

PT 11-09
Tax Type: Property Tax
Issue: Government Ownership/Use

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

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

STEPHENSON COUNTY

Applicant

Docket # 10-PT-0023

Tax Year 2009

RECOMMENDATION FOR DISPOSITION

Appearances: Robin Gill, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Christopher E. Sherer of Giffin, Winning, Cohen & Bodewes, P.C. for Stephenson County

Synopsis:

Stephenson County (“applicant”) filed an application for a property tax exemption for the year 2009 for a parcel of property located in Stephenson County. The applicant contends that the property qualifies for an exemption pursuant to section 15-60 of the Property Tax Code (35 ILCS 200/1-1 *et seq.*). On May 1, 2009, the applicant began leasing the property from a non-exempt organization, and the applicant contends that it maintains the indicia of ownership to warrant an exemption. The Stephenson County Board of Review recommended that the property be exempt beginning May 1, 2009. The Department of Revenue (“Department”) disagreed and determined that the exemption

should be denied because the property is not owned by a tax-exempt entity. The applicant timely protested the Department's decision. The parties filed Motions for Summary Judgment and a Stipulation of Facts. The parties also waived their right to an evidentiary hearing and requested that this matter be resolved based on the documents submitted. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The subject property is located in Freeport, Illinois and is improved with a multi-story office building of approximately 65,725 square feet of rentable area. (Joint Stip. #3)
2. Stewart Centre, LLC acquired the subject property by a Quit Claim Deed dated February 14, 2007 and recorded on February 27, 2007. (Joint Stip. #4)
3. On March 3, 2009, the applicant executed a written "triple net" lease agreement¹ with Stewart Centre, LLC as lessor for the entire 5th floor, part of the 10th floor, and part of the lower level of the subject property totaling 6,431 square feet (approximately 9.7847% of the total rentable area). The lease commenced on May 1, 2009 and is for a term of 10 years with two 5-year options for renewal. (Joint Stip. #5)
4. The leased portion of the subject property has been used since May 1, 2009 for the offices of the Stephenson County Clerk and Recorder, the Stephenson County Treasurer and Collector, the Stephenson County Supervisor of Assessments, the

¹ As part of the applicant's monthly rent payment, the applicant pays 1/12th of the lessor's operating expenses, taxes, insurance expenses, and utilities. (Lease, Section 4, pp. 4-5)

Stephenson County Graphic Information System Department, the County Board, and the Stephenson County Administrator. (Joint Stip. #6)

5. The applicant is a county whose operations are subject to and governed by the Illinois Counties Code, and the applicant possesses the powers to levy and collect taxes pursuant to Section 5/5-1024 of the Counties Code, 55 ILCS 5/5-1024, which are necessary to qualify it as the type of “taxing district” whose property is subject to exemption under Section 200/15-60 of the Property Tax Code, 35 ILCS 200/15-60. (Joint Stip. #7)
6. On March 3, 2010, the Stephenson County Board of Review recommended that the Department grant an exemption as to 9.7847% of the assessment (representing the County’s percentage of use and occupancy of the entire premises). (Joint Stip. #8)
7. According to the lease, the applicant may only use the property as business offices for the Stephenson County Clerk and Recorder, the Stephenson County Treasurer and Collector, the Stephenson County Supervisor of Assessments, the Stephenson County Graphic Information System Department, the County Board, and the Stephenson County Administrator. The applicant cannot use the property for any other purpose. (Lease, Section 6, pp. 6-7)
8. The lessor has the right to make repairs, alterations, additions or improvements to the premises. (Lease, Section 10, p. 9)
9. According to the lease, the applicant shall not make any replacement, alteration, improvement or addition to the premises without the prior written consent of the lessor. Each alteration, whether temporary or permanent (excepting only the

applicant's furniture, equipment and trade fixtures), shall become the lessor's property and shall remain on the premises at the expiration or termination of the lease without compensation to the applicant. (Lease, Section 12, p. 10)

10. The applicant may not assign or sublease the premises without the prior written consent of the lessor. (Lease, Section 17, p. 13)

CONCLUSIONS OF LAW:

It is well-established under Illinois law that taxation is the rule, and tax exemption is the exception. Eden Retirement Center, Inc. v. Department of Revenue, 213 Ill. 2d 273, 285 (2004). “[A]ll property is subject to taxation, unless exempt by statute, in conformity with the constitutional provisions relating thereto.” *Id.* Statutes granting tax exemptions must be strictly construed in favor of taxation. *Id.* at 288; Chicago Patrolmen's Association v. Department of Revenue, 171 Ill. 2d 263, 271 (1996); People ex rel. County Collector v. Hopedale Medical Foundation, 46 Ill. 2d 450, 462 (1970). All facts are to be construed and all debatable questions resolved in favor of taxation. Eden Retirement Center, Inc., at 289. Every presumption is against the intention of the State to exempt the property from taxation. Oasis, Midwest Center for Human Potential v. Rosewell, 55 Ill. App. 3d 851, 856 (1st Dist. 1977). Whenever doubt arises, it must be resolved in favor of requiring the tax to be paid. Quad Cities Open, Inc. v. City of Silvis, 208 Ill. 2d 498, 508 (2004).

The burden of proof is on the party who seeks to qualify its property for an exemption. Eden Retirement Center, Inc., *supra*; Chicago Patrolmen's Association, *supra*. The burden is a very heavy one. Provena Covenant Medical Center v. Department of Revenue, 236 Ill. 2d 368, 388 (2010); Oasis, Midwest Center for Human

Potential, *supra*. The party claiming the exemption bears the burden of proving by clear and convincing evidence that the property in question falls within both the constitutional authorization and the terms of the statute under which the exemption is claimed. Eden Retirement Center, Inc., *supra*; Board of Certified Safety Professionals of the Americas, Inc. v. Johnson, 112 Ill. 2d 542, 547 (1986) (citing Coyne Electrical School v. Paschen, 12 Ill. 2d 387, 390 (1957)).

Authority to grant property tax exemptions emanates from article IX, section 6 of the Illinois Constitution of 1970. Section 6 authorizes the General Assembly to exempt certain property from taxes 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 15-60 of the Property Tax Code, which allows exemptions for taxing district property and provides, in part, as follows:

All property belonging to any county or municipality used exclusively for the maintenance of the poor is exempt, as is all property owned by a taxing district that is being held for future expansion or development, except if leased by the taxing district to lessees for use for other than public purposes.

Also exempt are: ...

(b) All public buildings belonging to any county, township, or municipality, with the ground on which the buildings are erected;.... (35 ILCS 200/15-60(b)).

When determining whether property is owned by a county, legal title alone is not the decisive factor. City of Chicago v. Department of Revenue, 147 Ill. 2d 484, 504-505

(1992). Legal title is considered as one factor, but control of the property and the right to its benefits are more important. *Id.* The concern is with the realities of ownership rather than legal title. Chicago Patrolmen's Association v. Department of Revenue, 171 Ill. 2d 263, 273 (1996). "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).

The applicant argues that from a practical standpoint, it "owns" the portion of the property that it occupies, and granting the exemption will allow the applicant to obtain the tax savings that the General Assembly intended for it to receive. See Cole Hospital, Inc. v. Champaign County Board of Review, 133 Ill. App. 3d 96 (4th Dist. 1983). The applicant claims that it has been granted use and control of the premises for 10 years with two 5-year options. The applicant is responsible for all routine maintenance of the premises, and the applicant may make alterations with the lessor's written approval. The applicant believes it is entitled to an exemption for 9.7847% of the premises.

The Department argues that the property is not entitled to an exemption, and the Cole Hospital case is distinguishable from the present case because in Cole Hospital the sale-leaseback was purely a financing tool that had to be performed in order for the hospital to be constructed. The applicant in the instant case did not enter into the lease

due to financial considerations. The Department also argues that the lease has all the characteristics of a lease and none of the features of a sale. The applicant has limited control over the property, and its control does not amount to equitable ownership. The Department notes that Section 6 of the lease limits the uses of the building, and Section 10 gives the lessor the right to make repairs, alterations, additions or improvements to the premises. Under Section 12 of the lease, the applicant cannot make any replacement, alteration, improvement or addition to the premises without the prior written consent of the lessor. Lastly, Section 17 of the lease states that the applicant may not assign or sublease the premises without the prior written consent of the lessor. The Department believes these provisions indicate that the lessor, Stewart Centre, LLC, is the true owner of the property.

In Cole Hospital, *supra*, 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.² 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 “[t]here are few, if any, *per se* rules in the field of property taxation. Obviously not every lease *qua* lease will qualify for exemption. [citation omitted] When, under proper circumstances, a sale-

² The annual rent was 13.5% of the \$5,500,000 advancement. Cole Hospital, at 100.

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

In Henderson County Retirement Center, Inc. v. Department of Revenue, 237 Ill. App. 3d 522 (3rd Dist. 1992), the retirement center was unable to obtain financing to construct and operate a retirement home. The retirement center entered into a 15 year sale-leaseback arrangement with a non-exempt organization. The lease gave the retirement center the option of renewing the lease for two five year terms and the right of first refusal to purchase the premises in the event the owner should choose to sell to a third party. The property taxes were the responsibility of the lessee. The retirement center and the owner subsequently appended an “addendum” to the lease which amended the “right of first refusal” clause and granted the retirement center an unconditional option to purchase the property on either the fifteenth or twentieth anniversary of the lease in an amount equal to 125 times the average monthly rental for the six-month period prior to the anniversary date. The court found that, upon the adoption of the amendment, the retirement center had sufficient incidents of ownership. The court stated that “the right to choose when and if property may be transferred is the single most significant incident of real estate ownership.” *Id.* at 527. Prior to the amendment, the retirement center had only the option to accept or reject the owner’s terms of conveyance at such time as the owner chose to convey to a third party. After the amendment, the retirement center acquired not only an unconditional option to purchase the property, “but also an agreement as to how the purchase price was to be computed if Retirement Center chose to exercise its option.” *Id.*

In the present case, the applicant has not clearly and convincingly shown that it maintains the indicia of ownership to warrant an exemption. As the Department has indicated, the applicant did not enter into the lease because it could not obtain financing, and the lease is not a financing device. The lessor controls the use of the property, and the lessor has the right to change or improve the property. The applicant cannot improve the property without the lessor's consent. The applicant also cannot assign or sublease the property without the lessor's consent. In addition, the applicant does not have the right to alienate the property at will. Looking at the realities of ownership, Stewart Center, LLC is the owner of the property, not the applicant.

Recommendation:

For the foregoing reasons, it is recommended that the property is not entitled to a property tax exemption.

Linda Olivero
Administrative Law Judge

Enter: May 2, 2011