

PT 12-04
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.

**HIERONYMUS MUELLER FAMILY FOUNDATION ,
Applicant**

Docket # 11-PT-0008

Tax Year 2010

RECOMMENDATION FOR DISPOSITION

Appearances: Robin Gill, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Scott E. Garwood of Samuels, Miller, Schroeder, Jackson & Sly, LLP for Hieronymus Mueller Family Foundation

Synopsis:

The Hieronymus Mueller Family Foundation (“Foundation” or “applicant”) filed an application for a property tax exemption for the year 2010 for a parcel of property located in Macon County. The applicant contends the property is owned by a charitable organization and is used exclusively for charitable purposes pursuant to section 15-65 of the Property Tax Code (35 ILCS 200/1-1 *et seq.*). The Macon County Board of Review recommended that the property receive a full year exemption. The Department of Revenue (“Department”) disagreed with that decision and denied the exemption on the basis that the applicant is not the owner of the property; the applicant is the lessee of the property. The applicant timely protested the Department’s decision. An evidentiary hearing was held during which the parties presented stipulated facts in addition to testimony and documents. The applicant contends that it is a charitable organization that uses the property exclusively for charitable purposes, and under the lease, it maintains the indicia of ownership to warrant an exemption. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. “The Foundation is an Illinois not-for-profit corporation incorporated on June 10, 1994. It has no capital stock or shareholders.” (Stip. #1)
2. The applicant is exempt from retailers’ occupation tax, service occupation tax, and use taxes pursuant to a determination made by the Department on October 16, 2009. (Stip. #2; App. Ex. #4)
3. “The Foundation is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code.” (Stip. #3)
4. “The Foundation has a six member board of directors. Four of the directors are descendants of Hieronymus Mueller, one of the directors is a representative of Mueller Co. and one is a former employee of Mueller Co.” (Stip. #4)
5. “The subject property is commonly known as 420 West Eldorado Street, Decatur, Macon County, Illinois. It is identified by property index number 04-12-15-201-016. Real estate taxes for the subject property for the year 2010, payable in 2011 totaled \$28,401.02.” (Stip. #5)
6. “Mueller Co., an Illinois corporation, is the record title holder of the property.” (Stip. #6)
7. “A portion of the subject property is leased by Mueller Co. [“Lessor”] to the Foundation [“Lessee”] subject to a lease dated August 1, 2004.” (Stip. #7)
8. “The leased portion of the subject property is improved with a building containing approximately 6,000 square feet of usable space. The building was constructed by the Foundation. The building is used by the Foundation as a museum, called the Hieronymus Mueller Museum, to display the history, products and manufacturing process of the Mueller Co. and other Macon County companies and to educate the public concerning the history of the Hieronymus Mueller family and the factories and manufactured products in Macon County, Illinois.” (Stip. #8)

9. The leased portion of the subject property is approximately 36% of the parcel. Approximately 22% of the eastern portion of the parcel is a lawn area that is maintained by the applicant. The remaining 42% of the parcel is a parking lot that is used by both museum visitors and Mueller Company visitors. (App. Ex. #13, 14; Tr. pp. 26-30)
10. The term of the Lease Agreement is 99 years, commencing on August 1, 2004 and ending at midnight on July 31, 2103. (App. Ex. #3, p. 1, §2)
11. Under the Lease Agreement, the Lessor leases to the Lessee a portion of the real estate located at 420 West Eldorado Street and referred to as “Leased Premises.” The term “New Building” refers to the new building constructed by the Lessee on the Leased Premises. The term “Improvements” refers to all improvements, alterations, changes and additions to the New Building and Leased Premises. (App. Ex. #3, p. 1, §1)
12. The Basic Rent for the initial term is the sum of \$1.00. According to section 3 of the Lease Agreement, the following obligations of the Lessee shall be deemed to be Additional Rent payable by the Lessee: “all taxes, if any, insurance premiums, charges, expenses and all other costs of every kind and description that Lessee is required to pay hereunder; all interests and penalties that may accrue on the foregoing items because of Lessee’s failure to pay same; and all damages and expenses of every kind and description that Lessor may incur because of Lessee’s default or failure to comply with the terms of this Lease Agreement.” (App. Ex. #3, p. 1, §3)
13. According to section 5, “if and so long as Lessee keeps and performs each and every covenant, agreement, term, provision, and condition contained in this Lease Agreement... Lessee shall have quiet and peaceable possession and enjoyment of the Leased Premises during the term of this Lease Agreement.” (App. Ex. #3, p. 1, §5)
14. Section 7 of the Lease Agreement concerns the permitted use of the Leased Premises, which is the following:

- (a) To operate a museum to display the history, products and manufacturing processes of the Mueller Co. and its affiliates and, at Lessee's option, the history, products and manufacturing processes of other Macon County, Illinois companies; and
- (b) To educate in the history of the Hieronymus Mueller Family and of Macon County, Illinois and of its factories and manufactured products. (App. Ex. #3, p. 2, §7)

15. Section 8 concerns the prohibited uses of the Leased Premises and states that the Lessee shall not use the Leased Premises for any purpose other than the purpose for which the Leased Premises are leased under the agreement. The Lessee shall also not use the Leased Premises for acts that will cause a cancellation of any insurance policy covering the New Building and Improvements. The Lessee shall not sell or keep any article on the Leased Premises that may be prohibited by the Lessee's insurance. The Lessee shall comply with all requirements of any insurance company that are necessary for the maintenance of insurance covering the Leased Premises, the New Building and Improvements. (App. Ex. #3, p. 2, §8)

16. Section 9 concerns the construction of the New Building and Improvements. Under section 9(a), the Lessee is required to prepare plans and specifications on or before August 1, 2004 for the New Building to be erected on the Leased Premises. Section 9(a) states that "Lessee shall submit to Lessor for Lessor's approval, the Lessee's architect, general contractor and all subcontractors, which approval shall not be unreasonably withheld or delayed. The plans and specifications shall be submitted to Lessor for Lessor's written approval or for any revisions required by Lessor. Lessor shall not unreasonably withhold or delay approval..." (App. Ex. #3, p. 2, §9(a))

17. Section 9(b) of the Lease Agreement concerns construction financing and states that the Lessor shall make a loan to the Lessee in an amount not to exceed \$500,000 for the construction financing of the New Building and Improvements. The loan amount will be collateralized by the New Building and Improvements. Repayment from the Lessee is structured using a

promissory note extending over a period of the lesser of (i) 36 months from the date the loan is made or (ii) 30 days after the Lessee obtains reasonably satisfactory replacement financing. Section 9(c) concerns arbitration if the Lessor and Lessee do not agree on the plans or financing documents. (App. Ex. #3, p. 3, §9(b), (c))

18. Section 9(d) states that the Lessee shall commence the construction of the New Building on or before September 1, 2004. “Lessee shall submit all change orders in excess of \$25,000.00 in the aggregate to Lessor in advance for Lessor’s approval which will not be unreasonably withheld. ... Lessee agrees to have the New Building ready for occupancy by May 18, 2005.” (App. Ex. #3, pp. 3-4, §9(d))

19. Section 9(e) concerns “[p]ermitted improvements, alterations, changes and additions.” The Lessee has the right to make improvements to the New Building and the Leased Premises “provided that Lessee demonstrates to Lessor’s reasonable satisfaction that Lessee has sufficient funds available to pay the cost of such Improvements and further provided that prior to making... improvements... Lessee is not in default hereunder.” In addition, “Lessee shall obtain Lessor’s written approval of plans and specifications therefor, provided that the general character, use and value of any building shall not be diminished and the structural integrity of any building shall not be adversely affected by any Improvements...” For Improvements with a cost in excess of \$25,000.00, “Lessee’s architect, general contractor and all subcontractors, are subject to Lessor’s approval, which approval shall not be unreasonably withheld.” (App. Ex. #3, p. 4, §9(e))

20. Under Section 9(f), the Lessor may employ a construction consultant (“Lessor’s Construction Agent”) to perform construction administration services for the Lessor during any construction on the Leased Premises. “Lessee, its architect, contractor, subcontractors and agents will cooperate with the Lessor’s Construction Agent to assure that quality materials are used and adequate workmanship occurs during construction. ... Should the Lessor’s Construction Agent

determine that quality materials are not being used or workmanship is inadequate, Lessor on seven (7) days' advance written notice to Lessee may cause construction to be delayed until quality or workmanship is restored to Lessor's satisfaction." (App. Ex. #3, pp. 4-5, §9(f))

21. Under section 9(k), the cost of all construction shall be paid by the Lessee. Under section 9(l), the New Building and all Improvements made shall be the property of the Lessee, subject to the terms and conditions of the Lease Agreement. The Lessee shall have no right to remove the New Building or Improvements from the Leased Premises. Section 9(m) states that while title to the Leased Premises is vested in the Lessor, the "Lessee shall have equitable ownership and the right of occupancy of the New Building and all Improvements subject to the terms and conditions of this Lease Agreement." (App. Ex. #3, p. 6, §9(k), (l), (m))
22. Section 11 requires the Lessee to pay all taxes that may be assessed against the Leased Premises, the New Building and all Improvements. (App. Ex. #3, p. 6, §11)
23. Section 15 requires the Lessee to pay for all utilities furnished to the Leased Premises throughout the term of the agreement. (App. Ex. #3, p. 8, §15)
24. Under section 16(a), the Lessee shall keep the New Building and all Improvements in good and clean order and condition and shall promptly make all necessary or appropriate repairs, replacements, and renewals of same. (App. Ex. #3, p. 9, §16(a))
25. Under section 16(b), the Lessor shall provide adequate snow removal and shall maintain the walks and driveways, flowers, shrubs and landscaping. (App. Ex. #3, p. 9, §16(b))
26. Under section 16(c), in the event that the Lessee fails to perform its obligations under section 16(a), the Lessor, after giving the Lessee 10 days written notice (except for emergencies) shall have the right to perform the Lessee's obligations under section 16(a) and to charge the cost to the Lessee as Additional Rent. (App. Ex. #3, p. 9, §16(c))
27. Section 17 requires the Lessee to keep the Leased Premises free of liens. (App. Ex. #3, p. 9, §17)

28. Under section 18(a), the Lessee must maintain insurance with insurers approved by the Lessor. The policies must be written in a form satisfactory to the Lessor. (App. Ex. #3, p. 10, §18(a))
29. Under section 18(c), in the event that either the Lessor or the Lessee shall “deem the limits of the personal injury or property damage public liability insurance then carried to be either excessive or insufficient, the parties shall endeavor to agree on the proper and reasonable limits for insurance then to be carried.... if the parties shall be unable to agree on the limits, the proper and reasonable limits for insurance then to be carried shall be determined by an impartial third person selected by the parties.” (App. Ex. #3, p. 11, §18(c))
30. All insurance required to be maintained pursuant to section 18 shall, except for comprehensive general liability insurance, name the Lessor and the Lessee as insureds. The insurance shall provide that no cancellation of the insurance shall be effective until at least 30 days after receipt by both the Lessor and the Lessee of written notice of cancellation. (App. Ex. #3, p. 12, §18(d))
31. “Lessee shall promptly on request deliver to Lessor certified copies of all insurance policies with respect to the Leased Premises.” (App. Ex. #3, p. 12, §18(f))
32. In the event the Lessee fails to either obtain the insurance required under section 18 or pay the premiums, “Lessor shall be entitled, but shall have no obligation, to effect such insurance and pay the premiums for the insurance, which premiums shall be repayable within thirty (30) days by Lessee to Lessor as Additional Rent.” (App. Ex. #3, p. 12, §18(g))
33. Section 23 of the Lease Agreement provides, in part, as follows:
- Except as provided in this Section 23, Lessee shall not sell, assign or transfer this Lease Agreement, or any interest in this Lease Agreement, or sublet the Leased Premises or any part thereof, without the prior, express, and written consent of Lessor which, considering that the Basic Rent is only the nominal amount of One Dollar, can be refused for any reason at the sole discretion of Lessor, and a consent to a sale or assignment shall not be deemed to be a consent to any subsequent sale or assignment. Any sale or assignment without consent shall be void, and shall, at the option of Lessor, terminate this Lease Agreement....” (App. Ex. #3, p. 18, §23)

34. Under section 25, if the Lessee is in default under the terms of the Lease, the Lessor shall have the option to either (1) terminate the Lease on a date selected by the Lessor that is not later than one year from the default, or (2) immediately re-enter and take possession or re-let the building. The personal property may be removed from the building at the cost of the Lessee. If the Lessor elects to immediately terminate the Lease and re-enter or re-let, then the Lessor shall purchase the New Building and Improvements, and the Lessee shall be liable to the Lessor for the expenses of re-letting incurred by the Lessor. If the Lessor does not immediately re-enter or re-let, then the Lessee shall immediately list the New Building and Improvements for sale or lease with a commercial real estate broker that is satisfactory to the Lessor until the termination date selected by the Lessor. If the building cannot be sold or leased to a purchaser or lessee that is satisfactory to the Lessor, then the Lessor must purchase the building. (App. Ex. #3, pp. 19-20, §25)
35. According to section 25(c), upon termination of the Lease Agreement for any reason, including either the Lessee's or Lessor's default, the Lessor shall purchase the New Building and Improvements. The purchase price shall be the lesser of (1) the aggregate total of Lessee's costs incurred in constructing the building or (2) fair market value. (App. Ex. #3, p. 20, §25(c))
36. Under section 27, if the Lessee is in default under the terms of the Lease and its failure to do or perform any act under the Lease continues for 30 days after written notice from the Lessor, then the Lessor may elect to do or perform such act or thing. The Lessor's action shall not be deemed to be an eviction of the Lessee and shall not release the Lessee from any obligation under the Lease. (App. Ex. #3, p. 20, §27(a))
37. According to section 29, at any time during the term of the Lease, the Lessee shall have the right to terminate the Lease Agreement upon giving the Lessor at least one year prior written notice of termination. Upon giving the notice, the Lessee shall immediately list the building for

sale or lease with a commercial real estate broker that is satisfactory to the Lessor. If the Lessee cannot sell or lease the property to a purchaser or lessee that is satisfactory to the Lessor, then the Lessor shall purchase the building. (App. Ex. #3, p. 21, §29)

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). 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).

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). 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. *Id.*; 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.

The constitution does not require the legislature to exempt property from taxation; an exemption exists only when the legislature chooses to create one by enacting a law. Eden Retirement Center, Inc., at 290.

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 relevant 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 may be exempt under this subsection 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 used with a view to profit. *Id.*; Chicago Patrolmen's Association, *supra*. Whether property is actually and exclusively used for charitable purposes depends on the primary use of the property. Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 149, 156-57 (1968). If the primary use of the property is charitable, then the property is "exclusively used" for charitable purposes. Cook County Masonic Temple Association v. Department of Revenue, 104 Ill. App. 3d 658, 661 (1st Dist. 1982). Incidental acts of charity by an organization are not enough to establish that the use of the property is charitable. Morton Temple Association, Inc. v. Department of Revenue, 158 Ill. App. 3d 794, 796 (3rd Dist. 1987).

The applicant argues that it is a charitable organization and that it is the owner of the property for purposes of the exemption. In determining ownership for property tax purposes, the concern is with the realities of ownership. Chicago Patrolmen's Association, at 273. The key issue in determining the owner is whether the applicant has sufficient incidents of ownership. The primary incidents of ownership include the right to possession, the use and enjoyment of the property, the right

to change or improve the property, and the right to alienate the property at will. *Id.*; Wheaton College v. Department of Revenue, 155 Ill. App. 3d 945, 946 (2nd Dist. 1987).

The applicant believes that it has sufficient incidents of ownership under the lease. Sections 3 and 11 require the applicant to pay all real estate taxes and maintenance costs on the premises. Section 5 gives the applicant the right to peaceful and quiet possession of the building. Section 9 gives the applicant the right to make improvements, alterations, changes and additions to the building. Section 9 also shows that the building is clearly the property of the applicant, and the applicant has equitable ownership of the building and the right to occupy it. The applicant, therefore, claims that it has the right to possession, use and enjoyment of the property and the right to change and improve the property.

In addition, the applicant contends that under sections 25 and 29 of the Lease Agreement, the applicant has the right to alienate the property. The applicant states that even if it is in default under the lease, it has a mechanism by which it is guaranteed to receive compensation for the building at the end of the lease. The applicant believes that sections 25 and 29 give the applicant the right to alienate the property at will because the applicant may terminate the lease at any time and force the Lessor or a third party to purchase the building from it. The applicant will receive compensation for the building upon termination of the lease for any reason. The applicant notes that Illinois courts have found charitable lessees with sufficient incidents of ownership where the leases contained an option to purchase the property on specific dates. See Henderson County Retirement Center, Inc. v. Department of Revenue, 237 Ill. App. 3d 522, 527 (3rd Dist. 1992) (option to purchase on the 15th and 20th anniversaries of the lease); Cole Hospital, Inc. v. Champaign County Board of Review, 113 Ill. App. 3d 96, 100 (4th Dist. 1983) (option to purchase on the 11th and 16th anniversary dates).

The applicant also argues that the portion of the parcel that is not leased by the applicant should be exempt. The portion of the parcel that is east of the building is green space maintained by the applicant, and the portion of the parcel to the west of the building is a parking lot that is used by both

the museum visitors and the Mueller Company. The applicant claims that these are incidental uses of the property and do not defeat the exemption. See Faith Builders Church v. Department of Revenue, 378 Ill. App. 3d 1037, 1043 (4th Dist. 2008) (incidental or secondary purpose will not defeat an exemption).

Alternatively, if it is determined that the non-museum uses of the property are not incidental, the applicant claims that the building and the land underlying it should be exempt. The applicant believes that it has established that it is the owner of the building and approximately 36% of the land. In Chicago Patrolmen's Association, *supra*, the court recognized that partial exemptions based on ownership and use are allowed. Thus, the specific portion of the property that is owned by the applicant should be exempt from taxes. In addition, in City of Chicago, *supra*, the Supreme Court found that buildings may be exempt separate from the underlying land where buildings are owned by a charity but the underlying land is not.

In response, the Department argues that the lease between the applicant and the Mueller Company does not give the applicant the realities of ownership. The Department notes that in City of Athens v. Department of Revenue, 10-PT-0042 (May 15, 2002), the applicant had a 99-year lease with a non-exempt owner for the use of a water tower for city purposes. The ALJ found that the lease in question “has all the characteristics of a lease and none of the features of a sale.” The ALJ further stated that the applicant could not do what it wishes with the property, had to get permission for the assignment or subletting of the property, and there was no evidence that the lease was created because the City of Athens could not adequately finance the water tower on its own. The exemption was, therefore, denied.

Similarly, the Department contends that there are several elements of the lease in the present case that demonstrate that the applicant has limited control over the property, and its control does not amount to equitable ownership. The Department asserts that section 7 narrowly limits the uses of the building for the operation of a museum. Section 8 provides the prohibited uses of the building and

leased areas, and section 9 addresses the Lessor's required consent for the construction of the building and improvements. In summary, the Department believes that all of these particular sections of the lease demonstrate that the lease is a typical garden variety lease that has none of the characteristics of a sale or genuine transfer of ownership, either legal or equitable.

As the Department has indicated, the lease in the present case does not provide the applicant with sufficient incidents of ownership to warrant a finding that the applicant is the owner of the property. Rather than providing the applicant with control of the property, the lease gives the Mueller Company substantial control of the property. Under section 5, the Lessee has possession and enjoyment of the property, but only if it performs "every covenant, agreement, term, provision, and condition" of the Lease Agreement. Under sections 9(l) and 9(m), the Lessee only owns the New Building and Improvements subject to the terms and conditions of the Lease Agreement. The Lessee does not have the right to remove the New Building and Improvements from the Leased Premises.

A review of the terms and conditions of the agreement shows that the Lessor maintains significant control over the property and is the owner for tax exemption purposes. The Lessor must approve the plans for the New Building and approve the Lessee's architect, general contractor, and all subcontractors. All change orders in excess of \$25,000 must be approved by the Lessor. Also, all improvements must be approved by the Lessor. The Lessor's construction consultant oversees the construction process to assure that quality materials are used and adequate workmanship occurs. The Lessor may delay the construction until the quality or workmanship is restored to the Lessor's satisfaction.

If the Lessee fails to maintain the New Building and Improvements, then the Lessor has the right to perform the Lessee's obligations and charge the cost to the Lessee as Additional Rent. Under sections 7 and 8, the permitted use is only to operate a museum. The Lessor must also approve the Lessee's insurance carriers and the policies. Both the Lessor and the Lessee must agree on the limits for the insurance. The insurance must name both the Lessor and the Lessee as the insureds. If the

Lessee fails to obtain the required insurance or pay the premiums, then the Lessor may obtain the insurance and pay the premiums, and the premiums would be repayable by the Lessee to the Lessor as Additional Rent.

Importantly, under section 23 the Lessee cannot sell, assign or transfer the Lease Agreement or sublet the Leased Premises without the consent of the Lessor, and the Lessor may refuse to allow its consent **for any reason**. In addition, under section 25, if the Lessee is in default under the terms of the Lease, then the Lessor has the option of immediately re-entering the building and taking possession of it or re-letting it. If the Lessor chooses that option, then the Lessor will purchase the building, and the Lessee will then bear the cost of removing the personal property and would be liable for the expenses of re-letting incurred by the Lessor. If the Lessee is in default and the Lessor chooses to terminate the Lease at a later date, then the Lessee must list the building for sale or lease with a broker who is approved by the Lessor, and the purchaser or lessee must be satisfactory to the Lessor. If not, then the Lessor must purchase the building. Similar requirements must be met if the Lessee terminates the Lease under section 29.

All of these provisions indicate that the Lessor retains significant control over the property, and these facts distinguish this case from those cited by the applicant. In Henderson County Retirement Center, *supra*, 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 15th or 20th 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 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. 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-and-lease-back is used as a financing device, alternatively to conventional financing, it may qualify.” *Id.* at 101.

In the present case, unlike both Henderson County Retirement Center and Cole Hospital, nothing indicates that the applicant was unable to obtain conventional financing. Although the lease requires the Lessor to provide the applicant with a loan, the repayment was supposed to be structured using a promissory note extending over a period of the lesser of (i) 36 months from the date the loan was made or (ii) 30 days after the Lessee obtained reasonably satisfactory replacement financing. The

record does not reveal whether the applicant repaid the loan within 36 months or obtained replacement financing. Either way, nothing indicates that the lease was the applicant's only financing option.

In addition, the applicant's right to alienate the property is significantly different than the rights of the applicants in Henderson County Retirement Center and Cole Hospital. The applicants in both of those cases had unconditional rights to purchase the property. The retirement center had an unconditional right to purchase the property on either the 15th or 20th anniversary of the lease, and the hospital had the absolute right to purchase the property on the 11th and 16th anniversary dates. In the present case, the applicant does not have any right to purchase the property. In the event that the applicant either defaults under the lease or decides to terminate the lease, then either the Mueller Company will purchase the property or it will be sold or leased to a buyer or lessee who meets the Mueller Company's satisfaction. Under the lease, the applicant has no option to own the property. In the cases cited by the applicant, the right to alienate the property was considered an incident of ownership because it allowed the lessee to actually own the property. In the present case, the applicant will never own the property; either the Mueller Company or a third party will acquire ownership of the property.

The case of Coles-Cumberland Professional Development Corporation v. Department of Revenue, 284 Ill. App. 3d 351 (4th Dist. 1996) is more instructive. In that case, a for-profit corporation leased property to a charitable organization. A 99-year lease was entered into rather than a sale because a city ordinance would have otherwise prevented construction of the building on the property. The lease required a payment of \$45,000 in rent, and the lessee paid a monthly maintenance fee of \$375. The lessee also was required to maintain the premises, purchase insurance, and pay all property taxes, which was considered part of the rent. The lease granted the lessee the unrestricted right to build and own improvements on the land. Upon termination of the lease, the lessee was permitted to remove any improvements it had built. The lessee could not assign its leasehold without the lessor's consent, and the lessor could sell, subject to the lease, the fee simple title at any time. The lessee had the right

of first refusal to purchase the property if the lessor decided to sell. The agreed price was \$45,000, less rents paid, plus \$1. If the lessee defaulted in performing any of its duties under the lease, the lessor could terminate the lease. The court found that ownership of the property remained with the lessor. The court noted that the lessee had no power to force the sale of the property; the lessor was not obligated to sell the property and could retain it indefinitely with the lessee paying the real estate taxes. The court also noted that the leasehold could not be assigned without approval from the lessor, and the lease was undertaken primarily for the benefit of the lessor.

The applicant claims that the present case is distinguishable from Coles-Cumberland Professional Development Corp. because, *inter alia*, the lessee in that case paid rent on the property and could not force the sale of the property without the lessor's approval. *Id.* at 356-357. The applicant claims that in contrast, the applicant in the present case has the right to alienate the property and force the sale of the building, either to a third party or the Lessor, even if the applicant is in default under the lease. Also, the applicant pays only \$1 in rent for the entire 99-year term.¹

Although the applicant in the present case can force the sale of the property to either a third party or the Lessor, the applicant, like the lessee in Coles-Cumberland Professional Development Corp., is never guaranteed ownership of the property. In addition, like the lessee in Coles-Cumberland Professional Development Corp., the applicant cannot assign, sell, or transfer the Lease Agreement or sublet the Leased Premises without the consent of the Lessor, and the Lessor may refuse to allow its consent for any reason. Furthermore, although the Base Rent in the present case is \$1, certain obligations of the Lessee are deemed to be Additional Rent, which means the rent may vary from year to year. Under the lease, Mueller Company maintains considerable control over the property, with relatively few benefits to the applicant. The lease primarily benefits the Mueller Company, and the Mueller Company must be considered to be the owner of the property.

¹ See Finding of Fact #12.

The applicant's claim that the building may be exempt separately from the underlying land according to City of Chicago, *supra*, is also without merit. In that case, the court found that the buildings were entitled to an exemption separately from the land pursuant to the section of the Property Tax Code that is currently found at 35 ILCS 200/15-60(b).² That section, as the applicant acknowledges, is different than the one at issue in the present case. The court in City of Chicago recognized the difference between these two sections, noting that the exemption in section 15-65 does not have a distinction between buildings and land like the exemption in section 15-60(b). *Id.* at 498. Furthermore, as stated earlier, the applicant's ownership of the building is subject to the terms and conditions of the lease. For the reasons already given, according to the terms and conditions of the lease, the Lessor has the incidents of ownership, not the applicant. The Lessor, therefore, is the owner of both the building and the land for property tax exemption purposes, and the building is not entitled to a separate exemption.

Finally, because the exemption must be denied on the basis that the Lessor is the owner of both the building and the land, the issue of whether the applicant is a charitable organization that uses the property for charitable purposes does not need to be addressed.

Recommendation:

For the foregoing reasons, it is recommended that the property is not entitled to an exemption for the year 2010.

Enter: April 26, 2012

Linda Olivero
Administrative Law Judge

² The exemption in section 15-60 concerns taxing district property and states, in relevant part, as follows: "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).