



TAX TRENDS

The newsletter of the Illinois State Bar Association's Section on State & Local Taxation

Editor's note

By Stanley R. Kaminski

This issue of *Tax Trends* features an article from David J. Kupiec on the Illinois Supreme Court's modified decision in *Exelon Corporation v. The Department of Revenue*. This decision concerned whether the sale of electric-

ity is the sale of a service or tangible personal property. David explains the decision and how the Supreme Court was able to agree that the taxpayer is right on the law, but still rule against the returning of any tax money. ■

Illinois Supreme Court issues modified opinion holding electricity is "tangible personal property" for purposes of Section 201(e) of the Illinois Income Tax Act but imposes prospective application

By David J. Kupiec JD, CPA and Natalie M. Martin JD of Kupiec & Martin, LLC.

On July 15, 2009, The Illinois Supreme Court issued a Modified Upon Denial of Rehearing Opinion prospectively applying its February 20, 2009 holding that electricity is "tangible personal property" for purposes of Section 201(e) of the Illinois Income Tax Act ("IITA") and affirming the judgment of the Appellate Court, *Exelon Corporation v. The Department of Revenue*, Docket No. 105582 (July 15, 2009). In the preceding February 20, 2009 Opinion, the Illinois Supreme Court held that the Department of Revenue's ("Department") denial of Exelon's claim for a Section 201(e) tax credit was erroneous as a matter of law and reversed the judgments of the Appellate Court and the Circuit Court, and set aside the Decision of the Department with Directions to grant Exelon's investment credits at issue. In the July 15th Modified Opinion, the Illinois Supreme Court continued to hold that electricity is "tangible personal property" for purposes of Section 201(e) of the IITA, but granted the Department's request, made within the Department's Petition for Rehearing, to ren-

der its Opinion prospectively for tax periods after the filing of this Opinion. The Illinois Supreme Court also considered it unnecessary to address the uniformity clause issue also before the Court as the case was decided in Exelon's favor on non-constitutional grounds.

At issue in this case is whether the Taxpayer's 1995 and 1996 investments in property used for generating, transmitting and distributing electricity to customers in Illinois qualified for the .5 percent investment credit provided under Section 201(e) of the IITA. Section 201(e) provides, in pertinent part, that property qualifies for the credit if it is: (A) tangible; (B) depreciable pursuant to Section 167 of the Internal Revenue Code; (C) acquired by purchase; (D) used in Illinois by a taxpayer who is primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing; and (E) has not previously been used in Illinois. Moreover, Section 201(e) of the IITA defines "retailing" as "the sale of tangible personal property

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or services rendered in conjunction with the sale of tangible consumer goods or commodities." The Department denied the use of the credit asserting that the Taxpayer, an electric utility company, is not primarily engaged in manufacturing or in retailing as electricity is not tangible personal property.

The Taxpayer protested the Department's denial of the credit and the parties filed cross motions for summary judgment during the Department's administrative review process. During administrative review, the Taxpayer submitted an affidavit and report from its expert witness opining that electricity is both a physical and material commodity as a matter of irrefutable evidence as electricity can be sensed, measured, stored and weighed. The Department did not enter evidence contesting the report and relied entirely on *Farrand Coal Co. v. Halpin*, 10 Ill. 2d 507 (1957), to support its position that electricity was not tangible. The Department, after raising relevance objections, admitted that it consistently allowed the investment credit to natural gas utilities and admitted that during the tax years at issue it granted the investment credit to a combined gas and electric utility under Section 201(e) for property used in its electric business.

The Director of the Department accepted the Administrative Law Judge's ("ALJ's") recommendation granting the Department's Summary Judgment Motion. In short, the ALJ found that there was no support for the Taxpayer's position that electricity was "tangible" based on the *Farrand Coal* decision. Moreover, the ALJ found that the Department's denial of the credit to an electric utility while granting the credit to a gas utility did not violate the Uniformity Clause of the Illinois Constitution.

The Circuit Court granted the Taxpayer's request for review and affirmed the Director's Decision. The Taxpayer appealed the Circuit Court's Decision contending that the Department erred both in finding that it did not engage in retailing for purposes of the investment credit as provided in Section 201(e) of the IITA and that the Department's granting of the investment credit to gas and combined gas and electric utilities unlawfully differentiates between energy utilities under the provisions of the Uniformity Clause of the Illinois Constitution.

The Appellate Court granted the Taxpayer's request for review and affirmed the Circuit Court's Summary Judgment Order. The Appellate Court found that the Taxpayer did not, as a matter of law, engage in "retail-

ing" pursuant to the provisions of Section 201(e) of the IITA based on the classification of energy as intangible property in the *Farrand Coal* decision, and the presumption that the Illinois legislature acted with knowledge of the *Farrand Coal* retailers' occupation tax case when the legislature enacted the income tax credit at issue nearly 25 years later. The Appellate Court noted that in *Farrand Coal*, the Illinois Supreme Court "considered whether electricity was tangible personal property under the Retailers' Occupation Tax Act" and that the Appellate Court is bound by the principles of *stare decisis* to adhere to the decisions of the Illinois Supreme Court.

In addressing the Taxpayer's uniformity issue, the Appellate Court explained that the Taxpayer is not challenging a tax or fee but is contending that it is entitled to a credit. The Appellate Court found that the plain language of the Uniformity Clause, specifically the first sentence, applies only to taxes or fees and does not apply to credits. Moreover, the Appellate Court explained that the second sentence of the clause applies to credits and "merely requires that a credit be 'reasonable.'" The Appellate Court concluded that under the aforementioned interpretation of the Uniformity Clause, the Taxpayer cannot contend under the Uniformity Clause that there is no real and substantial difference between gas companies receiving the credit and electric companies not receiving the credit. The Appellate Court added that the Taxpayer's Uniformity Clause argument is "limited to whether the credit itself is reasonable." The Appellate Court's uniformity conclusion relied entirely on *Head v. Korshak*, 62 Ill. 2d 226 (1976), *sua sponte* as the Department did not apply the *Head* decision as part of its case. Notwithstanding, the Appellate Court acknowledged a split in case law on this issue as several courts have analyzed tax exemptions and credits under the uniformity analysis used for taxes and fees. The Appellate Court cited *Milwaukee Safeguard Insurance Co. v. Selcke*, 179 Ill. 2d 94 (1997), and other cases more recently decided as evidence of this split.

The Supreme Court applied a *de novo* standard of review in this case as it involved a pure question of law. The Court explained that every aspect of its analysis in this case involved construing Section 201(e) of the IITA. The Court exercised its power to reexamine *Farrand Coal* and its authorities and legal concepts regarding the physical properties of electricity of which both the Department and Appellate Court asserted binding appli-

cation.

To determine whether the Taxpayer qualified for the Section 201(e) investment credit, the Court engaged in the two-tier analysis established in the *Van's Material* case, *Van's Material Co. v. Department of Revenue*, 131 Ill. 2d 196(1989). The first tier of the analysis involved reviewing Section 201(e) to determine the boundaries of the statute. The second tier of the analysis involved the determination of whether Section 201(e) applies to this particular case.

During the first tier of the analysis the Court reviewed the application of the *Farrand Coal* decision and the underlying evidence presented as to whether electricity is "tangible personal property" for purposes of Section 201(e) of the IITA. In analyzing the applicability of the *Farrand Coal* decision to Exelon's claim, the Court discussed *obiter* and judicial *dicta*. The Court explained that *obiter dictum* is "a remark or expression of opinion that a court uttered as an aside, and is generally not binding authority or precedent within the *stare decisis* rule." The Court also explained that judicial *dictum* is "an expression of opinion upon a point in a case argued by counsel and deliberately passed upon by the court, though not essential to the disposition of the cause," but which "is entitled to much weight, and should be followed unless found to be erroneous."

The Court agreed with Exelon that the *Farrand Coal* Court's references to the tangibility of electricity were nonbinding *obiter dicta*. The Court emphasized that "the coal company's coal was the focus of the case and not the electric company's electricity." In *Farrand Coal*, the Court "never had to—and never did—address definitively the issue of whether electricity is tangible." Notwithstanding, the Supreme Court stated that it was reasonable for the Appellate Court to consider itself bound by the *Farrand Coal* discussion of tangibility of electricity as "even *obiter dictum* of a court of last resort can be tantamount to a decision and therefore binding in the absence of a contrary decision of that court."

The Court next turned to the analysis of the properties of electricity and whether it constitutes "tangible personal property." The Court found that the unrebutted affidavit and report of Dr. Fajans proffered by Exelon "reflects the currently understood electron theory of electricity." Based on the evidence before it, the Court ruled that "[w]e now join the several courts that have expressly held in varying contexts that electricity constitutes 'tangible personal property.'"

Having determined that electricity constituted "tangible personal property" under Section 201(e) of the IITA, the Court turned to the second tier of the analysis involving the determination of whether Section 201(e) applies to this particular case. The Court noted that "the parties agree that if electricity is 'tangible personal property,' then Exelon would be engaged in 'retailing' as defined by section 201(e)." The Court concluded the second tier analysis by stating that the case presents only the need to resolve the legal issue since there are no factual issues before it and stated its "determination of that legal issue is conclusive."

The Court then addressed the Department's Petition for Rehearing request for the Court to modify its February 20, 2009 Opinion to render such Opinion on a prospective basis. The Court explained that a decision will be applied prospectively if: "(1) the decision establishes a new principal of law, either by overruling past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not

clearly foreshadowed; (2) given its purpose or history, the decision's operation will be impeded or promoted by prospective or retroactive application; and (3) a balance of the equities mandates prospective application," citing *Bogseth v. Emmanuel*, 166 Ill. 2d 507, 515 (1995) and *Deichmueller Construction Co. v. Industrial Comm'n*, 151 Ill. 2d 413, 416 (1992). "Considering these factors in light of the instant facts," the Court limited this decision to an entirely prospective application to taxes incurred, or credits sought, for the tax year 2009 and thereafter.

The Court added that its "disposition of the case obviates that need to determine whether the Department violated the uniformity clause of the Illinois Constitution." Accordingly, although the Court provided clarity as to the treatment of electricity as "tangible personal property" for purposes of the Section 201(e) investment credit, it left open the question regarding the application of the Uniformity Clause to tax credits and deductions. On August 18, 2009, Exelon filed a Petition for Rehearing. ■

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OFFICE

Illinois Bar Center
424 S. Second Street
Springfield, IL 62701
Phones: 217-525-1760 OR 800-252-8908
www.isba.org

EDITOR

Stanley R. Kaminski
190 S. LaSalle St., Ste. 3700
Chicago, IL 60603

ASSOCIATE EDITORS

Alexander P. White
Louise Calvert
Matthew Flaum
Mary Nicolau

MANAGING EDITOR/ PRODUCTION

Katie Underwood
kunderwood@isba.org

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