PT 09-14
Tax Type: Property Tax
Issue: Charitable Ownership/Use

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	
v.	**Docket # 08-PT-0004**
OKO, LLC	**Tax Year 2007**
Applicant	

RECOMMENDATION FOR DISPOSITION

Appearances: Terry Shafer, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Christopher M. Ellis of Bolen, Robinson & Ellis, LLP for OKO, LLC

Synopsis:

OKO, LLC ("applicant" or "OKO") filed an application for a property tax exemption for the year 2007 for a parcel of property located in Macon County. OKO contends that the property qualifies for a charitable purposes exemption pursuant to section 15-65 of the Property Tax Code (35 ILCS 200/1-1 *et seq.*). During the year in question, the previous owner of the property sold the property to OKO and began leasing it back from OKO. The Macon County Board of Review ("County") recommended that OKO's request for an exemption be denied because the parcel is not owned by a charitable organization. The Department of Revenue ("Department") agreed with the County's decision to deny the exemption. The Department initially determined that the property is neither owned nor used for charitable purposes, and OKO timely protested the Department's decision. OKO contends that under the sale-leaseback transaction, the previous owner maintains the indicia of ownership to warrant an exemption. At the pre-trial conference, the parties stipulated that the property is used for charitable purposes. The parties also agreed that the issues in this case are as follows: (1) whether the Lessee has the indicia of ownership for property tax purposes pursuant to the Lease that was in effect during 2007; (2) if the Lessee does not have the indicia of ownership pursuant to the original Lease, whether the modifications to the Lease that were made in 2008 revert back to the year 2007; and (3) if the modifications revert back to the year 2007, whether the Lessee has the indicia of ownership for 2007 property tax purposes pursuant to the modifications that were made during 2008. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The property at issue is located at 815 N. Church Street in Decatur, Illinois and was previously owned by Old King's Orchard Community Center ("Community Center" or "Center"). Since 2001, the Community Center has been operating, and continues to operate, a safe haven for the inner city children of Decatur on the property. (Dept. Ex. #3; Tr. pp. 9-10)
2. In 2007, the vice president of the Community Center, Joyce Keller, approached a personal friend, Thomas Kowa, for financial help for the Center. Mr. Kowa

agreed to pay off a loan for the Center by purchasing the property and leasing it back to the Center. (Tr. pp. 12-15)

3. Mr. Kowa created OKO for the purpose of purchasing the property. OKO is an Illinois limited liability company ("LLC"). Mr. Kowa is the sole member of OKO. (App. Ex. #1; Tr. pp. 32, 58)

4. Mr. Kowa is also the president of Huston-Patterson Corporation, which is a business that does printing for the packaging industry in North America. (Dept. Ex. #2; Tr. p. 32)

5. On March 16, 2007, OKO entered into a Purchase and Sale Agreement with the Community Center in order to purchase the property from the Community Center for $100,000. (Dept. Ex. #6)

6. The Purchase and Sale Agreement indicates that at the closing the parties will execute a Lease wherein OKO will lease to the Community Center the real and personal property that is the subject of the Agreement. (Dept. Ex. #6)

7. On March 30, 2007, OKO, as Lessor, entered into a Lease with the Community Center, as Lessee, to lease the property. The term of the Lease is 15 years, beginning on March 30, 2007 ("Effective Date"). Relevant provisions of the Lease include the following:

> 3. **Payment of Rent.** Except as otherwise provided in this Lease, Lessee must pay Lessor $12,000.00 per annum as rent for the term of the Lease, payable in equal monthly installments of $1,000.00 each, due in advance beginning April 1, 2007, and continuing on the 1st day of each subsequent month through the term of the Lease.
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> 4. **Lessor's Waiver of Rent.** The Premises that are the subject of this Lease were owned by Lessee prior to the Effective Date and were exempt from real estate taxation due to the not-for-profit

> operations of Lessee. It is acknowledged and agreed that the parties have executed contemporaneously with this Lease a Purchase and Sale Agreement wherein Lessor purchased the Premises from Lessee. It is further acknowledged and agreed that it is the intention and purpose of both parties that Lessee continue its current exempt operations uninterrupted and unabated despite the technical change of ownership of the Premises, and that Lessee will take whatever action is necessary and reasonable to assist Lessor in its efforts to have the Premises leased to Lessee declared tax exempt. *So long as the Premises subject to this Lease retains its status as exempt from real estate taxes, which shall be based upon a final determination by the relevant governmental authority*, then Lessor will waive its right to collect any rent pursuant to Paragraph 3 of this Lease. *If the Premises loses its status as exempt from real estate taxation because of the change of ownership* or because of any other reason at any other time in the future, then Lessor will have the right to collect rent pursuant to Paragraph 3 of this Lease.[1] (emphasis added) (App. Ex. #1)

8. According to the Lease that was executed on March 30, 2007, the Lessee covenants to pay rent, subject to the conditions of Paragraph 4. The Lessee also covenants to be responsible for payment of all utilities, maintenance and repairs and for maintaining insurance for the property. The Lessee covenants to not assign or sublet the premises without the written consent of the Lessor. The Lessor covenants to pay all real estate taxes, if any. (App. Ex. #1)

9. The Lease also includes the following provisions:

> 7. **Reentry.** In case of a breach of any of the Lessee's covenants above, or in case the estate created by the Lease is taken from the Lessee by process of law or by proceedings in bankruptcy or insolvency or otherwise, the Lessor may, while the default continues, or at any time after such taking, and regardless of any license or waiver of any prior breach of condition, without notice or demand, enter on the premises and by such act terminate this Lease, and may then expel and remove, forcibly, if necessary, the Lessee and its property, as allowed by law.
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> * * *

[1] The language that is emphasized in italics is the language that was subsequently changed by an Addendum to the Lease.

> 10. **Right of Purchase.** For only so long as the *Premises subject to this Lease maintains its status as exempt from real estate taxes*, then Lessee will have the right to purchase the Premises that is the subject of this Lease at any time for the then current fair market value. In the event Lessor and Lessee cannot agree on a Fair Market Value, such shall be determined in the following manner: Lessor and Lessee may each retain an appraiser of their choice and the Fair Market Value shall be considered to be the average of the two appraisals. If the *Premises that is the subject of this Lease loses its status as exempt from real estate taxation because of the change of ownership* or because of any other reason at any time, then Lessee will not have the Right of Purchase pursuant to this Paragraph 10. (emphasis added) (App. Ex. #1)

10. The Lease also includes a provision, numbered 11, titled "Right of First Refusal" that provides that in the event the Lessor decides to sell the premises during the term of the Lease, the Lessor shall give written notice thereof to the Lessee. If the Lessor receives a Bona Fide Offer for the purchase, then the Lessor shall again give written notice thereof to the Lessee. The Lessee shall then have the right and option to purchase the Premises at the price and upon the terms set forth in the Offer. The Lessee must exercise the option by written notice to the Lessor on or before the later of the 30th business day following the Lessee's receipt of the Notice of Bona Fide Offer or the 90th day following Lessee's receipt of the Notice of Intended Disposition. Similar conditions apply if the Lessor receives an unsolicited Bona Fide Offer to purchase the premises. (App. Ex. #1)

11. The Lease includes the following provision:

> 13. **Casualty.** *Except as otherwise specifically provided herein,* damage to or destruction of any portion or all of the buildings, structures and fixtures upon the Premises, by fire, the elements or any other cause whatsoever, whether with or without fault on the part of the Lessee, *shall not terminate this Lease or entitle Lessee to surrender the Premises*. (emphasis added) (App. Ex. #1)

12. On March 25, 2008, the Lessor and Lessee executed an "Addendum to Lease," which stated that it was made and effective March 1, 2008. The addendum states that Paragraph 4 of the Lease is hereby replaced with the following:

> 4. **Lessor's Waiver of Rent.** The Premises that are the subject of this Lease were owned by Lessee prior to the Effective Date and were exempt from real estate taxation due to the not-for-profit operations of Lessee. It is acknowledged and agreed that the parties have executed contemporaneously with this Lease a Purchase and Sale Agreement wherein Lessor purchased the Premises from Lessee. It is further acknowledged and agreed that it is the intention and purpose of both parties that Lessee continue its current exempt operations uninterrupted and unabated despite the technical change of ownership of the Premises, and that Lessee will take whatever action is necessary and reasonable to assist Lessor in its efforts to have the Premises leased to Lessee declared tax exempt. *So long as the Lessee continues its not-for-profit activities on the Premises*, then Lessor will waive its right to collect any rent pursuant to Paragraph 3 of this Lease. *If the Lessee terminates its not-for-profit activities on the Premises because of a change of ownership* or because of any other reason at any other time in the future, then Lessor will have the right to collect rent pursuant to Paragraph 3 of this Lease. (emphasis added) (App. Ex. #2)

13. On September 29, 2008, the Lessor and Lessee executed another "Addendum to Lease," which stated that it was made and effective March 30, 2007. The addendum states that Paragraphs 4, 10, 11, and 13 of the Lease are hereby replaced with the following:

> 4. **Lessor's Waiver of Rent.**[2] The Premises that are the subject of this Lease were owned by Lessee prior to the Effective Date and were exempt from real estate taxation due to the not-for-profit operations of Lessee. It is acknowledged and agreed that the parties have executed contemporaneously with this Lease a Purchase and Sale Agreement wherein Lessor purchased the Premises from Lessee. It is further acknowledged and agreed that it is the intention and purpose of both parties that Lessee continue its current exempt operations uninterrupted and unabated despite the technical change of ownership of the Premises, and that Lessee

[2] This paragraph is the same as Paragraph 4 in the first Addendum to Lease.

> will take whatever action is necessary and reasonable to assist Lessor in its efforts to have the Premises leased to Lessee declared tax exempt. So long as the Lessee continues its not-for-profit activities on the Premises, then Lessor will waive its right to collect any rent pursuant to Paragraph 3 of this Lease. If the Lessee terminates its not-for-profit activities on the Premises because of a change of ownership or because of any other reason at any other time in the future, then Lessor will have the right to collect rent pursuant to Paragraph 3 of this Lease.
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> 10. **Right to Purchase.** For only so long as the *Lessee continues its not-for-profit activities on the Premises during the term of this Lease*, then Lessee will have the *exclusive* right to purchase the Premises that is the subject of this Lease at any time for the then current fair market value. In the event Lessor and Lessee cannot agree on a Fair Market Value, such shall be determined in the following manner: Lessor and Lessee may each retain an appraiser of their choice and the Fair Market Value shall be considered to be the average of the two appraisals. If the *Lessee terminates its not-for-profit activities on the Premises because of a change of ownership* or because of any other reason at any time *in the future*, then Lessee will not have the Right of Purchase pursuant to this Paragraph 10.
>
> 11. ***Exclusivity of Right to Purchase.*** *Lessor agrees and covenants that, for only so long as the Lessee continues its not-for-profit activities on the Premises during the term of this Lease, then Lessor will not sell or otherwise transfer the Premises to any third party that is unrelated to either Lessor or Lessee, absent Lessee's consent. A related entity is one that is a direct successor in interest to either Lessor or Lessee or a permitted assign. It is further acknowledged that Lessee's exclusive right to purchase the Premises provided for in paragraphs 10 and 11 of this Lease shall survive the sale of the Premises and shall be fully binding upon the purchaser as if it were the original Lessor.*
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> 13. **Casualty.** *In the event of* damage to or destruction of any portion or all of the buildings, structures and fixtures upon the Premises, by fire, the elements or any other cause whatsoever, whether with or without fault on the part of the Lessee, *Lessee shall have the option to terminate this Lease and surrender the Premises*. (emphasis added) (App. Ex. #3)

14. The Addendum to the Lease that was executed on September 29, 2008 includes the following paragraph:

> In executing this Addendum, Lessee acknowledges that it has never been asked to pay, nor has it ever paid, any amount to Lessor as rent or otherwise while the Lease as [sic] been in effect. Lessor acknowledges and covenants that it will not request or demand that Lessee pay to Lessor any amount as rent or otherwise for any time period when Lessee conducted its not-for-profit activities on the Premises. (App. Ex. #3)

15. Mr. Kowa, as president of Huston-Patterson Corporation, signed an undated document titled "Pledge" that states as follows:

> Huston-Patterson Corporation, an Illinois corporation, by this document does hereby pledge to [the Community Center], an Illinois not-for-profit corporation, that Huston-Patterson Corporation will pay for directly, or reimburse to [the Community Center], any costs incurred or associated with maintaining insurance on the real and personal property associated with [the Community Center's] activities at 815 N. Church St., Decatur, Illinois, including automobile insurance on vehicles owned by the not-for-profit corporation. Huston-Patterson further pledges to pay for directly, or reimburse to [the Community Center], any costs incurred or associated with major maintenance of the real property leased by [the Community Center] at 815 N. Church St., Decatur, Illinois. This pledge shall be effective *so long as the real property leased by [the Community Center] remains exempt from real estate taxation*. (emphasis added) (App. Ex. #4)

16. Mr. Kowa, as president of Huston-Patterson Corporation, signed another undated document titled "Pledge" that states as follows:

> Huston-Patterson Corporation, an Illinois corporation, by this document does hereby pledge to [the Community Center], an Illinois not-for-profit corporation, that Huston-Patterson Corporation will pay for directly, or reimburse to [the Community Center], any costs incurred or associated with maintaining insurance on the real and personal property associated with [the Community Center's] activities at 815 N. Church St., Decatur, Illinois, including automobile insurance on vehicles owned by the not-for-profit corporation. Huston-Patterson further pledges to pay for directly, or reimburse to [the Community Center], any costs incurred or associated with major maintenance of the real property leased by [the Community Center] at 815 N. Church St., Decatur, Illinois. This pledge shall be effective *for the duration the [sic] Lease made and effective March 30, 2007, between [the*

> *Community Center] and OKO, LLC for the property at 815 N. Church St., Decatur, Illinois*. (emphasis added) (App. Ex. #5)

17. OKO does not contend that it is a charitable organization. (Tr. pp. 7-8)

CONCLUSIONS OF LAW:

Article IX, section 6 of the Illinois Constitution of 1970 authorizes the General Assembly to grant property tax exemptions in limited circumstances and provides in part as follows:

> The General Assembly by law may exempt from taxation only the property of the State, units of local government and school districts and property used exclusively for agricultural and horticultural societies, and for school, religious, cemetery and charitable purposes. Ill. Const. 1970, art. IX, §6.

Pursuant to this constitutional authority the General Assembly enacted section 15-65 of the Property Tax Code, which allows exemptions for charitable purposes and provides in part as follows:

> All property of the following is exempt when actually and exclusively used for charitable or beneficent purposes, and not leased or otherwise used with a view to profit:
>
> (a) Institutions of public charity….
>
> Property otherwise qualifying for an exemption under this Section shall not lose its exemption because the legal title is held (i) by an entity that is organized solely to hold that title and that qualifies under paragraph (2) of Section 501(c) of the Internal Revenue Code or its successor, whether or not that entity receives rent from the charitable organization for the repair and maintenance of the property, … or (iii) for any assessment year including and subsequent to January 1, 1996 for which an application for exemption has been filed and a decision on which has not become final and nonappealable, by a limited liability company organized under the Limited Liability Company Act provided that (A) the limited liability company receives a notification from the Internal Revenue Service that it qualifies under paragraph (2) or (3) of Section 501(c) of the Internal Revenue Code; (B) the limited liability company's sole members, as that term is used in Section 1-5 of the Limited Liability Company Act, are the institutions of public charity that actually and exclusively use the property

> for charitable and beneficent purposes; and (C) the limited liability company does not lease the property or otherwise use it with a view to profit. 35 ILCS 200/15-65.

Property may be exempt under subsection (a) if it is (1) owned by an entity that is an institution of public charity; (2) actually and exclusively used for charitable purposes; and (3) not leased or otherwise used with a view to profit. *Id.*; Chicago Patrolmen's Association v. Department of Revenue, 171 Ill. 2d 263, 270 (1996); Methodist Old People's Home v. Korzen, 39 Ill. 2d 149, 156-157 (1968).

It is well-established that property tax exemption provisions are strictly construed in favor of taxation. People ex rel. County Collector v. Hopedale Medical Foundation, 46 Ill. 2d 450, 462 (1970). The party claiming the exemption has the burden of proving by clear and convincing evidence that it is entitled to the exemption, and all doubts are resolved in favor of taxation. *Id.*; City of Chicago v. Department of Revenue, 147 Ill. 2d 484, 491 (1992); Evangelical Hospitals Corporation v. Department of Revenue, 223 Ill. App. 3d 225, 231 (2^{nd} Dist. 1992).

The vice president of the Community Center, Ms. Keller, testified that before the building that is currently on the property was constructed, two people offered to provide \$300,000 to finance the construction if the Center could match that amount. The Center received the matching amount from the State of Illinois. (Tr. pp. 10-11) In 2006, the two people who paid the \$300,000 indicated they would forgive \$200,000 if the Center would pay back \$100,000. (Tr. pp. 11-12) The Center then obtained a loan from Regions Bank for \$100,000, and Regions Bank obtained a mortgage on the property. (Tr. p. 12) Sometime later, Regions Bank "called in" the loan, and the Center was unable to pay it. (Tr. pp. 12-13) The Center then went to several places to try to get funding and could not obtain it; Regions Bank indicated it would foreclose on the property. (Tr. pp. 13-14) Ms. Keller then approached Mr. Kowa for help.

Ms. Keller and Mr. Kowa both testified that since the inception of the Lease, the Community Center has not paid any rent to OKO, and it has not paid for any maintenance, insurance, or property taxes.[3] The Center does pay for its utilities. (Tr. p. 18) Mr. Kowa said as long as the Center continued the programs for the children, it would not have to pay these expenses. (Tr. pp. 34-35)

Mr. Kowa did not simply pay off the note and allow the Community Center to keep the property because "history repeats itself." (Tr. p. 93) The Center had failed to make the previous note payments, and Mr. Kowa did not know how the Center would spend its money. He believed the chances of it staying open were greater if he paid the loan off and paid the maintenance, insurance, and property taxes than if he had simply made a donation. He did not want to be involved with running the programs; he was only interested in keeping a safe haven for the children. (Tr. p. 35)

OKO argues that pursuant to the original Lease that was in effect during 2007, the Community Center has indicia of ownership for property tax purposes. OKO claims that it followed the guidance of the Fourth District Appellate Court in Cole Hospital, Inc. v. Champaign County Board of Review, 113 Ill. App. 3d 96 (4th Dist. 1983) and Coles-Cumberland Professional Development Corporation v. Department of Revenue, 284 Ill. App. 3d 351 (4th Dist. 1996) in order to construct the sale-leaseback arrangement to maintain the Center's ownership. Under the original Lease, the Center does not have to

[3] Mr. Kowa asked his electrical and plumbing contractors to donate their time for maintenance, and he believed it was financially better to include the Center on the insurance policy for Huston-Patterson Corporation rather than have a separate insurance policy for the Center. (Tr. pp. 33-34, 49) His company pledged to maintain the property because his company has the resources to do it. (Tr. pp. 38-39)

pay a security deposit, rent or property taxes, and the Center has an option to purchase and a right of first refusal so long as the property maintains its tax-exempt status. According to OKO, the arrangement occurred because the Center was unable to obtain alternative financing. In addition, during the term of the Lease, the Center has never paid for rent, property taxes, insurance or maintenance.

OKO also argues that the 2008 amendments relate back and are effective from the beginning of the contract. OKO has cited cases for the contention that a contract may relate back, which is determined by the intent of the parties as deduced from the contract itself. See <u>Grubb & Ellis Company v. Bradley Real Estate Trust</u>, 909 F. 2d 1050, 1054 (7th Cir. 1990). OKO believes the amendments clarify, rather than modify, the original terms of the Lease, and there is effectively no difference between the original Lease and the 2008 amendments. The original Lease allows for no rent and the right to purchase so long as the property maintains its tax-exempt status; the amendment allows for no rent and the right to purchase so long as the Center maintains its tax-exempt activities. OKO believes that the Center's tax-exempt activities are what maintain the tax exempt status of the property, so the amended Lease reflects what the agreement has always been: as long as the Center maintains its tax exempt activities, it will never have to pay rent or property taxes. OKO claims that the Center has the exclusive right to purchase the property at any time for fair market value. OKO argues that the Center's operation has been virtually guaranteed for the next 15 years; Mr. Kowa will spend significant funds for its upkeep and will not make money on the property. OKO claims that the Center, and the community it serves, have benefitted substantially, and the intent is charitable.

The Department argues that LLC's are specifically mentioned in section 15-65, and OKO simply cannot qualify for an exemption because it does not qualify under paragraph (2) or (3) of section 501(c) of the Internal Revenue Code. The Department contends that the Cole Hospital and Coles-Cumberland cases, as well as Henderson County Retirement Center, Inc. v. Department of Revenue, 237 Ill. App. 3d 522 (3rd Dist. 1992), are distinguishable from the present cases because all three cases involve corporations, not LLC's. In addition, the lessee in each case was responsible for paying the property taxes. Furthermore, in Henderson the court found that the right of first refusal did not take effect until the date of an addendum that was executed sometime after the original lease.

The Department also states that OKO has not submitted any financial information to verify the testimony, and it has not submitted documentation to show that the Center has control of the property. The Department contends that Mr. Kowa controls the property; he did not give the money directly to the Center because he was concerned about how it would be spent. He maintains the property and pays for the insurance and property taxes. The Department also argues that an exemption cannot be given based on an amendment that was made after the year in question. The Department claims that in the cases cited by OKO concerning contracts, only the parties to the original contract were allowed to have retroactive application of the terms; contracting parties cannot force others to retroactively give them something they were not entitled to during a time when the original terms were in place.

Although OKO clearly does not meet the requirements under section 15-65 that would allow an exemption when legal title is held by an LLC, the Cole Hospital case, among others, states that the realities of ownership, not merely legal title, are determinative for property tax exemptions. Cole Hospital, at 99. Legal title is considered as one factor, but control and the right to the benefits of the property are of greater importance. *Id*. "The primary incidents of ownership include the right to possession, use and enjoyment of the property, the right to change or improve the property, and the right to alienate the property at will." Wheaton College v. Department of Revenue, 155 Ill. App. 3d 945, 946 (2nd Dist. 1987). The right to sublease the property is considered an incident of ownership. *Id*. at 947. Contractual responsibility for real estate taxes is also an incident of ownership, as well as "a substantial monetary interest in the property." Christian Action Ministry v. Department of Local Government Affairs, 74 Ill. 2d 51, 61-62 (1978).

In Cole Hospital, the hospital made extensive efforts to obtain conventional financing in order to build a new facility, but it could not obtain it. The hospital's only financing option was to enter into a sale-leaseback arrangement with a private organization for a 20-year term with options to renew for two additional 10-year terms. The hospital paid rent, property taxes, insurance, and maintenance costs.[4] There was no provision for a security deposit, and the hospital had the absolute right to purchase the property at ten times the annual rent on the 11th and 16th anniversary dates. The hospital also had the right of first refusal if the lessor received a bona fide purchase offer. All the terms of the lease remained in effect in the event of a sale to a third party. In finding the property qualified for an exemption, the court stated that "[o]bviously not every lease *qua* lease will qualify for exemption. [citation omitted] When, under proper circumstances, a

[4] The annual rent was 13.5% of the $5,500,000 advancement. Cole Hospital, at 100.

sale-and-lease-back is used as a financing device, alternatively to conventional financing, it may qualify." *Id*. at 101.

In the present case, the facts do not support a similar finding that the Community Center is, in reality, the owner of the property. First, OKO did not clearly establish through documentary evidence that the sale-leaseback arrangement was the Center's only "financing" option. OKO did not give substantiating evidence to show that the Center had a troubled financial history and that it made extensive efforts to obtain financing. OKO did not present a copy of the mortgage or other documents to show that the arrangement was financially necessary. The date that the Center obtained the loan from Regions Bank is not in the record, but it was apparently sometime during 2006 because that is when the Center was asked to pay $100,000 to the two original donors. Although the testimony indicated that the Center could not make some of the loan payments, the record does not clearly disclose why the $100,000 loan "was called in" less than a year after issuing it. (Tr. pp. 12-13) No documentary evidence was provided to substantiate the fact that the loan was called in.

The remaining evidence supports a finding that the Center does not have sufficient indicia of ownership to warrant an exemption. Although the Center has the right to use the property, the Center does not have the contractual responsibility to pay the real estate taxes, and the Center cannot sublease the property without OKO's written consent. The Center also does not have a substantial monetary interest in the property. Mr. Kowa, through OKO and Huston-Patterson, is the one whose monetary interest in the property is substantial. Although OKO has not presented documentation that it (or Huston-Patterson) has actually paid for the insurance and maintenance or that the rent was waived, the fact that the Center may not have paid rent, insurance, or maintenance does not support a finding that the arrangement is a financing agreement like the one in Cole Hospital or that the Center maintains control over the property.[5] If the Lease were a financing method, then the Center would be expected to make rent payments. The Center would also be expected to be responsible for maintaining and insuring the property and for paying the property taxes. Mr. Kowa, through OKO and Huston-Patterson, has generously agreed to pay for these expenses to ensure that the Center continues to operate. His good intentions, however, have nevertheless divested the Center of ownership for property tax purposes because if Mr. Kowa is responsible for the rent, insurance, maintenance, and property taxes, then he is responsible for the things that are generally associated with ownership.

In addition, the Center does not have the unconditional right to alienate the property at will. Under the original Lease, the Center does not have an unconditional right to purchase the property; the right to purchase is conditioned on the property maintaining its tax-exempt status. OKO may also terminate the Lease if the Center breaches any of its covenants (regardless of any waiver of a prior breach), and under the original Lease, if the property is destroyed by any cause whatsoever, this does not terminate the Lease or entitle the Center to surrender the premises.

The right to alienate the property was discussed in Henderson, *supra*. In that case, the parties entered into a sale-leaseback arrangement because the lessee, a charitable organization, was unable to obtain financing for construction of a building, and the parties to the lease agreement argued the property should be exempt. The original lease

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[5] The dates that Mr. Kowa, as president of Huston-Patterson, signed the "Pledges" to pay for the insurance and maintenance were not on the documents or discussed during the testimony.

in Henderson included the right of first refusal in the event the lessor chose to sell the property; the lessee was also responsible for the property taxes. The court found the property did not qualify for an exemption under the original lease and stated that the significant difference between the lease at issue and the one in Cole Hospital was the "right of first refusal" clause. Henderson, at 526-527. "[T]he right to choose when and if property may be transferred is the single most significant incident of real estate ownership." *Id*. at 527. The original lease gave the lessor the sole right to choose when, and if, to convey title; the court, therefore, found the property was not entitled to an exemption under the original lease. See also Coles-Cumberland, *supra* (insufficient incidents of ownership where lessee under long-term lease had no power to force the sale of the property).

The parties in Henderson subsequently, during the year in question, executed an "addendum" to the lease that gave the lessee an unconditional option to purchase the property on the 15^{th} and 20^{th} anniversaries of the lease; the addendum included an agreement as to how the purchase price was to be computed. The court found that upon the date that the amendment to the lease was adopted, the incidents of ownership changed for tax purposes, and the property, therefore, was entitled to an exemption as of the date of the amendment. OKO argues that the Henderson case is not applicable to the present case because the Community Center always had the right to purchase the property at any time during the lease for fair market value, and the lease did not need to be amended, as it was in Henderson, to grant this right. In addition, OKO claims that the Henderson court did not discuss the specific issue of whether the parties had attempted to make the amendment retroactive.

The original Lease does not give the Center the unconditional right to choose when the property may be transferred. The Center's right to purchase the property is allowed only if the property keeps its tax-exempt status. OKO's contention that the Center's tax-exempt activities determine the tax-exempt status of the property does not accurately state the requirements for the exemption. The property must be both owned by an institution of public charity and used primarily for charitable purposes. Chicago Patrolmen's Association, *supra*. As the court stated in Coles-Cumberland, *supra*, it would be inappropriate to allow any private property not entitled to an exemption to become tax exempt merely by leasing it to an exempt organization. Coles-Cumberland, at 357, citing Victory Christian Church v. Department of Revenue, 264 Ill. App. 3d 919, 923 (1st Dist. 1994). As already mentioned, property that is leased by an entity to an exempt organization may be exempt if the lessee has sufficient incidents of ownership to warrant the exemption. Cole Hospital, *supra*. Under the facts in the present case, however, the Lease that was executed in 2007 divested the Center of ownership; the Center does not maintain sufficient incidents of ownership to warrant the exemption.

OKO argues that even if the Center does not maintain sufficient indicia of ownership under the original Lease, the addendum to the Lease that was executed in 2008 relates back to the date that the original Lease was executed, and the property should be exempt under the new provisions. In Grubb & Ellis Company, *supra*, the contract between the parties indicated that it was to commence on April 15, but one of the parties did not sign it until April 28. The court found that the agreement commenced on April 15 and quoted from the following case:

> In the law of contracts, it is elementary that ordinarily a contract speaks from the day of its date, regardless of when it was executed and delivered.

> It is of common occurrence in connection with deeds, leases and other contracts that, while they are not in effect at all and have no legal existence until delivered, yet, in respect to the date of delivery, they, in point of commencement, relate back or commence in the future. Such relation back or forward contravenes no principle of law and is determined by the intent of the parties as deduced from the instrument itself. Monahan v. Fidelity Mutual Life Ins. Co., 148 Ill. App. 171, 174 (1st Dist.), aff'd 242 Ill. 488 (1909).

Grubb & Ellis Company, at 1054. In the Monahan case, the court found that an insurance policy that was dated September 30, 1903 but was not issued and delivered until October 30, 1903 related back to the date of the policy.

None of the cases cited by OKO address the issue of whether the effective date of a contract may be retroactive when the terms of the contract have been substantially changed, and none of the cases address the issue of whether an addendum to a lease may relate back for purposes of determining a property tax exemption. As OKO has indicated, the Henderson court did not address the specific issue of whether the addendum applied retroactively for exemption purposes. The court simply found that the property was exempt as of the date of the addendum.

Unlike the cases cited by OKO, the addendum that the Center and OKO executed in 2008 substantially changed the original terms of the Lease. Under paragraphs 4 and 10 of the original Lease, the Center pays no rent and has the right to purchase the property so long as the property maintains its tax-exempt status. Under the addendum, these paragraphs are changed to condition the rent and the right to purchase on the Center maintaining its tax-exempt activities. As previously mentioned, having the Center maintain its tax-exempt activities does not automatically entitle the property to an exemption. These paragraphs, therefore, have significantly changed.

Paragraphs 11 and 13 have also changed substantially under the addendum. Under the original paragraph 13, if the property is destroyed by any cause whatsoever, this does not terminate the Lease or entitle the Center to surrender the premises. Under the amended paragraph 13, the opposite is now true: the Center has the option to terminate the Lease and surrender the premises if the property is destroyed. Under the original paragraph 11, the Center has the right of first refusal if OKO receives a bona fide offer to purchase the property. Under the amended paragraph 11, for as long as the Center continues its not-for-profit activities on the property, OKO will not sell the property to a party who is unrelated to either OKO or the Center without the Center's consent. Again, this is a considerable change to the original terms of the agreement; the addendum does not simply clarify the agreement as OKO contends.

Because the addendum substantially modified the original Lease, the terms of the agreement between OKO and the Center during 2007 were significantly different than the terms that they began operating under during 2008. For purposes of determining whether the property should be exempt from taxes, the agreement as it existed during 2007 is the only agreement that must be considered. Because the Center did not retain sufficient indicia of ownership under the terms of the Lease as it existed during 2007, the property is not entitled to an exemption.

Recommendation:

For the foregoing reasons, it is recommended that the applicant's request for an exemption be denied.

Linda Olivero
Administrative Law Judge

Enter: August 14, 2009