Retailers' Occupation Tax). *See generally* STATE TAX HANDBOOK (CCH Oct. 1, 1980).

41. *E.g.*, ILL. REV. STAT. ch. 120, §§ 417-434 (1979) (tax on the privilege of operating motor vehicles on public highways measured by a percentage of the purchase price of gasoline). *See generally* STATE TAX HANDBOOK (CCH Oct. 1, 1980).

42. *E.g.*, *Educational Films Corp. v. Ward*, 282 U.S. 375, 387 (1931); *Marshall v. South Carolina Tax Comm'n*, 178 S.C. 57, 182 S.E. 96 (1935).

43. 255 U.S. 288 (1921).

44. *Id.* at 289.

45. *Id.* at 293.

46. *Id.* at 294.

DOUBLE TAXATION: ORIGINS AND DEFINITION

The unfavorable treatment accorded to double taxation springs from an intuitive feeling that something which is already subject to one tax should not be subject to additional taxes.⁴⁷ At law, this feeling is reflected in the notion that taxes should be equitably imposed. As noted by the United States Supreme Court:

Justice requires that the burdens of government shall as far as is practicable be laid equally on all, and, if property is taxed once in one way, it would ordinarily be wrong to tax it again in another way, when the burden of both taxes falls on the same person.⁴⁸

This notion of an equitable distribution of the tax burden has been incorporated into most state constitutions in what have been termed "uniformity" clauses.⁴⁹ These clauses generally require that all objects of a given class or type must be uniformly or equally taxed.⁵⁰

The primary effect of these uniformity clauses has been to insure an equal tax burden distribution with respect to any one particular tax.⁵¹ Under these clauses, if a tax is imposed on a given class or type of object, all such objects must be subject to the same tax.⁵² If some objects of a class or type are taxed while others of the same type or class are not, or if the objects of the same class or type are taxed differently, the tax is found to be nonuniformly applied and is invalidated.⁵³ In *Flynn v. Kucharski*,⁵⁴ a county property tax was being collected in such a manner that, in some parts of the county, a small percentage of the tax funds was retained by units of local government and not paid into the county treasury. The Illinois Supreme Court found that the effect of this practice was that people paid less county tax in some areas of the

47. See *Zenith Radio Corp. v. United States*, 437 U.S. 443, 457 (1978) (the Court referring to the policy of avoiding the imposition of custom duties on the same goods by both the exporting and importing countries as based on the "intuitively appealing principle regarding double taxation").

48. *Tennessee v. Whitworth*, 117 U.S. 129, 137 (1886). *Accord*, *Schreiber v. Cook County*, 388 Ill. 297, 58 N.E.2d 40 (1944).

49. NEWHOUSE, *supra* note 37, at 3.

50. *E.g.*, ILL. CONST. art. IX, § 4(a) (real property must be uniformly taxed). See HELLERSTEIN, *supra* note 20, at 43-44; NEWHOUSE, *supra* note 37, at 9-11. See generally Matthews, *The Function of Constitutional Provisions Requiring Uniformity in Taxation*, 38 KY. L.J. 31, 181, 377, 503 (1949-50).

51. Matthews, *The Function of Constitutional Provisions Requiring Uniformity in Taxation*, 38 KY. L.J. 31, 51-54 (1949-50).

52. *Id.*

53. See, *e.g.*, *Idaho Telephone Co. v. Baird*, 91 Idaho 425, 423 P.2d 337 (1967) (property of utilities taxed differently from other property); *In re Assessment of Kanawha Valley Bank*, 144 W. Va. 346, 109 S.E.2d 649 (1959) (banks' capital stock taxed differently from other personal property).

54. 45 Ill. 2d 211, 258 N.E.2d 329 (1970).

county than in others, thus violating the uniformity clause of the Illinois Constitution.

A secondary effect of uniformity clauses has resulted from their application to situations where an inequitable tax burden distribution results not from one but from two taxes. This extended application of the requirement for a uniform tax burden evolved into the doctrine of double taxation.⁵⁵

The doctrine of double taxation developed at a time when property taxes were the predominant form of state taxation.⁵⁶ The imposition of a second property tax on some but not all the property already taxed in a taxing jurisdiction was readily recognized by the courts as an unequal distribution of the tax burden and was, therefore, disallowed.⁵⁷ For example, in *Campbell County v. Newport*⁵⁸ the Kentucky Court of Appeals considered two real property taxes, one county-wide and the other limited to real property in cities and towns within the county. The court noted that a relatively greater tax burden was placed on property located in cities and towns than on other property in the county.⁵⁹ Citing the uniformity clause of the Kentucky Constitution, the court found that this unequal distribution of the tax burden amounted to double taxation and overturned the cities-and-towns tax.⁶⁰ With the advent of new types of state privilege taxes in the first half of this century,⁶¹ the definition of double taxation was expanded beyond its property tax context and given a more generalized form.

Double taxation has come to be defined in terms of four elements. Three of these elements establish that the same governmental burden is being supported by both taxes. These elements require that both taxes be imposed by the same unit of state government, for the same purpose, and that both taxes be levied over the same time period. The fourth element of the definition tests for the unequal distribution of this burden: both taxes must have objects that partially overlap.⁶² Unless both

55. See, e.g., *C.F. Smith Co. v. Fitzgerald*, 270 Mich. 659, 259 N.W. 352, appeal dismissed, 296 U.S. 659 (1935). See also COOLEY, *supra* note 4, § 225 ("[T]here can be no double taxation, strictly speaking, under any constitution requiring equality and uniformity in taxation."); WICKERSHAM, *Double Taxation*, 12 VA. L. REV. 185, 191 (1926).

56. See HELLERSTEIN, *supra* note 20, at 1-6.

57. E.g., *Chicago v. Collins*, 175 Ill. 445, 51 N.E. 907 (1898) (a tax on all tangible personal property and a second property tax on automobiles results in double taxation). See COOLEY, *supra* note 4, § 223.

58. 174 Ky. 712, 193 S.W. 1 (1917).

59. *Id.* at 720-21, 193 S.W. at 6-7.

60. *Id.*

61. See HELLERSTEIN, *supra* note 20, at 6-9.

62. E.g., *People ex rel. Hanrahan v. Caliendo*, 50 Ill. 2d 72, 277 N.E.2d 319 (1971), appeal

taxes exhibit all four elements, no double taxation results.

Both Taxes Imposed By Same Unit Of State Government

The requirement that both taxes be imposed by the same unit of state government concerns the governmental entity under whose authority and jurisdiction the two taxes are levied. The entity may be the state itself, a county, a municipality, a school district or any other unit of state government that exercises taxing authority. If the two taxes are imposed by different units of state government, no double taxation results.⁶³ In *People ex rel. Hanrahan v. Caliendo*,⁶⁴ the Illinois Supreme Court observed that the City of Chicago and the Chicago Urban Transportation District were distinct governmental entities and thus held that the real property taxes imposed by each entity did not result in double taxation.

Both Taxes Imposed For Same Purpose

The requirement that both taxes be imposed for the same purpose involves the application or use of the revenue from the two taxes.⁶⁵ A tax may have a specific purpose, such as funding particular public works or providing particular public services, or it may have a general revenue-raising purpose. Where the two taxes have different purposes, no double taxation results.⁶⁶ In *People ex rel. Hanrahan v. Caliendo*,⁶⁷ the Illinois Supreme Court also noted that funding public transportation and raising general revenues for a municipality were different purposes so that the two taxes having these purposes did not result in double taxation.

Both Taxes Imposed Over Same Time Period

Both taxes must also be imposed over the same time period. For

dismissed, 406 U.S. 965 (1972); *Milwaukee Motor Transp. Co. v. Commissioner*, 292 Minn. 66, 193 N.W.2d 605 (1971). See also COOLEY, *supra* note 4, § 223.

63. *Kucharski v. White*, 42 Ill. 2d 335, 247 N.E.2d 428 (1969) (no double taxation where two taxes are imposed by different taxing bodies). *Accord*, *People v. Francis*, 40 Ill. 2d 204, 239 N.E.2d 129 (1968). See also *Jamison v. City of Charlotte*, 239 N.C. 682, 80 S.E.2d 904 (1954) (no double taxation where two taxes are imposed by a city and a county).

64. 50 Ill. 2d 72, 277 N.E.2d 319 (1971), *appeal dismissed*, 406 U.S. 965 (1972).

65. It is well established that taxes may be levied only for public purposes. *E.g.*, *Jones v. City of Portland*, 245 U.S. 217 (1917). See also COOLEY, *supra* note 4, § 235.

66. *E.g.*, *Bardon v. Nudelman*, 369 Ill. 214, 15 N.E.2d 836 (1938) (a tax for general revenue-raising and a tax for funding regulatory activity do not result in double taxation); *Klemm v. Davenport*, 100 Fla. 627, 129 So. 904 (1930) (a tax for general revenue-raising and a tax for funding street improvements do not result in double taxation). See also *People ex rel. Witte v. Franklin*, 352 Ill. 528, 186 N.E. 137 (1933).

67. 50 Ill. 2d 72, 277 N.E.2d 319 (1971), *appeal dismissed*, 406 U.S. 965 (1972).

the large majority of taxes this period consists of a twelve-month period termed the taxable year.⁶⁸ Where the two taxes are imposed over non-overlapping time periods, no double taxation results.⁶⁹ In *People ex rel. Carey v. Board of Education*,⁷⁰ the Illinois Supreme Court found that two taxes, respectively imposed from January through August and from September through December had non-overlapping time periods and therefore did not result in double taxation.

Objects of the Two Taxes Partially Overlap

The requirement that the objects of the two taxes partially overlap concerns the persons, property or privileges that are the objects of the two taxes.⁷¹ Partial overlap occurs when some of the objects of one tax are also the objects of a second tax. This may only occur if both taxes are imposed on the same type of object, be it the same type of property or the same privilege. If the two taxes are imposed on different types of objects, such as different types of property⁷² or different privileges,⁷³ no partial overlap can occur and no double taxation will result. Similarly, if one of the two taxes is imposed on property and the other on a privilege, no double taxation will result.⁷⁴

The partial overlap required for double taxation is most evident when some of the property that is subject to one property tax is also subject to another property tax.⁷⁵ In *City of Chicago v. Collins*,⁷⁶ for example, automobiles were among the personal property that was sub-

68. *E.g.*, ILL. REV. STAT. ch. 120, § 15-1501(24) (1979) (income tax); *id.* § 508a (real property tax). See generally STATE TAX HANDBOOK (CCH Oct. 1, 1980). The twelve-month period may coincide with the calendar year but not in all cases.

69. *State ex rel. Spink v. Kemp*, 365 Mo. 368, 283 S.W.2d 502 (1955) (two taxes imposed over different calendar years do not result in double taxation). See also *E & L Transp. Co. v. Ellington*, 212 Tenn. 671, 371 S.W.2d 456 (1963).

70. 55 Ill. 2d 533, 304 N.E.2d 273 (1973).

71. For a discussion of the various objects of taxes, see text accompanying notes 20-46 *supra*.

72. See, *e.g.*, *Harvey Coal & Coke Co. v. Dillon*, 59 W. Va. 605, 53 S.E. 928 (1905) (two taxes, each imposed on different estates in land do not result in double taxation). See also COOLEY, *supra* note 4, §§ 239, 240.

73. See, *e.g.*, *People v. Deep Rock Oil Corp.*, 343 Ill. 388, 175 N.E. 572 (1931) (a tax on the privilege of operating an automobile and a tax on the privilege of using state highways do not result in double taxation); *C.F. Smith Co. v. Fitzgerald*, 270 Mich. 659, 259 N.W. 352, *appeal dismissed*, 296 U.S. 659 (1935) (a tax on the privilege of operating chain stores and a tax on the privilege of carrying on a retail business do not result in double taxation). See also COOLEY, *supra* note 4, §§ 233, 1684.

74. See, *e.g.*, *Ohio Tax Cases*, 232 U.S. 576 (1914) (a property tax and a tax on the privilege of conducting a railroad business do not result in double taxation); *Bode v. Barrett*, 412 Ill. 204, 106 N.E.2d 521 (1952) (a property tax on automobiles and a tax on the privilege of using state highways do not result in double taxation). See also COOLEY, *supra* note 4, §§ 228, 232.

75. *E.g.*, *Campbell County v. Newport*, 174 Ky. 712, 193 S.W. 1 (1917). See text accompanying notes 56-58 *supra*.

76. 175 Ill. 445, 51 N.E. 907 (1898).

ject to a personal property tax. A second property tax imposed only on automobiles produced a partial overlap as to automobiles between the personal property that was the object of the two taxes. The Illinois Supreme Court held that the second tax resulted in double taxation.

Where the two taxes are imposed on the same privilege, partial overlap is tested in terms of the legal entities whose privilege is being taxed. If the privilege of a given group of entities is subject to one tax, and the same privilege of some of those entities is subject to a second tax, a partial overlap exists.⁷⁷ In *New York R.R. v. Stevenson*,⁷⁸ a tax had been imposed on all corporations on the privilege of issuing stock. When another tax was then imposed on the same privilege of incorporated public utilities, such utilities became subject to two taxes while the same privilege of other corporations was subject to only one tax.⁷⁹ The Illinois Supreme Court found that the second tax on the privilege of incorporated public utilities to issue stock resulted in double taxation. Of course, where the entities whose privilege is taxed are distinct and do not overlap, no double taxation will result.⁸⁰

Interestingly, if the objects of the two taxes overlap exactly so that both taxes are imposed on the same property or privilege, no prohibited double taxation exists. Courts regard the second tax as merely an increase of the first tax.⁸¹ This treatment is consistent with the fact that no unequal distribution of the tax burden exists in this type of situation.

The determination of whether two taxes result in double taxation may thus be seen as a two-step process. The first step is to establish the objects of each of the two taxes at issue.⁸² The second step is to determine whether all of the four elements of double taxation are present. If both taxes are imposed by the same unit of state government for the same purpose and over the same time period, and if the objects of both

77. See, e.g., *Franklin County Coal Co. v. Ames*, 359 Ill. 178, 194 N.E. 268 (1934) (a tax on the privilege of carrying on a retail business, imposed on different retailers selling the same product, is not double taxation). See also COOLEY, *supra* note 4, §§ 233, 1684.

78. 277 Ill. 474, 115 N.E. 633 (1917).

79. *Id.* at 481, 115 N.E. 635 ("Both . . . [taxes] are exacted for the privilege of exercising a corporate franchise. . . .").

80. See *Milwaukee Motor Transp. Co. v. Commissioner*, 292 Minn. 66, 193 N.W.2d 605 (1971) (a parent corporation and its subsidiary are different entities so that taxing each corporation's privilege of earning income does not result in double taxation). See also *Union Central Life Ins. Co. v. Lowe*, 349 Ill. 464, 182 N.E. 611 (1932).

81. See, e.g., *Independent School Dist. of Cedar Rapids v. Iowa Employment Security Comm'n*, 237 Iowa 1301, 25 N.W.2d 491 (1946); *Van Dyke v. Wisconsin Tax Comm'n*, 217 Wis. 528, 259 N.W. 700 (1935). See also COOLEY, *supra* note 4, § 233.

82. See, e.g., *Educational Films Corp. v. Ward*, 282 U.S. 379 (1921).

taxes partially overlap, double taxation results.⁸³

This two-step process was followed by the Illinois Supreme Court in *New York R.R. v. Stevenson*.⁸⁴ There, the court first determined that the two taxes at issue were both imposed on a corporation's privilege of issuing stock.⁸⁵ The court then proceeded to establish that both taxes were imposed by the state itself for general state purposes and that both taxes accrued over the same time period—upon the issuance of stock.⁸⁶ Noting that one tax was imposed on the stock-issuing privilege of all corporations and that the other tax was imposed on the same privilege of incorporated public utilities, the court concluded that this partial overlap—with regard to incorporated public utilities—resulted in double taxation.⁸⁷

Given a finding of double taxation, courts will generally construe one of the two taxes involved in such a manner as to eliminate the partial overlap between the objects of both taxes.⁸⁸ Such action is consistent with the established rule that if a statute can fairly be given a constitutional construction, courts should adopt that construction, on the ground that legislatures are presumed to act within their authority.⁸⁹ In *New York R.R. v. Stevenson*,⁹⁰ the Illinois Supreme Court construed the tax on the stock-issuing privilege of all corporations as inapplicable to the privilege of incorporated public utilities. Through this construction, the court eliminated the partial overlap that existed between the tax on the privilege of all corporations and the tax on the privilege of incorporated public utilities and thereby eliminated double taxation.

The only significant exception allowing double taxation involves situations where a state legislature clearly intended to impose double taxation and it is not prohibited by the state's constitution. In most such states, courts will allow double taxation only where the legislative intent is unmistakable.⁹¹ This high standard of clarity significantly

83. See note 62 *supra*.

84. 277 Ill. 474, 115 N.E. 633 (1917).

85. *Id.* at 481, 115 N.E. at 635-36.

86. *Id.* at 481-82, 115 N.E. at 635-36.

87. *Id.* at 483, 115 N.E. at 636.

88. See, e.g., *Milwaukee Motor Transp. Co. v. Commissioner*, 292 Minn. 66, 193 N.W.2d 605 (1971); *Old Colony Trust Co. v. Commissioner*, 346 Mass. 667, 195 N.E.2d 332 (1964). See also COOLEY, *supra* note 4, §§ 224-226.

89. See, e.g., *St. Louis Southwestern Ry. Co. v. Arkansas*, 235 U.S. 350, 369-70 (1914); *C.F. Smith Co. v. Fitzgerald*, 270 Mich. 659, 259 N.W. 352, *appeal dismissed*, 296 U.S. 659 (1935). See also COOLEY, *supra* note 4, §§ 495, 509.

90. 277 Ill. 474, 115 N.E. 633 (1917).

91. *Tennessee v. Whitworth*, 117 U.S. 129, 137 (1886). *Accord*, *People v. Schweitzer*, 369 Ill. 355, 360, 16 N.E.2d 897, 901 (1938). See also *E & L Transp. Co. v. Ellington*, 212 Tenn. 671, 675,

narrows the scope of the exception, making it largely unavailable.⁹² In nine states where double taxation is deemed absolutely prohibited, no exception to the general treatment of remedial construction is recognized.⁹³

PARTNERSHIPS AND DOUBLE TAXATION: THE ENTITY AND AGGREGATE VIEWS

Partnership law is characterized by a tension between the entity and aggregate views of a partnership.⁹⁴ Under the entity view, a partnership is recognized as a separate legal entity to which rights and duties accrue.⁹⁵ Under the aggregate view, a partnership is deemed to be no more than a collection of individuals to whom all the rights and duties arising from a partnership accrue.⁹⁶ Both approaches are well represented among the various legal contexts in which a partnership is viewed.⁹⁷ The view adopted becomes particularly significant to partnership taxation where the approach utilized can affect the determination of whether double taxation results.

At common law, artificial legal entities could only be created by the sovereign.⁹⁸ Thus, early partnership law was based on the aggre-

371 S.W.2d 456, 458 (1963) ("[D]ouble taxation [is] not proscribed . . . where it is plain that the Legislature intended such result.").

92. Research has not revealed any cases in which this exception has been successfully invoked.

93. Two states have an express constitutional provision absolutely banning double taxation. See IDAHO CONST. art. 7, § 5 (1890); ILL. CONST. art IX, § 3(a) (1970). The other seven states have recognized such a prohibition in their constitutions through judicial interpretation. See *Flynn v. City and County of San Francisco*, 18 Cal. 2d 210, 115 P.2d 3 (1941); *C.F. Smith Co. v. Fitzgerald*, 270 Mich. 659, 259 N.W. 352, *appeal dismissed*, 296 U.S. 659 (1935); *Panola County v. C.M. Carrier & Sons*, 92 Miss. 148, 45 So. 426 (1908); *Opinion of the Justices*, 106 N.H. 202, 208 A.2d 458 (1965); *State ex rel Attorney Gen. v. Tittmann*, 42 N.M. 76, 75 P.2d 701 (1938); *Olson v. Oklahoma Tax Comm'n*, 198 Okla. 607, 180 P.2d 622 (1947); *Marshall v. South Carolina Tax Comm'n*, 178 S.C. 57, 182 S.E. 96, *cert. denied*, 296 U.S. 585 (1935). See also COOLEY, *supra* note 4, § 225.

94. See generally S. ROWLEY, ON PARTNERSHIP § 1.3 (2d ed. 1960) [hereinafter referred to as ROWLEY]; J. CRANE, HANDBOOK ON THE LAW OF PARTNERSHIP 9-21 (2d ed. 1952) [hereinafter referred to as CRANE].

95. See, e.g., *Lansing v. Bever Land Co.*, 158 Iowa 693, 138 N.W. 833 (1912); *Drucker v. Wellhouse*, 82 Ga. 129, 8 S.E. 40 (1888). See also Drake, *Partnership Entity and Tenancy in Partnership: The Struggle for a Definition*, 15 MICH. L. REV. 609 (1917); Crane, *The Uniform Partnership Act—A Criticism*, 28 HARV. L. REV. 762 (1915).

96. See, e.g., *Abbott v. Anderson*, 265 Ill. 285, 106 N.E. 782 (1914); *Adams v. Church*, 42 Or. 270, 70 P. 1037 (1902). See also Lewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism*, 29 HARV. L. REV. 158, 291 (1916).

97. See Uniform Partnership Act (codified in Illinois at ILL. REV. STAT. ch. 106½, §§ 1-43 (1979)). The Uniform Partnership Act has been adopted by all fifty states. See 6 UNIFORM LAWS ANNOTATED, *Uniform Partnership Act* (1969). See also Jensen, *Is a Partnership Under the Uniform Partnership Act an Aggregate or an Entity?*, 16 VAND. L. REV. 377 (1963); Crane, *The Uniform Partnership Act and Legal Persons*, 29 HARV. L. REV. 838 (1916).

98. See 1 C. BATES, THE LAW OF PARTNERSHIP § 171 (1888); CRANE, *supra* note 94, at 10.

gate view.⁹⁹ The right to manage the partnership business, the right to share in partnership profits and civil liability for partnership acts were among the rights and duties that accrued to the individual partners.¹⁰⁰ The rapid commercial expansion that characterized the industrial revolution brought about an increased use of partnerships as a form of doing business.¹⁰¹ The increase in partnership litigation which followed unearthed some commercial shortcomings in the aggregate theory that prompted a different approach in the law.

The entity view of a partnership had its origin in the English mercantile law. This law initially developed during the close of the Middle Ages in special courts and later in courts of equity. Forged by the needs of its mercantile constituency, the law was based largely on the commercial customs of the day. Noting that the commercial world accorded de facto entity status to a partnership, courts were increasingly persuaded to recognize a partnership as a separate entity.¹⁰²

Property ownership was one of the earlier aspects of a partnership in which the common law aggregate view was supplanted by the entity view. Courts had initially attempted to fit partnership ownership of property within the concepts of joint tenancy or tenancy in common.¹⁰³ Thus, title to partnership property was held among the individual partners. This approach had the effect of relegating a partnership creditor to the status of personal creditor of the individual partners, thereby depriving his claim of any priority over partnership assets.¹⁰⁴ This approach also made partnership property available to satisfy a partner's personal obligations whether or not these obligations were related to the partnership business and whether or not this would be detrimental to the partnership and its business creditors.¹⁰⁵ In order to strengthen the rights of partnership creditors and to insulate the partnership from

99. See, e.g., *Puerto Rico v. Russell & Co.*, 288 U.S. 476 (1933); *Faulker v. Hyman*, 142 Mass. 53, 6 N.E. 846 (1886). See also 1 J. BARRETT & E. SEAGO, *PARTNERS AND PARTNERSHIPS LAW AND TAXATION* 13 (1956) [hereinafter referred to as BARRETT]; F. MECHEM, *ELEMENTS OF THE LAW OF PARTNERSHIP* § 6 (2d ed. 1920).

100. See generally ROWLEY, *supra* note 94; CRANE, *supra* note 94.

101. See 1 BARRETT, *supra* note 99, at 13.

102. See 1 BARRETT, *supra* note 99, at 10-13. See also ROWLEY, *supra* note 94, § 1.1; Burdick, *What is a Law Merchant?*, 2 COL. L. REV. 470 (1902). See also F. MECHEM, *ELEMENTS OF THE LAW OF PARTNERSHIP* § 7 (2d ed. 1920).

103. See, e.g., *Johnson v. Shirley*, 152 Ind. 453, 53 N.E. 459 (1899); *Woodward v. McAdam*, 101 Cal. 438, 35 P. 1016 (1894). See also 2 BARRETT, *supra* note 99, at 451-52; CRANE, *supra* note 94, at 11; Drake, *Partnership Entity and Tenancy in Partnership: The Struggle for a Definition*, 15 MICH. L. REV. 609 (1917).

104. See F. BURDICK, *LAW OF PARTNERSHIP* 252 (3d ed. 1917); 1 C. BATES, *THE LAW OF PARTNERSHIP* § 172 (1888).

105. See F. BURDICK, *LAW OF PARTNERSHIP* 269-71 (3d ed. 1917).

non-related personal obligations of the individual partners, courts began to recognize a partnership as a separate entity for purposes of property ownership.¹⁰⁶ This recognition was eventually adopted by the Uniform Partnership Act.¹⁰⁷

In contrast, the treatment of partnership income has always reflected the aggregate view. The common law's view is consistent with the definition of a partnership as an association of individuals engaged in business for profit.¹⁰⁸ Partners are seen as individually sharing in the profits and losses of their undertaking,¹⁰⁹ thus rendering the entity view inappropriate. Perhaps because the distribution of its income is a matter internal to a partnership, there were no creditors or other outside parties urging the courts to adopt the entity view. The aggregate view of partners sharing in the profits and losses of a partnership was also adopted by the Uniform Partnership Act.¹¹⁰

The treatment accorded to partnerships under state taxes also reflects both the entity and aggregate views.¹¹¹ Generally, the view taken for purposes of a particular tax will be the same as the view taken for the underlying substantive aspect of a partnership most closely related to the object of the tax. Thus, where a tax classifies property according to the different entities owning it, partnership property is taxed separately from the property of the individual partners because a partnership is treated as a separate entity for purposes of owning property.¹¹² Similarly, the aggregate view of partners sharing in the profits and losses of a partnership has been adopted by the vast majority of state income tax laws.¹¹³ Under these laws, a partnership is treated as sim-

106. See, e.g., *Pratt v. McGuinness*, 173 Mass. 170, 53 N.E. 380 (1899); *Richard v. Allen*, 117 Pa. 199, 11 A. 552 (1887). See also 2 BARRETT, *supra* note 99, at 453.

107. See 6 UNIFORM LAWS ANNOT., Uniform Partnership Act, §§ 8, 25(2)(c).

108. See, e.g., *Meehan v. Valentine*, 145 U.S. 611 (1892); *Berthold v. Goldsmith*, 65 U.S. (24 How.) 536 (1860). See also 6 UNIFORM LAWS ANNOT., Uniform Partnership Act, § 6(1). See generally CRANE, *supra* note 94, § 4.

109. See ROWLEY, *supra* note 94, § 6.8; 1 BARRETT, *supra* note 99, at 28-33.

110. See 6 UNIFORM LAWS ANNOT., Uniform Partnership Act, § 26.

111. Both the entity and aggregate views have been adopted by courts in resolving federal tax controversies. Compare *Burde v. Commissioner*, 352 F.2d 995 (2d Cir. 1965) (two partnerships treated as separate entities for purposes of transferring a patent between them), with *Liflans Corp. v. United States*, 390 F.2d 965 (Ct. Cl. 1968) (a partnership treated as an aggregate of individuals for purposes of qualifying for a deduction between related taxpayers). See A. WILLIS, PARTNERSHIP TAXATION §§ 2.01-.04 (2d ed. 1976); CRANE, *supra* note 94, at 20 n.34.

112. See, e.g., *Walter G. Hougland & Sons v. McCracken County Bd. of Supervisors*, 306 Ky. 234, 206 S.W.2d 951 (1947); *Svoboda & Hannah v. Bd. of Equalization*, 180 Neb. 215, 142 N.W.2d 328 (1966). See also 6 UNIFORM LAWS ANNOT., Uniform Partnership Act, §§ 8, 25(2)(c); COOLEY, *supra* note 4, § 596; 1 C. BATES, THE LAW OF PARTNERSHIP §§ 175, 176 (1888).

113. Thirty-two states and the District of Columbia have an express statutory provision declaring a partnership to be a conduit for income tax purposes: ALA. CODE § 40-18-24 (1977); ARIZ. REV. STAT. ANN. § 43-141 (1980); ARK. STAT. ANN. § 84-2012(3) (1980); CAL. REV. & TAX.

ply a "conduit" through which partnership income flows unimpeded to the individual partners. No income tax is imposed on the partnership itself; rather, each partner's share of partnership income is treated as his own income which is then subject to tax.

As to other privilege taxes, the entity view has generally been favored.¹¹⁴ Perhaps reflecting the same deference to commercial reality that motivated the English mercantile courts, most other state privilege taxes treat a partnership as the entity whose particular privilege is taxed. In Illinois, a partnership is recognized as a separate entity for purposes of taxes on such privileges as utilizing state highways, engaging in a retail business and operating a hotel.¹¹⁵

The choice between the entity and aggregate views with respect to how a partnership is treated under the law of a given state can affect the determination of whether double taxation exists where two taxes on the same privilege are involved.¹¹⁶ For two such taxes, partial overlap of

CODE § 17851 (West 1970); COLO. REV. STAT. § 39-22-201 (1973); DEL. CODE ANN. tit. 30, § 1143 (1974); D.C. CODE ANN. § 47-1574e (Supp. V 1978); GA. CODE ANN. § 91A-3604 (1980); HAWAII REV. STAT. § 235-60 (1976); KAN. STAT. ANN. § 79-32,129 (1977); KY. REV. STAT. § 141.206(2) (1972); LA. REV. STAT. ANN. § 47:201 (West Supp. 1980); ME. REV. STAT. ANN. tit. 36, § 5190 (1978); MD. ANN. CODE art. 81, § 315 (1980); MASS. GEN. LAWS ANN. ch. 62, § 17 (West 1969); MINN. STAT. ANN. § 290.31 (West 1966); MISS. CODE ANN. § 27-7-25 (1972); MO. ANN. STAT. § 143.401 (Vernon 1976); MONT. REV. CODES ANN. § 84-4911 (1966); NEB. REV. STAT. § 77-2727 (1976); N.J. STAT. ANN. § 54A:2-2 (West Supp. 1980); N.Y. TAX LAW § 364 (McKinney 1975); N.C. GEN. STAT. § 105-142(c) (1979); N.D. CENT. CODE § 57-38-08 (1971); OHIO REV. CODE ANN. § 5747.22 (Page 1980); OKLA. STAT. ANN. tit. 68, § 2363 (West Supp. 1980); OR. REV. STAT. § 316.342 (1979); PA. STAT. ANN. tit. 72, § 3402-203 (Purdon 1964); R.I. GEN. LAWS § 44-30-1(b) (1980); S.C. CODE § 12-7-300 (Law. Co-op 1976); UTAH CODE ANN. § 59-14A-36 (1974); VA. CODE § 58-151.03(b) (Supp. 1980); W. VA. CODE § 11-21-3(b) (1974).

Six states treat a partnership as a conduit for income tax purposes by virtue of the fact that they base their income tax on the Internal Revenue Code, which provides for such treatment (I.R.C. § 701): IDAHO CODE § 63-3022 (1976); IOWA CODE ANN. § 422.7 (West 1971); MICH. COMP. LAWS ANN. § 206.51 (West Supp. 1980); N.M. STAT. ANN. § 7-2-2 (Supp. 1980); VT. STAT. ANN. tit. 32, § 5822 (Supp. 1980); WIS. STAT. ANN. § 71.02(2)(a) (West Supp. 1980).

New Hampshire and Tennessee impose a limited income tax on the income of partnerships—only income from stocks and bonds is subject to the tax. Additionally, the income taxed as a partnership's is received by the partners without the imposition of any additional tax. *See* N.H. REV. STAT. ANN. §§ 77:3, :4, :15 (1970); TENN. CODE ANN. § 67-2602 (1976).

Eight states do not impose any income tax: Alaska, Connecticut, Florida, Nevada, South Dakota, Texas, Washington and Wyoming.

114. *See* 1 C. BATES, THE LAW OF PARTNERSHIP § 175 (1888).

115. *See, e.g.*, ILL. REV. STAT. ch. 120, § 417.11 (1979) (privilege of operating motor vehicles on state highways); *id.* § 440 (privilege of carrying on a retail business); *id.* § 481b.32(8) (privilege of carrying on a hotel business).

116. Differences between the entity and aggregate views of a partnership do not affect double taxation where two property taxes are involved. The object of such taxes is property and the partial overlap required for double taxation must occur with respect to the property taxed, not with respect to the property owners. *See, e.g.*, Bode v. Barrett, 412 Ill. 204, 106 N.E.2d 521 (1952). Because a partnership can hold title to property in its own name, *see* 6 UNIFORM LAWS ANNOT., Uniform Partnership Act, §§ 8(3), 25(2)(c), such property would not also be deemed owned by the individual partners, so even where property is classified by the type of entity owning it for tax

their objects is tested in terms of the legal entities whose privilege is subject to the two taxes. If the entities partially overlap, the requisite partial overlap for a finding of double taxation exists.¹¹⁷ Where one tax is imposed on the privilege of a partnership, the choice between the entity and aggregate views in construing the second tax will determine if a partial overlap exists. If the entity view is taken, no partial overlap can occur between the distinct entities of a partnership and the individual partners. However, under the aggregate view, partners are also individuals so that a partial overlap would exist and double taxation could result.

Although not in a double taxation context, courts have previously addressed the question of whether a privilege subject to tax is to be attributed to a partnership or to the individual partners. In *Corn v. Fort*,¹¹⁸ the Tennessee Supreme Court considered a tax imposed on the privilege of doing business as a partnership. Although the statute referred to the privilege taxed as that of a partnership, the court treated the privilege as that of the individual partners and overturned the tax.¹¹⁹ More recently, in *Tax Review Board v. Shapiro*,¹²⁰ the Pennsylvania Supreme Court considered a municipal income tax that the municipality sought to apply to a partnership as a separate entity. By finding that the tax was not applicable to the income of partners residing outside the municipality, the court effectively treated the income-earning privilege taxed as that of the individual partners and not that of the partnership.¹²¹ Unfortunately, the absence of a supporting rationale in these two cases for the courts' applications of the aggregate view leaves other courts without guidance as to the factors which should be considered when deciding whether the entity or the aggregate view should be applied to a particular tax.

purposes, no overlap and, hence, no double taxation would result. See 1 C. BATES, THE LAW OF PARTNERSHIP §§ 175, 176 (1888).

117. See text accompanying notes 78-80 *supra*.

118. 170 Tenn. 377, 95 S.W.2d 620 (1936).

119. *Id.* at 387, 95 S.W.2d at 623-24. Noting that a single individual's privilege of doing business was not subject to tax while that of two or more individuals in a partnership was taxed, the court found such a classification of individuals to be arbitrary and capricious in violation of the equal protection clause of the Tennessee Constitution and U.S. Constitution. *Id.* See note 2 *supra*.

120. 409 Pa. 253, 185 A.2d 529 (1962).

121. *Id.* The court stated: "[W]e must hold that the weight of authority in this Commonwealth is to the effect that a partnership is treated as an aggregate of individuals and not as a separate entity." *Id.* at 260, 185 A.2d at 533.

DOUBLE TAXATION, INCOME TAXES AND PARTNERSHIPS
UNDER ILLINOIS LAW

As in other jurisdictions, the doctrine of double taxation in Illinois developed as an extended application of its constitution's uniformity clause to double property taxes.¹²² As privilege taxes came into vogue, the doctrine expanded to consider these types of taxes.¹²³ The doctrine has enjoyed continued vitality to the present day.¹²⁴

The Illinois legislature first enacted a general income tax in 1932.¹²⁵ The tax was graduated in nature, whereby the rate at which income was taxed increased with the amount of income received.¹²⁶ In *Bachrach v. Nelson*,¹²⁷ the constitutionality of this income tax was challenged. After stating that the Illinois Constitution empowered the legislature to enact only property and privilege taxes, the Illinois Supreme Court concluded that an income tax was really a tax on personal property.¹²⁸ Examining the tax in light of the constitution's uniformity clause, the court then found that the tax's graduated rate violated the uniformity requirement.¹²⁹ Accordingly, the income tax was overturned.

It was not until 1969 that the Illinois legislature again enacted a general income tax.¹³⁰ Mindful of the Illinois Supreme Court's limited view of the state's taxing power in *Bachrach* and perhaps acting on the suggestion of one commentator,¹³¹ the legislature imposed the new tax

122. See ILL. CONST. of 1870, art. IX, § 1 (repealed 1971). See also *Chicago v. Collins*, 175 Ill. 445, 51 N.E. 907 (1898). For a general discussion of the early development of double taxation, see text accompanying notes 56-60 *supra*.

123. See, e.g., *Union Central Life Ins. Co. v. Lowe*, 349 Ill. 464, 182 N.E. 611 (1932); *People v. Deep Rock Oil Corp.*, 343 Ill. 388, 175 N.E. 572 (1931).

124. See, e.g., *People ex rel. Carey v. Board of Educ.*, 55 Ill. 2d 533, 304 N.E.2d 273 (1973); *People ex rel. Hanrahan v. Caliendo*, 50 Ill. 2d 72, 277 N.E.2d 319 (1971), *appeal dismissed*, 406 U.S. 965 (1972).

125. Income Tax Law, Fifty-Seventh Illinois General Assembly, 1st. Sp. Sess., 1931-32 Ill. Laws 91 (1932).

126. *Id.*

127. 349 Ill. 579, 182 N.E. 909 (1932).

128. *Id.* at 591-92, 182 N.E. at 914. The court stated:

[M]oney or any other thing of value acquired as gain or profit . . . is property, and . . . in the aggregate, these acquisitions constitute income, and, in accordance with the axiom that the whole includes all of its parts, income includes property and nothing but property and therefore is itself property.

Id. at 592, 182 N.E. at 914. For a discussion of the split among state courts that developed concerning whether the object of an income tax is property or a privilege, see note 37 *supra*.

129. 349 Ill. at 595-96, 182 N.E. at 915.

130. Illinois Income Tax Act, P.A. 76-261, 1969 Ill. Laws 409 (1969) (codified at ILL. REV. STAT. ch. 120, §§ 1-101 to 17-1701 (1979)).

131. See Cohn, *Constitutional Limitations on Income Taxation in Illinois*, 1961 U. ILL. L.F. 586, 606-11.

on the privilege of earning income¹³² and measured the tax with a single, non-graduated rate.¹³³ In *Thorpe v. Mahin*,¹³⁴ the Illinois Supreme Court upheld the tax by overruling *Bachrach* and adopting the legislature's view that the tax was imposed on the income-earning privilege and not on property.¹³⁵ The court also adopted a more expansive interpretation of the state's taxing power.

The newly enacted tax followed the majority of states in treating a partnership as a conduit.¹³⁶ No income tax was levied on the income of the partnership per se.¹³⁷ Instead, the tax was imposed on partnership income accruing to partners in their individual capacity.¹³⁸ As individuals, the net income of the partners was made subject to a 2.5% tax.¹³⁹

On December 15, 1970, Illinois adopted a new constitution.¹⁴⁰ Two provisions of the new constitution concerned double taxation. Section 3(a) of article IX prohibited double taxation of an individual's income.¹⁴¹ Section 5(c) of article IX, however, called for an end to the personal property tax and directed the Illinois legislature to replace lost revenue by imposing other types of taxes.¹⁴² Section 5(c) further pro-

132. ILL. REV. STAT. ch. 120, § 2-201(a) (1979) ("A tax . . . is hereby imposed . . . on the privilege of earning income in or as a resident of this State.").

133. ILL. REV. STAT. ch. 120, § 2-201(b) (1979).

134. 43 Ill. 2d 36, 250 N.E.2d 633 (1969).

135. *Id.* at 39-40, 250 N.E.2d at 635. The Illinois Supreme Court quoted approvingly from *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937), as follows:

The incidence of a tax on income differs from that of a tax on property. Neither tax is dependent upon the possession by the taxpayer of the subjects of the other. His income may be taxed although he owns no property, and his property may be taxed although it produces no income. The two taxes are measured by different standards, the one by the amount of income received over a period of time, the other by the value of the property at a particular date. Income is taxed but once; the same property may be taxed recurrently.

Id. at 314.

136. See text accompanying note 113 *supra*.

137. ILL. REV. STAT. ch. 120, § 2-205(b) (1977) (amended 1979) provided in part:

A partnership as such shall not be subject to the tax imposed by this Act. . . . Persons carrying on business as partners shall be liable for the tax imposed by this Act only in their separate or individual capacities.

138. *Id.*

139. ILL. REV. STAT. ch. 120, § 2-201(b)(1) (1979).

140. See ILL. REV. STAT., Const. of the State of Ill., at 15 (1979).

141. ILL. CONST. art. IX, § 3(a) provides:

A tax on or measured by income shall be at a non-graduated rate. At any one time there may be no more than one such tax imposed by the State for State purposes on individuals and one such tax imposed on corporations. In any such tax imposed on corporations the rate shall not exceed the rate imposed on individuals by more than a ratio of 8 to 5.

142. ILL. CONST. art. IX, § 5(c) provides:

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. Such revenue shall be replaced by imposing statewide taxes, other than ad valorem taxes on real estate, solely

vided that if an additional income tax on individuals was levied to replace the lost revenue, that income tax would not be subject to the ban against double taxation of an individual's income which appears in section 3(a).¹⁴³

From 1970 through 1978, the Illinois legislature failed to comply with the mandate of section 5(c) that the property tax be abolished and other taxes be enacted to replace it on or before January 1, 1979.¹⁴⁴ In *Client Follow-Up Co. v. Hynes*,¹⁴⁵ the Illinois Supreme Court held that the effect of this mandate was to invalidate the personal property tax after 1978. In the summer of 1979, the Illinois legislature abolished the personal property tax and enacted four taxes to replace the lost revenue.¹⁴⁶ One of the four taxes was the partnership income tax.

The partnership income tax consists of a 1.5% levy on partnership net income.¹⁴⁷ Because the conduit provision of the state's general income tax was left untouched by the legislature when it enacted the partnership tax,¹⁴⁸ partnership income continues to flow to the individ-

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. If any taxes imposed for such replacement purposes are taxed on or measured by income, such replacement taxes shall not be considered for purposes of the limitations of one tax and the ratio of 8 to 5 set forth in Section 3(a) of this Article.

Illinois' personal property tax, ILL. REV. STAT. ch. 120, §§ 499, 502, 508a (1977) (repealed 1979), was abolished due to its high administrative burden and to the inequity arising from the fact that the tax is not well related to a taxpayer's ability to pay. See Note, *Taxation: Assessment and Collection of Personal Property Taxes*, 28 OKLA. L. REV. 933 (1975).

143. ILL. CONST. art. IX, § 5(c) (1970).

144. *Id.* The text of section 5(c) appears in note 142 *supra*.

145. 75 Ill. 2d 208, 390 N.E.2d 847 (1979).

146. Personal Property Tax Replacement Income Tax Act, P.A. 81-1st Sp. Sess.-1, 1979 Ill. Laws 4925 (1979). The taxes were: an additional 2.85% corporate income tax; a 1.5% income tax on the income of partnerships and subchapter S corporations; an additional 1.5% income tax on trusts; and a 0.8% levy on the invested capital of public utilities. *Id.*

147. The partnership income tax is imposed on what is termed state partnership net income. This income figure is defined as partnership income per I.R.C. § 703, modified by certain adjustments. These include adding the federal deductions for interest and dividends received, for capital gains, for state income tax paid and for any guaranteed payments (salary) to partners. The adjustments also include subtracting from capital gains the valuation limitation amount (Illinois' basis for property acquired before the imposition of the state income tax in 1969); income tax refunds; amounts exempt from the state income tax; personal service income per I.R.C. § 1348(b)(1) or reasonable compensation to partners for personal service to the partnership; and amounts distributed to a partner which is itself an entity subject to one of the taxes enacted to replace the revenue lost from the abolished personal property tax. See ILL. REV. STAT. ch. 120, §§ 2-202, 2-203(d) (1979).

148. ILL. REV. STAT. ch. 120, § 2-205(b) (1979) now provides:

A partnership as such shall not be subject to the . . . [general income tax] but shall be subject to the . . . [partnership income tax] The partners in a partnership shall be liable for the . . . [partnership income tax] to the extent such tax is not paid by the partnership Persons carrying on business as partners shall be liable for the . . . [general income tax] only in their separate or individual capacities.

ual partners where it is subject to a 2.5% general income tax as well.¹⁴⁹

Although the statute declares that the tax is imposed on a partnership's privilege of earning income,¹⁵⁰ the interpretation of whose privilege is being taxed was not altogether clear to one of the delegates at the constitutional convention which drafted section 5(c). Noting that section 5(c) authorizes an additional income tax to replace lost revenue from the abolished personal property tax, Delegate McCracken discussed whose income would be the object of such a tax:

I am thinking about individuals, . . . perhaps in their capacities as partners. I am not sure whether I am talking about them or not, because I am not sure of the Supreme Court's interpretation of the term 'individual'; . . . I may be talking about partnerships.¹⁵¹

This potential ambiguity was not considered by the Illinois legislature when it enacted the partnership income tax,¹⁵² and this ambiguity became the central issue in *Continental Illinois National Bank & Trust Co. v. Zagel*.

CONTINENTAL ILLINOIS NATIONAL BANK & TRUST CO. V. ZAGEL

In *Zagel*,¹⁵³ the partnership seeking to overturn the partnership income tax characterized the tax as falling on the income of the individual partners and not on the income of a partnership.¹⁵⁴ Because each partner's income is also taxed by the state's general income tax, the plaintiff argued that the new tax resulted in double taxation, thus violating the section 3(a) ban on double taxation of an individual's income.¹⁵⁵

149. ILL. REV. STAT. ch. 120, § 2-201(b)(1) (1979).

150. *Id.* § 2-201(c) (1979) ("[T]here is also hereby imposed the Personal Property Tax Replacement Income Tax . . . on every . . . partnership. . . . Such taxes are imposed on the privilege of earning or receiving income in or as a resident of this State.")

151. 5 PROCEEDINGS, SIXTH ILLINOIS CONSTITUTIONAL CONVENTION 3889 (1972).

152. See Illinois General Assembly House of Representatives, Transcript of Proceedings (August 6, 1979).

153. 78 Ill. 2d 387, 401 N.E.2d 491 (1979).

154. *Id.* at 407, 401 N.E.2d at 501.

155. *Id.* The partnership income tax was also challenged on two other constitutional grounds. One ground was that section 3(a) authorized the imposition of income taxes on individuals and corporations but not on partnerships. Looking to the constitutional debates pertinent to section 3(a), the court found that such a narrow reading of the section had not been intended. *Id.* at 405-07, 401 N.E.2d at 500-01. The other ground was that the tax violated the equal protection clause of Illinois' constitution by treating individuals differently depending on whether or not they were partners. As to this ground, the court found that a showing that this difference in treatment was arbitrary and capricious had not been made. *Id.* at 407-08, 401 N.E.2d at 501.

The validity of the other taxes that were also enacted to replace the revenue lost by the abolishment of the personal property tax was also challenged, although the issues raised by this other challenge are not addressed in this comment. Their validity was upheld. For descriptions of these other taxes, see note 146 *supra*.

In its brief discussion of the issue, the Illinois Supreme Court¹⁵⁶ stated:

Petitioners' claim that the act subjects the income of an individual partner to two taxes in violation of section 3(a) of Article IX is disposed of by the opinion of this court in *Lake Shore Auto Parts Co. v. Korzen*, . . . where it was held that the personal property of a partnership is distinct from and, thus, taxable apart from the personal property of the individual partners. (See also *Hanley v. Kusper*. . . .)¹⁵⁷

In both *Lake Shore Auto Parts v. Korzen*¹⁵⁸ and *Hanley v. Kusper*,¹⁵⁹ the court had considered the scope of the term "individuals" as used in a provision of the old constitution which exempted individuals from the state's personal property tax.¹⁶⁰ Although partnership property had not been directly at issue in these two cases, the court had noted that partnership personal property remained subject to the personal property tax.¹⁶¹

Justice Clark, in his dissent,¹⁶² argued that the distinction in *Lake Shore Auto Parts* between partnership personal property and that of the individual partners was not applicable to partnership income. He reasoned that no such distinction could be made for partnership income because the conduit provisions of the general income tax made partnership income and the partners' income the same.¹⁶³ Justice Clark then proceeded to show that the four elements of double taxation were present. He noted that both taxes were imposed by the state, for a general revenue-raising purpose, and that both taxes were levied over the same tax year.¹⁶⁴ He also noted that the objects of the two taxes partially overlapped in that the income of partners was subject to both the partnership income tax and the general income tax. He urged the elimination of double taxation by construing the general income tax as

156. Upon a motion by one of the parties for leave to file an original action, the Illinois Supreme Court, under its power to hear actions challenging the validity of state revenue measures, directly heard the case. 78 Ill. 2d at 393-94, 401 N.E.2d at 494. See ILL. CONST. art. IV, § 4(a); ILL. SUP. CT. R. 381.

157. 78 Ill. 2d at 407, 401 N.E.2d at 501 (citations omitted).

158. 54 Ill. 2d 537, 296 N.E.2d 342, *cert. denied*, 414 U.S. 1039 (1973).

159. 61 Ill. 2d 452, 337 N.E.2d 1 (1975).

160. Article IX-A was added to the ILL. CONST. of 1870 in November of 1970 by referendum. It provided:

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

Id. This provision was repealed in 1971.

161. 61 Ill. 2d at 461, 337 N.E.2d at 6; 54 Ill. 2d at 239, 296 N.E.2d at 343.

162. 78 Ill. 2d at 415-18, 401 N.E.2d at 505-06 (Clark, J., concurring in part and dissenting in part).

163. *Id.* at 416, 401 N.E.2d at 505.

164. *Id.* at 416-17, 401 N.E.2d at 505.

inapplicable to the income that individuals obtain from partnerships.¹⁶⁵

ANALYSIS

The Illinois Supreme Court concluded that the partnership income tax did not result in double taxation of the individual partners' income because partnership personal property is taxed separately from that of the individual partners.¹⁶⁶ Assuming that this terse explanation was directed at establishing that no partial overlap between the objects of the two taxes existed, there are two possible underlying rationales that would preclude double taxation. If the partnership income tax was deemed to be a property tax under *Bachrach v. Nelson*,¹⁶⁷ its object would not overlap with the general income tax's object which is the income-earning privilege.¹⁶⁸ Alternatively, if the object of the partnership income tax is deemed to be the same income-earning privilege that is taxed by the general income tax,¹⁶⁹ the treatment of a partnership as a separate entity, analogous to the manner in which the property tax had been construed, would also preclude a partial overlap.¹⁷⁰ However, neither of these underlying rationales would have been tenable had the majority properly undertaken the same type of comprehensive double taxation analysis which the dissent utilized.

The correct approach to double taxation issues is the two-step analysis which first determines the objects of the two taxes and then determines whether the four elements of double taxation are present. Such a treatment begins in this situation with a determination of the respective objects of the partnership income tax and the general income tax.¹⁷¹ As to the partnership income tax, the statute declares that the tax is imposed on the privilege of earning income.¹⁷² The tax is measured as a specified percentage of net income earned over a twelve-month period,¹⁷³ as are most income taxes. In its operation and effect, the tax accrues only upon the earning of income, unaffected by other

165. *Id.* at 418, 401 N.E.2d at 506.

166. *See* text accompanying note 112 *supra*.

167. 349 Ill. 579, 182 N.E. 909 (1932). For an excerpt of the court's rationale, *see* note 128 *supra*.

168. Where the object of one tax is property and the object of a second tax is a privilege, no partial overlap can occur. *See* note 74 *supra*.

169. This is consistent with the statutory language of the partnership income tax. *See* note 150 *supra*.

170. *See* text accompanying notes 77-80 *supra*.

171. *See* text accompanying notes 19-22 *supra*.

172. ILL. REV. STAT. ch. 120, § 2-201(c) (1979).

173. *Id.* §§ 2-201(c), 2-201(d) (1979).

circumstances or activities of a partnership.¹⁷⁴ Although the tax was imposed to replace lost revenue from the abolished personal property tax, it cannot be considered a property tax measured by the related income because the tax accrues regardless of whether a partnership has personal property or not.¹⁷⁵ Moreover, such an interpretation of the tax's object would render the tax unconstitutional.¹⁷⁶ Thus, the object of the partnership income tax is clearly the privilege of earning income and any interpretation of the court's terse explanation that would treat the partnership income tax as a tax on personal property lacks a plausible basis in law.

The state's general income tax is also statutorily imposed on the privilege of earning income.¹⁷⁷ In *Thorpe v. Mahin*,¹⁷⁸ the Illinois Supreme Court approved this characterization of the tax's object. Thus, the object of both taxes is the privilege of earning income. The majority's discussion fails to comment on the nature of the partnership income tax's object and, at best, confuses this issue by relying on two personal property tax cases.¹⁷⁹

Once it is shown that the objects of the two taxes are the same, the second step of the analysis is to determine whether the four elements of double taxation are present. Whether the partnership income tax and the general income tax exhibit the four elements of double taxation, however, is not as straightforward as was portrayed by the dissent. It is uncontroverted that both taxes are imposed by the same unit of state government—the state itself—and that they are imposed over the same time period—the taxable year.¹⁸⁰ However, it is less certain whether both taxes are levied for the same purpose and whether the objects of both taxes partially overlap.

The purpose of the state's general income tax is to raise unrestricted funds. Its purpose is implied by the Illinois legislature's direction that all revenue collected under the tax is to be paid into the

174. See *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937).

175. Cases construing a tax as imposed on property and measured by the derived income assume or require the presence of the property that is subject to tax. See, e.g., *Great Northern Ry. Co. v. Minnesota*, 278 U.S. 503 (1929); *Redfield v. Fisher*, 135 Or. 180, 292 P. 813 (1930), cert. denied, 284 U.S. 617 (1931).

176. In *Client Follow-Up Co. v. Hynes*, 75 Ill. 2d 208, 390 N.E.2d 847 (1979), the Illinois Supreme Court held that a personal property tax would be unconstitutional as of January 1, 1979. *Id.* at 230, 390 N.E.2d at 857. See text accompanying note 145 *supra*.

177. ILL. REV. STAT. ch. 120, § 2-201(a) (1979).

178. 43 Ill. 2d 36, 250 N.E.2d 633 (1969).

179. 78 Ill. 2d at 404, 401 N.E.2d at 499.

180. See ILL. REV. STAT. ch. 120, §§ 2-201(a), 2-201(c) (1979).

general reserve fund of the state treasury.¹⁸¹ In contrast, as stated by section 5(c),¹⁸² the purpose of the partnership income tax is to replace the revenue lost by units of local government and school districts as a result of the abolition of the state's personal property tax. To this end, revenue collected under the tax is deposited in a special fund of the state treasury for distribution in accordance with that purpose.¹⁸³

It is arguable whether this difference between the two taxes is sufficient to conclude that the two taxes have different purposes. The dissent felt that both taxes had the same general purpose of raising operating revenue for the state and its political subdivisions.¹⁸⁴ This view is also supported by the fact that the application of the partnership tax funds remains largely discretionary and is not directed toward specific governmental functions or acts. On the other hand, the fact that some restrictions existed on the entities that were to apply the fund in the case of the partnership income tax imports a narrower and arguably different purpose from that of the general income tax. Although imputing to both taxes the same general revenue-raising purpose appears to be the better reasoned view,¹⁸⁵ a careful court could have relied on this ostensible difference in concluding that no double taxation existed. By so doing, the court would have avoided the deeper doctrinal issue that lurked in the question of whether the objects of the two taxes partially overlap.

Given that the object of both taxes is the privilege of earning income, partial overlap is tested with respect to the legal entities whose income-earning privilege is taxed.¹⁸⁶ Because the two taxes at issue are imposed on the privilege of partnerships and of individuals, the question of partial overlap turns on how a partnership's income-earning privilege is viewed. If the privilege is viewed as that of a legal entity distinct from its individual partners, the groups whose privilege is being taxed—partners and partnerships—do not overlap. If, however, the privilege taxed is viewed as that of the individual partners, a partial overlap between partners and individuals exists.¹⁸⁷ Under this latter

181. Illinois Income Tax Act art. IX, § 901(a), 1969 Ill. Laws 436 (1969) (codified at ILL. REV. STAT. ch. 120, § 9-901(a) (1979)).

182. ILL. CONST. art. IX, § 5(c). See note 142 *supra* for the text of § 5(c).

183. Personal Property Replacement Income Tax Act, P.A. 81-1st Sp. Sess.-1, § 1(e), 1979 Ill. Laws 4927-28 (1979). See ILL. REV. STAT. ch. 85, § 616 (1979).

184. 78 Ill. 2d at 416-17, 401 N.E.2d at 505 (Clark, J., concurring in part and dissenting in part).

185. For examples of the distinctions that have been made concerning tax purposes, see note 66 *supra*.

186. See text accompanying notes 77-80 *supra*.

187. Partners are treated as individuals for purposes of the state's general income tax. See ILL.

view, the income-earning privilege of individuals who are not partners is only subject to the general income tax while the privilege of those individuals who are partners becomes subject to both the partnership income tax and the general income tax.

The more convincing interpretation of the court's explanation is that it viewed the privilege being taxed as that of a legal entity distinct from the individual partners. Although the two property tax cases on which the court relied¹⁸⁸ are indicative of this distinction, they do not provide a meaningful supporting rationale. A partnership has long been treated as a separate entity for the purpose of owning property.¹⁸⁹ To say that, therefore, a partnership should be treated as a separate entity with respect to the privilege of earning income constitutes an unconvincing analogy.

The recognition of a partnership as a distinct entity for purposes of property ownership developed in response to the inadequacy of applying traditional modes of property ownership to a partnership. In order to strengthen the rights of partnership creditors and insure a measure of financial stability for a partnership, the entity view was adopted.¹⁹⁰ Partnership income, on the other hand, is premised on the sharing of profits and losses among the partners. This premise is an element in the definition of a partnership and is also reflected in the conduit provision of the vast majority of state income tax laws.¹⁹¹ Given that the underlying rationale for treating a partnership as a separate entity in a property tax setting is markedly different from the considerations attaching to the application of the aggregate view in the income tax context, the analogy to the property tax rule provides scant support for the income tax distinction between partnerships and partners which the court seemed to make.

A more convincing analogy might have been made to the entity treatment generally given to partnerships under non-income privilege taxes,¹⁹² but it would have required more incisive and better articulated reasoning than the court seemed willing to do. Even if such an argument had been made, the fact remains that the entity treatment of partnership income is fundamentally at odds with the income-sharing

REV. STAT. ch. 120, § 1-205(b) (1979). See note 148 *supra* for the pertinent text of § 1-205(b).

188. *Hanley v. Kusper*, 61 Ill. 2d 452, 337 N.E.2d 1 (1975); *Lake Shore Auto Parts Co. v. Korzen*, 54 Ill. 2d 237, 296 N.E.2d 342, *cert. denied*, 414 U.S. 1039 (1973).

189. ILL. REV. STAT. ch. 106½, § 8(3) (1979) (section 8(3) of the Uniform Partnership Act).

190. See text accompanying notes 103-07 *supra*.

191. See text accompanying notes 108-10 *supra*.

192. See text accompanying notes 114-15 *supra*.

characteristics of a partnership. Accordingly, for purposes of a tax on partnership income, the aggregate view should prevail.

The Illinois Supreme Court could have based its conclusion that no double taxation existed by finding either that the two taxes had different purposes or that the objects of the two taxes did not partially overlap. However, none of the grounds underlying such findings appear readily supportable. Indeed, the more cogent arguments lead to contrary findings. Thus, the partnership income tax and the general income tax fulfill the four elements and double taxation is the result.

Ironically, a finding that the partnership income tax resulted in double taxation would not have made it unconstitutional under the section 3(a) ban against double income taxation of individuals.¹⁹³ Section 5(c) specifically exempts from the section 3(a) ban any income taxes enacted to replace the lost revenue from the abolished personal property tax.¹⁹⁴ Since the partnership income tax was one of the taxes enacted to replace such lost revenue,¹⁹⁵ it is not subject to the section 3(a) ban.

Because the court did not view the partnership income tax as imposed on the income-earning privilege of the individual partners, it did not consider the tax as a second tax on the income of individuals. Hence, there was no occasion to consider the section 5(c) exception. Had the court properly found that the partnership income tax was imposed on the income-earning privilege of the individual partners and that it therefore resulted in double taxation, the court could have then nevertheless applied the section 5(c) exception to uphold the tax. The court would thus have avoided the strained analogy on which it relied. The dissent's failure to apply the section 5(c) exception was a significant oversight on its part as well.

Absent the section 5(c) exception to the section 3(a) double taxation ban, a finding of double taxation should have led the *Zagel* court to construe either the partnership income tax or the general income tax in such a manner as to avoid double taxation.¹⁹⁶ The dissent's suggestion that the general income tax should be construed so as not to tax the income that individuals receive as partners from a partnership would have worked well in this regard.¹⁹⁷ The partnership income tax would then have been viewed as taxing an individual's privilege of earning

193. ILL. CONST. art. IX, § 3(a). See note 141 *supra* for the text of § 3(a).

194. ILL. CONST. art. IX, § 5(c). See note 142 *supra* for the text of § 5(c).

195. See text accompanying notes 144-46 *supra*.

196. See text accompanying notes 88-93 *supra*.

197. 78 Ill. 2d at 418, 401 N.E.2d at 506 (Clark, J., concurring in part and dissenting in part).

income through a partnership, while the general income tax would be viewed as taxing an individual's privilege of earning income from all other sources, so that no partial overlap of the objects of the two taxes would occur and, thus, no double taxation would result.

In *Zagel*, the Illinois Supreme Court sanctioned a substantive departure from the aggregate view of a partnership which is generally followed in partnership income taxation. The court adopted the entity view of a partnership in rather brusque fashion, neglecting to provide a plausible rationale for upholding this change in the law. Without such a rationale, the decision offers no guidance to other courts that may be called upon to decide between the entity and aggregate view of a partnership both in the income tax context and in other areas of partnership law.¹⁹⁸

The court's decision also serves to disparage the doctrine of double taxation. The majority's cursory treatment of the double taxation issue is inappropriate to the vitality which the doctrine has enjoyed in Illinois as well as in other jurisdictions.¹⁹⁹ In an era in which the need for state tax revenues is increasing dramatically and in which the scheme of state taxes is growing in complexity,²⁰⁰ the doctrine of double taxation has an important role to play in ensuring an equitable distribution of the tax burden.²⁰¹ Accordingly, it should continue to be applied by the courts. In failing to apply the doctrine adequately to the situation before it, the Illinois Supreme Court has permitted an inequitable and legally indefensible tax burden to fall on those individuals who are partners.

CONCLUSION

In *Zagel*, the Illinois Supreme Court faced a double taxation challenge to a novel partnership income tax. It was alleged that the new tax, together with the state's general income tax on individuals, resulted in double taxation of the individual partners' income in violation of section 3(a) of article IX of the Illinois Constitution. By summarily finding a partnership to be a legal entity distinct from its partners for purposes of the new tax, the court avoided a double taxation result. However, in so doing, the court ignored the rationale that supports the

198. The political attractiveness of a partnership income tax as a source of revenue makes it likely that other state courts may soon be faced with double taxation challenges to tax statutes similar to the one at issue in *Zagel*.

199. See notes 57-93, 122-24 *supra*.

200. See generally HELLERSTEIN, *supra* note 20, at 1-26.

201. See notes 47-55 *supra*.

widely held aggregate view of a partnership with respect to partnership income. The court also undermined the doctrine of double taxation by its cursory treatment of the issue and circumvented the doctrine's purpose by allowing an inequitable tax burden distribution to stand. Ironically, a finding that the partnership income tax results in double taxation would not have made it unconstitutional under section 3(a) in any event since the tax was one of those enacted to replace revenues lost from the abolished personal property tax. As such, it is exempted from the section 3(a) ban by section 5(c) of article IX of the Illinois Constitution.

CARLOS A. SAAVEDRA

