IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT, LAW DIVISION
TAX AND MISCELLANEOUS REMEDIES SECTION

MICHAEL LABELL, et al.,	)	
	)	Case No. 2015 CH 13399
Plaintiffs,	)	
	)	(Transferred to Law)
v.	)	
	)	
THE CITY OF CHICAGO, et al.,	)	
	)	
Defendants.	)	

PLAINTIFFS' RESPONSE TO DEFENDANTS' MOTION TO DISMISS THE AMENDED COMPLAINT

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INTRODUCTION

The City of Chicago has begun taxing charges paid for Internet-based streaming video, audio, and gaming services ("Internet services"), which the City never taxed before, by "interpreting" the City's ordinance taxing "amusements" to apply to Internet services. Plaintiffs challenge the application of the tax on amusements to Internet services because: Internet services are outside the scope of the City's ordinance taxing amusements; (2) the City taxes Internet services differently than it taxes equivalent in-person amusements in violation of the Illinois Constitution's Uniformity Clause; (3) applying the tax to Internet services imposes a discriminatory tax on electronic commerce in violation of the Internet Tax Freedom Act; and (4) the City is taxing activity outside its borders in violation of the U.S. Constitution's Commerce Clause.

BACKGROUND

The City imposes a 9% tax on admission fees or other charges paid for the privilege to enter, witness, view, or participate in certain activities *within the City of Chicago* that the Chicago Municipal Code ("Code") defines as "amusements." (the "Amusement Tax"). Chi. Mun. Code 4-156-020. On June 9, 2015, the City, through its Comptroller, issued Amusement Tax Ruling #5 ("Ruling"), which declares that the term "amusement" as defined by Chi. Mun. Code 4-156-010 includes "charges paid for the privilege to witness, view or participate in amusements that are *delivered electronically*." (Ruling, ¶ 8, Am. Compl., Ex. A.) (emphasis in original). According to the Ruling, charges paid for the privilege of "watching electronically delivered television shows, movies or videos," "listening to electronically delivered music," and "participating in games, on-line or otherwise" are subject to the Amusement Tax if they are "delivered to a patron (i.e., customer) in the City." (Ruling, ¶ 8.)

The Ruling requires providers of Internet services to collect the Amusement Tax from their customers and remit the proceeds to the City. The Ruling adopts the sourcing rules from the

Mobile Telecommunications Sourcing Conformity Act, 35 ILCS 638/1 et seq., ("Mobile Sourcing Act"), to impose the Amusement Tax on a person "whose residential street address or primary business street address is in Chicago, as reflected by his or her credit card billing address, zip code or other reliable information." (Ruling, ¶ 13.)

On December 17, 2015, Plaintiffs, who are customers of Internet services, filed their six-count First Amended Complaint. Counts I, II, and III challenge the authority of the Comptroller to apply the Amusement Tax to Internet services because Internet services are beyond the scope of the Amusement Tax section of the Code. Count IV alleges that the application of the Amusement Tax to Internet services imposes an unlawful discriminatory tax on electronic commerce in violation of the Internet Tax Freedom Act ("ITFA"). Count V alleges a violation of the Uniformity Clause of the Illinois Constitution because the Amusement Tax as interpreted by the Ruling applies to Internet services differently that it applies to equivalent in-person amusements. Count VI alleges a violation of the Commerce Clause of the United States Constitution because the City has no nexus with the transactions it seeks to tax, the tax is not fairly apportioned or fairly related to services the City provides.

LEGAL STANDARD

Defendants filed a motion to dismiss ("Motion") pursuant to § 2-615 of the Illinois Code of Civil Procedure, 735 ILCS 5/2-615. "A cause of action should not be dismissed under section 2-615 unless it is clear that no set of facts can be proved under the pleadings that would entitle the plaintiff[s] to recover." *Imperial Apparel, Ltd. v. Cosmo's Designer Direct, Inc.*, 227 Ill. 2d 381, 392 (2008).

ARGUMENT

I. The text of the Amusement Tax does not authorize taxation of Internet services.

In adopting the Ruling, the Comptroller imposed the Amusement Tax on transactions that are beyond the scope of the Code and thus exceeded his authority. Therefore the Ruling should be invalidated.[1] *First*, Internet services that are taxed under the Ruling are not "amusements within the City" because customers could use those services entirely outside of Chicago. The City cannot overcome this defect by citing, as it has, the Mobile Sourcing Act, 35 ILCS 638/1, which has only been applied to cell phone services, not Internet services. *Second*, Internet services that are taxed under the Ruling are not "amusements within the City" even if a subscriber does view or listen to the content while physically in Chicago. *Third*, the definition of "amusement" in the Code does not encompass Internet services.

A. The Ruling exceeds the scope of the Amusement Tax because it taxes Internet services that may be delivered entirely outside of Chicago.

1. The Ruling exceeds the scope of the Amusement Tax because in many instances it applies to Internet services consumed entirely outside of Chicago.

The Ruling is invalid because it exceeds the scope of the Amusement Tax, which only applies to "patrons of every amusement *within the city*" (emphasis added). The Ruling applies the Amusement Tax on customers of Internet services who have a billing address in Chicago regardless of whether they use those services "within the city" or somewhere else. Defendants

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[1] Defendants' Motion treats Counts I, II, and III of the Amended Complaint as facial constitutional challenges and concludes that "Plaintiffs must establish that the Ordinance could *never* be applied to *any* charge paid by a Chicago resident for the privilege of receiving streamed videos, music or games in Chicago." (Mot. at 2 (emphasis in original), citing *Carter v. City of Alton*, 2015 IL App (5th) 130544, ¶ 20 and *Lamar Whiteco Outdoor Corp. v. City of W. Chi.*, 355 Ill. App. 3d 352, 365 (2d Dist. 2005).) But *Carter* and *Lamar* involved constitutional challenges to statutes and Counts I, II, and III challenge the Ruling for exceeding the Comptroller's authority. They are not constitutional challenges. Thus, Defendants' assertion that "Plaintiffs must establish that the Ordinance could *never* be applied to *any* charge paid by a Chicago resident for the privilege of receiving streamed videos, music or games in Chicago" is incorrect. (Mot. at 2 (emphasis in original).)

argue that this method of taxation is justified because the Amusement Tax is imposed for the privilege of using an amusement in Chicago. (Memo. at 8.) To the contrary, this method does not tax the privilege of using Internet services while a person is physically "within the city" because many people without billing addresses in Chicago can use Internet services while they are physically "within the city" without having to pay the tax. Thus, the imposition of the Amusement Tax on Internet services exceeds the Code's scope of "amusements within the city."

Defendants argue that the Ruling's tax on Internet services is a tax on "the *privilege* of watching Netflix videos [or consuming other Internet services] in Chicago . . . regardless of whether the person chooses to watch the videos exclusively in Chicago, partly in Chicago, or not at all." (Memo. at 8) (emphasis in original). Defendants compare this to a purchase of a ticket to see the Cubs play at Wrigley Field: the tax applies "even if the customer ends up not going to the game." (Memo. at 8.) Defendants' analogy – and their argument – fails. The Amusement Tax on baseball tickets applies to any person, whether a resident or non-resident of Chicago, who buys a ticket to a baseball game at Wrigley Field, which is physically located in Chicago. The Amusement Tax does not apply to a person with a billing address in Chicago who purchases tickets to watch the Cubs play baseball in a stadium located outside Chicago, such as Busch Stadium in St. Louis. In contrast, the Ruling imposes a tax on Internet services for any person who has a billing address in Chicago, regardless of where they are physically located when they use those services. Because the tax only applies to customers with billing addresses in Chicago, persons without billing addresses in Chicago will never be charged the tax even if they use these services "within the city," and persons with billing addresses in Chicago will always be charged the tax even if they use these services outside of Chicago. The Ruling applies the Amusement Tax to Internet services entirely differently than the Code applies it to amusements physically located in Chicago.

If the Amusement Tax were applied to amusements in the same way that the Ruling attempts to apply it to Internet services, the City would have to charge persons with a billing address in Chicago when they purchase tickets for any amusement anywhere – like a baseball game at Busch Stadium – but would not tax persons who do not have a billing address in Chicago when they purchase tickets for any amusements "within the city" – like a baseball game at Wrigley Field. The Code does not permit the City to apply the Amusement Tax in this manner,[2] which is exactly why the Ruling's attempt to tax Internet services in this way exceeds the scope of the Code.

A second example further illustrates the point. A student at the University of Illinois could subscribe to Netflix and use it exclusively while at school in Champaign-Urbana, while being billed at his or her home address in Chicago – and, under the Ruling, would have to pay the Amusement Tax. Meanwhile, a student who attends the University of Chicago could subscribe to Netflix, use it exclusively while at school, and be billed at his or her home address in Naperville – and would not have to pay the Amusement Tax. Each day there are likely thousands of people like this who use Internet services while they are physically in Chicago, who are not subject to the tax because they do not have a billing address in Chicago. Thus, contrary to the City's assertion, the Ruling's application of the Amusement Tax to Internet services is not a tax on the privilege to use Internet services "within the city."

2. The Mobile Sourcing Act does not authorize the Ruling's extension of the Amusement Tax.

There is no merit to the City's arguments that the state's Mobile Sourcing Act, 35 ILCS 638/1 et seq., gives the City express or implied authority to impose the Amusement Tax on customers of Internet services with Chicago billing addresses, regardless of whether they consume the Internet services within Chicago.

[2] The City does not have the constitutional or statutory authority to tax amusements that do not take place within the City. *See* ILL. CONST. art. VII, § 6(a); 65 ILCS 5/11-42-1; 65 ILCS 5/11-42-5.

As an initial matter, the Mobile Sourcing Act does not purport to supersede – and thus cannot overcome – the plain language of the Amusement Tax, which makes clear that the tax only applies to amusements "within the city." So even if the Mobile Sourcing Act authorized municipal governments to tax consumers of Internet services based upon their billing address, which it does not, it would have no effect on the Amusement Tax, which does not impose a tax on that basis.

In addition, as discussed below, the Mobile Sourcing Act does not pertain, expressly or implicitly, to the taxation of Internet services, and the sourcing methodology contained therein has not been adopted by Congress or any state for use in the context of Internet services.

a. The City lacks express authority in the Mobile Sourcing Act.

The Mobile Sourcing Act does not expressly authorize the City to impose a tax on Internet services based on a customer's billing address rather than the location where the customer actually uses the services. Congress passed the Mobile Telecommunications Sourcing Act ("Federal Mobile Sourcing Act"), 4 U.S.C. § 116 et seq., to establish sourcing requirements for state and local taxation of mobile telecommunication services. To implement the Federal Mobile Sourcing Act, Illinois, in turn, adopted its own Mobile Sourcing Act, which provides:

> All charges for mobile telecommunications services that are deemed to be provided by the customer's home service provider under this Act are authorized to be subjected to tax, charge, or fee by the taxing jurisdictions whose territorial limits encompass the customer's place of primary use, regardless of where the mobile telecommunications services originate, terminate, or pass through, and no other taxing jurisdiction may impose taxes, charges, or fees on charges for such mobile telecommunications services.

35 ILCS 638/20(b).

Defendants erroneously assert that the Mobile Sourcing Act applies to charges for Internet services because they are "charges for mobile telecommunication services," which the Mobile Sourcing Act defines as:

> any charge for, or associated with, the provision of commercial mobile radio service, as defined in Section 20.3 of Title 47 of the Code of Federal Regulations . . . , or any charge for, or associated with, a service provided as an adjunct to a *commercial mobile radio service*, that is billed to the customer by or for the customer's home service provider regardless of whether individual transmissions originate or terminate within the licensed service area of the home service provider.

35 ILCS 638/10 (emphasis added). (Memo. at 10.) As Defendants state, the Code of Federal Regulations defines "commercial mobile radio service" as:

> A *mobile service* that is: (a) (1) provided for profit, i.e., with the intent of receiving compensation or monetary gain; (2) An interconnected service; and (3) Available to the public, or to such classes of eligible users as to be effectively available to a substantial portion of the public; or (b) The functional equivalent of such a mobile service described in paragraph (a) of this section.

47 C.F.R. § 20.3 (emphasis added). (Memo. at 10, n.3.)

The regulation's definition of "mobile service," which Defendants fail to cite, plainly does *not* encompass Internet services but instead only encompasses:

> A radio communication service carried on between mobile stations or receivers and land stations, and by mobile stations communicating among themselves, and includes:
>
> (a) Both one-way and two-way radio communications services;
>
> (b) A mobile service which provides a regularly interacting group of base, mobile, portable, and associated control and relay stations (whether licensed on an individual, cooperative, or multiple basis) for private one-way or two-way land mobile radio communications by eligible users over designated areas of operation; and
>
> (c) Any service for which a license is required in a personal communications service under part 24 of this chapter.

47 C.F.R. § 20.3.

Under the regulation's definitions, Internet services are not "mobile services" and therefore are not "commercial mobile radio services." Nor are they "associated with" or "adjunct to" commercial mobile radio services. Accordingly, charges for Internet services do not fall under the

Mobile Sourcing Act's definition of "charges for mobile telecommunications services" – and there is no support within the Mobile Sourcing Act itself to justify the use of its sourcing rules in the context of Internet services.

Moreover, the Ruling does not actually follow the Mobile Sourcing Act's method of determining how to apply the tax. The Mobile Sourcing Act allows taxes for "charges for mobile telecommunications services that are deemed to be provided by the customer's *home service provider* . . . by the taxing jurisdictions *whose territorial limits encompass the customer's place of primary use.*" 35 ILCS 638/20(b) (emphasis added). "Home service provider" means the facilities-based carrier or reseller with which the customer contracts for the provision of mobile telecommunications services. 35 ILCS 638/10. "Place of primary use" means

> the street address representative of where the customer's use of the mobile telecommunications service primarily occurs, which must be: (i) the residential street address or the primary business street address of the customer; and (ii) *within the licensed service area of the home service provider.*

35 ILCS 638/10 (emphasis added). The sourcing requirements of the Mobile Sourcing Act allow a local taxing jurisdiction to tax mobile telecommunications services when both the customer's home or primary business address *and* the licensed service area of the home service provider are in that taxing body's jurisdiction. There is no analogous limitation on the Ruling's application to Internet services because providers of Internet services do not have licensed service areas that put them directly within the jurisdiction of the same local taxing entity in which their customers are located.

b. The City lacks implied authority to rely on the sourcing method in the Mobile Sourcing Act.

Defendants also assert that they have implied authority to use the Mobile Sourcing Act for determining how to charge customers of Internet services because "the [Mobile Sourcing] Act is a reasonable means of dealing with the issue of how to source charges related to the use of mobile devices." (Memo. at 11.) But the Mobile Sourcing Act actually implies that Defendants do *not*

have the authority to tax consumers of Internet services based on their billing addresses. Before the Federal Mobile Sourcing Act, it was not apparent which jurisdictions had the authority to tax cellular phone service. To address this problem, Congress passed the Federal Mobile Sourcing Act, and the Illinois General Assembly passed the Mobile Sourcing Act, to allow state and local governments to tax cellular service based on where the customer's primary use of service occurs. It took a federal law and a state law to permit a local jurisdiction like the City to tax mobile telecommunications services in this way. No similar statutes authorize the City to tax Internet services that are outside its jurisdiction. *See* ILL. CONST. art. VII, § 6(a). The legislature has granted the City the authority to tax all amusements *within the city; see* 65 ILCS 5/11-42-1; 11-42-5; it has not granted the City the authority to tax activities outside its borders – which the City inevitably does when it taxes customers of Internet services based on their billing addresses alone.

B. The Ruling is not authorized because Internet services, unlike other amusements, need not both be provided and received "within the city" and therefore are not "amusements within the city."

In addition and in the alternative, Internet services are not "amusements within the city" because they are not both provided and received "within the city" even if a person uses such services while physically located in Chicago. The Amusement Tax "is imposed upon the patrons of every amusement within the city." Chi. Mun. Code 4-156-020(A). As the definition and all the examples provided in the Code imply (Chi. Mun. Code 4-156-010), an "amusement within the city" means that the amusement is both provided to a customer "within the city" and that the customer views, listens, or otherwise participates in that amusement "within the city." Sporting events, concerts, performances, motion picture shows, amusement park rides, dancing, and bowling are all provided in Chicago and require that the person participating in the amusement is located in Chicago. Even paid television programming is provided and received in Chicago: A cable or satellite television company physically installs cable wire or a satellite to a place of

residence or business in Chicago that allows one to watch television programming from that location.

Internet services are unlike other amusements because they are not necessarily provided in Chicago and may be received by a customer anywhere, either in or out of Chicago. They are not provided in the City, because, for example, a company like Netflix need not have a physical location or any relationship with Chicago in order to provide content to customers that is viewable over the Internet anywhere the customer is located. Unlike in-person amusements – which must be both provided and received in Chicago – Internet services need not both be provided and received in Chicago. Therefore, it does not make sense to say that these Internet services are "amusements within the city."

C. The Ruling improperly expands the definition of "amusement" in the Code.

Defendants assert that the term "amusements" in the Code is broad enough to encompass Internet services. But the Code's definition of "amusement" does not encompass Internet services; it only contemplates activities that occur physically "within the city," and none of the activities provided in the definition encompass Internet services.[3]

The Code's definition of "amusement" covers three categories of activities:

> (1) any exhibition, performance, presentation or show for entertainment purposes, including, but not limited to, any theatrical, dramatic, musical or spectacular performance, promotional show, motion picture show, flower, poultry or animal show, animal act, circus, rodeo, athletic contest, sport, game or similar exhibition such as boxing, wrestling, skating, dancing, swimming, racing, or riding on animals

[3] Defendants assert that the Ruling says nothing about Amazon Prime or Xbox Live Gold and assert that "nothing on the face of the Ruling requires the improper taxation of Amazon Prime or Xbox Live Gold." (Memo. at 8.) Defendants' assertion that Amazon Prime and Xbox Live Gold are not subject to the Amusement Tax contradicts the Amended Complaint, which alleges that both Amazon Prime and Xbox Live Gold provide Internet services that the Ruling requires to be subject to the Amusement Tax (Am. Compl. ¶¶ 17, 18, 29, 28, 29) and thus, requires evidence outside of the Amended Complaint pursuant to a § 2-619 motion. *See Figiel v. Chi. Plan Comm'n*, 408 Ill. App. 3d 223, 229 (1st Dist. 2011). Defendants have not submitted any external submissions to show that the Amusement Tax does not apply to Amazon Prime and Xbox Live Gold.

> or vehicles, baseball, basketball, softball, football, tennis, golf, hockey, track and field games, bowling or billiard or pool games;
>
> (2) any entertainment or recreational activity offered for public participation or on a membership or other basis including, but not limited to, carnivals, amusement park rides and games, bowling, billiards and pool games, dancing, tennis, racquetball, swimming, weightlifting, bodybuilding or similar activities; or
>
> (3) any paid television programming, whether transmitted by wire, cable, fiber optics, laser, microwave, radio, satellite or similar means.

Chi. Mun. Code 4-156-0 10. The Code's definition of "amusement" does not encompass Internet services. Internet services do not fall under the first "amusement" category – "any exhibition, performance, presentation or show for entertainment purposes" – which only includes *in-person* amusements. Internet services also do not fall under the definition's second "amusement" category – "any entertainment or recreational activity offered for public participation or on a membership or other basis" – which only encompasses activities in which persons physically participate in person, such as "carnivals, amusement park rides and games, bowling, and dancing."[1]

Finally, Internet services do not fall under the definition's third "amusement" category, which covers "paid television programming." This category covers cable and satellite television subscriptions and, presumably, pay-per-view events over such services. It could not have been intended to cover Internet streaming video services such as Netflix and Hulu, which of course did not exist and could not have been imagined at the time the ordinance was enacted, and which do not provide "television programming" but rather provide many types of videos that can be streamed to various devices other than televisions, such as computers, tablets, and smartphones. And even if this definition could be stretched to cover Internet *video* services such as Netflix and Hulu – which it cannot – it certainly does not cover services that provide audio rather than video,

[1] Defendants assert that online games are included in this definition of "amusement" by highlighting the word "games" in the second definition. (Memo. at 6.) However, the Defendants ignore the preceding words: "amusement park rides and games." Clearly the definition of amusement refers to amusement park games, not online games, which are quite different.

such as Spotify, and services that provide online gaming, such as Xbox Live Gold. Moreover, the definition's inclusion of a separate third category to cover "paid television programming" confirms that the first two categories of amusements do *not* cover electronic media services. If the first two categories did encompass entertainment other than in-person events, it would not have been necessary to include the third category. Accordingly, the Comptroller does not have the authority to effectively amend the Code himself through the Ruling.

For these reasons, the Ruling exceeds the Amusement Tax by attempting to apply the tax to Internet services because such services are not "amusements within the City." Therefore the Motion to Dismiss Counts I, II, and III should be denied.

II. The Amusement Tax applies to Internet services differently than it applies to in-person amusements in violation of the Uniformity Clause of the Illinois Constitution.

The Ruling's application of the Amusement Tax to Internet services also violates Uniformity Clause (Article IX, § 2) of the Illinois Constitution, which provides:

> In any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subjects and objects within each class shall be taxed uniformly. Exemptions, deductions, credits, refunds and other allowances shall be reasonable.

This clause "imposes more stringent limitations than the equal protection clause on the legislature's authority to classify the subjects and objects of taxation." *Allegro Servs. v. Metropolitan Pier & Exposition Auth.*, 172 Ill. 2d 243, 249 (1996). Any tax classification "must be based on a real and substantial difference between those taxed and those not taxed" and must bear some "'reasonable relationship' to the object of the legislation or to public policy." *Ball v. Village of Streamwood*, 281 Ill. App. 3d 679, 684-85 (1st Dist. 1996).

Once Plaintiffs establish a good-faith Uniformity challenge, "the taxing body must produce a justification for the classification." *Geja's Cafe v. Metro. Pier & Exposition Auth.*, 153 Ill. 2d 239,

248 (1992). It then becomes Plaintiffs' burden to persuade the Court that the justification is insufficient, either as a matter of law or as unsupported by the facts. *Id.* at 248-49; *see also Empress Casino Joliet Corp. v. Giannoulias*, 231 Ill. 2d 62, 72 (2008). Thus, even if Defendants state a justification for the differential treatment of Internet services – taxing them differently than in-person amusements, exempting automatic amusement machines from the tax, and exempting certain live in-person performances – it is not appropriate to dismiss Plaintiffs' claim, as long as they could prove some set of facts that would persuade the Court that Defendants' justification is insufficient. *See Imperial Apparel*, 227 Ill. 2d at 392.

A. The Amusement Tax violates the Uniformity Clause because it applies to Internet services inconsistently.

Defendants assert that the purpose of the Ruling is to apply the Amusement Tax to charges paid by customers for the privilege of using Internet services in Chicago. However, as explained in Section I, customers of Internet services with a billing address in Chicago are taxed when they use such services outside of Chicago, unlike customers of in-person amusements, who are only taxed for in-person amusements in Chicago. In addition, customers of Internet services who do not have billing addresses in Chicago are not taxed for using Internet services while in Chicago, while customers of in-person amusements who do not have billing addresses in Chicago are always taxed for viewing in-person amusements in Chicago. There is no "real and substantial difference" between these two sets of customers to justify this differential treatment. The only difference is the medium by which these customers receive such services: some customers participate on the Internet, while others participate in-person. But the substance of what these customers are receiving is the same. Thus, there cannot be a substantial difference to justify the different treatment in the way that the Amusement Tax is applied to these two sets of customers.

Further, the differential application of the Amusement Tax to Internet services and in-person amusements does not bear a "reasonable relationship to the object of the legislation or to public policy" because the object of the Amusement Tax is to tax "amusements within the city," but the Ruling applies the Amusement Tax to customers who do not use Internet services in Chicago and does not tax others who do use Internet services in Chicago. In contrast, the Amusement Tax applies to in-person amusements only when those amusements are in Chicago and does not apply based on whether a person participating in such an amusement has a billing address in Chicago. Thus, the application of the Amusement Tax to Internet services violates the Uniformity Clause.

B. The application of the Amusement Tax to Internet services violates the Uniformity Clause because it taxes Internet services while automatic amusement machines that deliver the same types of entertainment are exempt from the Amusement Tax.

Applying the Amusement Tax to Internet services violates the Uniformity Clause for a second reason: because it results in differential treatment of "automatic amusement machines," such as jukeboxes, while taxing substantially similar services transmitted over the Internet.

Under the Code, an automatic amusement machine is:

> any machine, which, upon . . . any . . . payment method, may be operated by the public generally for use as a game, entertainment or amusement . . . and includes but is not limited to such devices as jukeboxes, marble machines, pinball machines, movie and video booths or stands and all [similar] games, operations or transactions . . . .

Chi. Mun. Code § 4-156-150. The Code exempts use of these machines from the Amusement Tax and instead subjects their operators to a $150 tax per year per device. Chi. Mun. Code § 4-156-160.

There is no "real and substantial difference" between automatic amusement machines and Internet services. For example, Spotify, an Internet music service, allows consumers to access recorded music from a library of music over the Internet for a fee (Am. Compl. ¶ 27) – just as a jukebox does. Similarly, Xbox Live Gold allows one to play videogames (Am. Compl. ¶ 28), just as

a coin-operated video game machine does, and Netflix allows one to watch videos (Am. Compl. ¶ 26), just as a video booth does. Yet customers of Internet services are taxed at 9%, while customers of non-Internet forms of the same entertainment are not.

Because the Ruling results in differing treatment of automatic amusement machines and substantially similar Internet services, it violates the Uniformity Clause. *See Nat'l Pride of Chicago, Inc. v. Chicago*, 206 Ill. App. 3d 1090, 1104-05 (1st Dist. 1990) (administrative ruling taxing coin-operated self-serve car washes while exempting automatic car washes violated Uniformity Clause because it "[made] an artificial distinction between plaintiff and its competitors based solely on the customer's hands-on participation in plaintiff's wash process").

C. The application of the Amusement Tax to Internet services violates the Uniformity Clause because it taxes Internet services at a different rate than it taxes in-person live performances that provide the same types of entertainment.

The Ruling applying the Amusement Tax to Internet services violates the Uniformity Clause because it taxes Internet services at a different rate than the Code taxes in-person live performances that provide the same kind of entertainment. The Amusement Tax exempts "admission fees to witness in person live theatrical, live musical or other live cultural performances that take place in any auditorium, theater or other space in the city whose maximum capacity, including all balconies and other sections, is not more than 750 persons," Chi. Mun. Code § 4-156-020(D)(1), and taxes such performances in a space with a capacity of greater than 750 persons at a reduced rate of 5%. Chi. Mun. Code § 4-156-020(E).

Defendants assert that the Illinois Supreme Court sanctioned the favoring of "live fine arts performances" over other forms of amusement in *Pooh-Bah Enters. v. County of Cook*, 232 Ill. 2d 463 (2009). (Memo. at 15.) But *Pooh-Bah* did not address the Uniformity Clause; rather, it upheld dismissal of a First Amendment challenge to the Amusement Tax's exemption of "live fine art performances" but not "adult entertainment cabarets." *Id.* at 503.

Defendants assert that the purpose of the exemption is "to foster the production of live performances that offer theatrical, musical or cultural enrichment to the city's residents and visitors." With this in mind, the first question is whether there is a real and substantial difference between live theatrical, musical, or cultural performances and Internet services providing similar or identical performances. The only difference is that live performances take place at a specific venue in the City, whereas such performances on the Internet could be viewed from anywhere. This is not a difference in substance; it is a difference in form. The substance – the performances – are the same; it is only the form – whether one is watching at a specific venue or on the Internet – that is different. This is not enough to satisfy the "real and substantial difference" test of the Uniformity Clause.

The second question is whether exempting (or applying a reduced rate to) live theatrical, musical, or cultural performances from the Amusement Tax while not doing so for Internet services providing similar or identical performances bears some "'reasonable relationship' to the object of the legislation or to public policy." *Ball*, 281 Ill. App. 3d at 684-85. The City's purpose is to foster the production of live performances that offer theatrical, musical, or cultural enrichment to the City's residents and visitors, and viewing such performances over the Internet furthers that purpose. City residents who view such performances on the Internet can be just as enriched as persons who view them in person. Viewing theatrical, musical, or cultural performances on the Internet can be just as beneficial to theaters or venues in Chicago that provide live performances because it could give more people access to such performances.

Thus, Plaintiffs could prove facts to persuade the Court that Defendants' justification distinguishing between live performances in theaters and those over the Internet is insufficient. Therefore the Motion to Dismiss Count V should be denied.

III. The Ruling applying the Amusement Tax to Internet services discriminates against electronic commerce and therefore violates ITFA.

ITFA, which is set forth in a note to 47 U.S.C. § 151, provides that no state or political subdivision of a state may impose multiple or discriminatory taxes on electronic commerce. ITFA § 1101(a). The United States Congress enacted ITFA to "foster the growth of electronic commerce and the Internet by facilitating the development of a fair and consistent Internet tax policy." S. Report No. 105-184, at 1 (1998). One of ITFA's primary purposes is to prevent state and local taxing authorities from imposing discriminatory taxes on electronic commerce that would thereby stifle its development. *See, e.g.,* H.R. Rep. No. 105-808, pt. 1, at 8–9 (1998) (explaining that discriminatory state taxation could prevent electronic commerce from becoming ubiquitous); S. Rep. No. 105-184, at 2, 11 (1998) (stating that ITFA was intended to encourage "policies on taxation that eliminate any disproportionate burden on interstate commerce conducted electronically and establish a level playing field between electronic commerce using the new media of the Internet and traditional means of commerce").

ITFA accordingly imposes a moratorium on "discriminatory taxes on electronic commerce." ITFA § 1101(a)(2). Congress recently enacted a permanent moratorium on discriminatory taxes on electronic commerce. Trade Facilitation and Trade Enforcement Act of 2015, 114 Pub. L. No. 125, § 922, 130 Stat. 122 (2016). "Electronic commerce" is "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access." ITFA § 1105(3). The term "tax" under the ITFA includes those that a seller is required to collect and remit. ITFA § 1105(8). A tax on electronic commerce tax is deemed to be a "discriminatory tax" if it:

> (i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means; [or]
>
> (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means . . .; [or]
>
> (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means . . . .

Id. § 1105(2)(A)(i)-(iii). Thus, ITFA does not prohibit the taxation of electronic commerce transactions per se but does prohibit jurisdictions from imposing greater tax burdens on electronic transactions when such burdens are not imposed on traditional commerce. Moreover, in determining the existence of discrimination, ITFA compares transactions that are "similar" and does not require that they be identical.

The Illinois Supreme Court recently relied on ITFA to strike down a state tax. In *Performance Mktg. Ass'n v. Hamer*, 2013 IL 114496, the Court struck down a tax on performance marketing – an arrangement where a person or organization who publishes an advertisement is paid by a retailer when a sale is completed – as discriminatory under ITFA because it applied to performance marketing over the Internet but not to "performance marketing by an out-of-state retailer which appears in print or on over-the-air broadcasting in Illinois." *Id.* at ¶ 23.

The Amusement Tax, as interpreted and applied by the Comptroller in the Ruling, imposes an unlawful discriminatory tax on electronic commerce and thus violates ITFA. As so interpreted, the Amusement Tax applies to Internet services if the customer has a billing address in Chicago even if the customer views or listens to those Internet services outside the City. But the Amusement Tax is not imposed on the rental of the same movies, music, or games. This is an unlawful discrimination against electronic commerce. The City argues in its brief that there is no discrimination because the 9% Personal Property Lease Transaction Tax is imposed on the rental of movies, music and

games if they are rented within the City limits. However, the Personal Property Lease Transaction Tax does not apply to the rental of those movies, music, or games if the rental occurs outside the City even if the customer has a billing address in Chicago.

The Ruling also violates ITFA because, as explained in Section II.B, the Ruling requires customers of Internet services to pay the Amusement Tax, while patrons of "automatic amusement machines," which also allow users to watch videos, listen to music, and play games, are not taxed. Another way in which the Ruling imposes a discriminatory tax is in the context of live performances delivered through Internet services. As explained in Section II.C, live theatrical, musical, and cultural performances at theaters and other venues are either exempt from the Amusement Tax or are taxed at a lower rate than other amusements, depending on the size of the venue. Under the Ruling, however, the same live performances delivered through Internet services are not taxed at a lower rate than other amusements. Defendants attempt to distinguish between live performances in a theater or other venue and those on the Internet by stating that they are different because the experience of watching an in-person performance is different than the experience of watching a performance on the Internet. (Memo. at 15.) But that is the exact distinction that ITFA prohibits: treating a product delivered online as though it is different simply because it is delivered online.

Thus, Count IV of the Complaint should not be dismissed because there are several ways in which the application of the Amusement Tax to Internet services violates ITFA.

IV. Applying the Amusement Tax to Internet services when those services are used outside the City violates the Commerce Clause of the United States Constitution.

The Commerce Clause (Article I, Section 8, Clause 3) of the United States Constitution prohibits state interference with interstate commerce. A local tax satisfies the Commerce Clause only if it "(1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly

apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977); *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992). The Ruling's application of the Amusement Tax to Internet services violates requirements (1), (2) and (4).

The Amusement Tax, as interpreted by the Comptroller in the Ruling and as applied to Plaintiffs, does not satisfy the substantial nexus requirement. A tax violates the Commerce Clause unless it "is applied to an activity with a substantial nexus" with the taxing jurisdiction. *Complete Auto*, 430 U.S. at 279; *Quill Corp.*, 504 U.S. at 311. The state must have the requisite connection with the specific activity being taxed. *See Allied Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 777-78 (1992); *Goldberg v. Sweet*, 488 U.S. 252, 263 (1989). When Plaintiffs are using Internet services while located outside Chicago, there is a lack of a transactional nexus between the City and the property that it seeks to tax.

Defendants assert that a substantial nexus exists in this case because the "Amusement Tax applies only to amusements that take place in Chicago and . . . the Ruling said nothing about . . . whether a given provider has sufficient nexus such that it will be required to collect Amusement Tax from its Chicago customers." (Memo. at 19-20.) As discussed in Section I above, the assertion that the Amusement Tax applies only to amusements that take place in Chicago is not true with respect to the Ruling's taxation of Internet services. Again, the Ruling imposes the tax on customers with Chicago billing addresses whose use of Internet services occurs entirely outside Chicago – which means there is no transactional nexus between the Internet services and the City. Defendants' claim that "when video, audio or games are streamed to Chicago residents there is substantial nexus between Chicago and the people being taxed" (Memo. at 20) is incorrect because, again, Plaintiffs have no nexus with the City when they consume Internet services entirely outside of Chicago.

The Amusement Tax, as interpreted by the Comptroller in the Ruling and as applied to Plaintiffs, does not satisfy the fair apportionment requirement because the tax is imposed when the customer is witnessing, viewing, or participating in the amusements outside of Chicago. "The primary purpose of the fair apportionment prong . . . is to prevent multiple taxation by 'ensur[ing] that each State taxes only its fair share of an interstate transaction.'" *Irwin Indus. Tool Co. v. Ill. Dep't of Revenue*, 238 Ill. 2d 332, 345 (2010) (citation omitted). To be fairly apportioned, a tax must be internally and externally consistent. *Id.* at 345-46. To be internally consistent, a tax must be structured so that, if every state were to impose the same tax, no multiple taxation would result. *Id.* at 346. To be externally consistent, a tax must apply only to that portion of the revenues from the interstate activity that reasonably reflects the in-state component of the activity being taxed. The Court thus examines "the in-state business activity which triggers the taxable event and the practical or economic effect of the tax on that interstate activity." *Id.* (quoting *Goldberg*, 488 U.S. at 260-61). Plaintiffs might consume Internet services entirely outside of Chicago, but they would remain subject to the City's tax on that activity. Such a result violates the external consistency test.

Finally, the Amusement Tax, as interpreted by the Comptroller in the Ruling and as applied to Plaintiffs, does not satisfy the fairly related requirement. Defendants argue that, even though Internet service providers do not receive any protection, opportunities, or benefits from Chicago or Illinois, the provider's customers, on whom the tax is imposed, do. (Memo. at 22.) But that is not the case when the Plaintiffs access Internet services while located outside of Chicago.

For these reasons, the Court should deny Defendants' Motion to Dismiss Count VI.

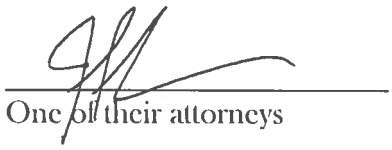
CONCLUSION

The Amended Complaint states viable claims that the Ruling exceeds the scope of the Amusement Tax and violates the Internet Tax Freedom Act, the Uniformity Clause of the Illinois

Constitution, and the Commerce Clause of the U.S. Constitution. Therefore, the motion to dismiss should be denied.

Dated: March 22, 2016

Respectfully submitted,



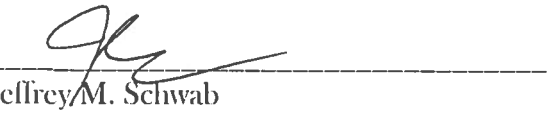
One of their attorneys

Jacob H. Huebert (#6305339)
Jeffrey M. Schwab (#6290710)
Liberty Justice Center (#49098)
190 S. LaSalle Street, Suite 1500
Chicago, Illinois 60603
Telephone (312) 263-7668
Facsimile (312) 263-7702
jhuebert@libertyjusticecenter.org
jschwab@libertyjusticecenter.org

CERTIFICATE OF SERVICE

I, Jeffrey Schwab, an attorney, hereby certify that on March 22, 2016, I served the foregoing Plaintiffs' Response to Defendants' Motion to Dismiss the Amended Complaint on Defendants' counsel of record by U.S. mail and electronic mail sent to:

Steve Tomiello
Weston Hanscom
Kim Cook
City of Chicago Department of Law
Revenue Litigation Division
30 North LaSalle Street, Suite 1020
Chicago, IL 60602
Steven.Tomiello@cityofchicago.org



Jeffrey M. Schwab