

**PT 11-08**  
**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.

**OKO, LLC**

**Applicant**

**Docket # 10-PT-0018**

**Tax Year 2009**

---

---

**RECOMMENDATION FOR DISPOSITION**

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Shane M. Mendenhall 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 2009 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.*). In 2007, the previous owner of the property (a charitable organization) 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 determined that the property is neither owned by a charitable organization 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. The applicant filed a Motion for Summary Judgment, and the parties filed two Statements of Stipulated Facts, which included a stipulation that the property is used for charitable purposes. 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. Old Kings Orchard Community Center, Inc. (“Community Center”) is a tax exempt not-for-profit Illinois corporation engaged in tax exempt community outreach activities for the benefit of the local youth in Decatur, Illinois. (Joint Stip. #1)
2. In June of 2001, the Community Center built the real property and improvements where it engages in its tax exempt activities, and said property was accordingly exempt from real estate taxes. (Joint Stip. #2)
3. The Community Center was operating at a loss, had a mortgage that was about to be foreclosed, and was unable to get additional funding from the State of Illinois or other sources to continue its exempt activities. (Joint Stip. #3)

4. In order to avoid foreclosure, the Community Center sold its real property and improvements to OKO, LLC (which is owned by Decatur businessman Thomas W. Kowa) in March 2007. (Joint Stip. #4)
5. In exchange for the property, Mr. Kowa agreed to pay off the Community Center's existing mortgage. (Joint Stip. #5)
6. As part of the transfer, Mr. Kowa, through OKO, LLC, and his other company Huston-Patterson Corporation, entered into a fifteen year lease-back and pledge arrangement to the Community Center. (Joint Stip. #6)
7. The reason Mr. Kowa decided to take responsibility for the property and its upkeep rather than make a donation to the Community Center was because he believed that would enhance the chances of the center actually staying open since the Community Center had a history of encumbering its property with liens it could not repay. (Joint Stip. #7)
8. Mr. Kowa was supporting the Community Center in order to help the community and the children served by the center and not for any kind of profit, and Mr. Kowa has not realized any profit. (Joint Stip. #8)
9. The Lease between OKO, LLC and the Community Center dated March 30, 2007 and the Pledge from Huston-Patterson provided that the Community Center would not have to pay any rent, insurance or maintenance so long as the property remained tax exempt (i.e., maintained its tax exempt activities, since the exemption flowed from the activities). (Joint Stip. #9)

10. In addition, the Lease between OKO, LLC and the Community Center dated March 30, 2007 provided the Community Center with a traditional option to purchase and right of first refusal. (Joint Stip. #10)
11. After the transfer of legal title of the real property from the Community Center to OKO, LLC, the property tax exemption was revoked. (Joint Stip. #11)
12. On March 25, 2008, OKO, LLC, the Community Center and Huston-Patterson modified the original Lease and Pledge retroactive to its inception (March 30, 2007) to provide that the Community Center will never have to pay rent, insurance or maintenance so long as it continues its current tax exempt activities on the property, regardless of whether that actually translates into a tax exemption. (Joint Stip. #12)
13. On September 29, 2008, OKO, LLC and the Community Center executed a second addendum to the original Lease which provided that the Community Center has the exclusive right to purchase the property. Although executed September 29, 2008, this second addendum was retroactive to the date the original Lease was executed (March 30, 2007). (Joint Stip. #13)
14. The Illinois Department of Revenue has denied OKO, LLC a property tax exemption by finding that (a) the property is not in exempt ownership and (b) the property is not in exempt use. (Joint Stip. #14)
15. The parties agree that the property is used for charitable purposes. (2<sup>nd</sup> Joint Stip. #2)
16. Under paragraph 3 of the Lease, rent is due from the Community Center in the amount of \$1,000 each month. (Joint Ex. B, p. 1)

17. The second addendum that was executed on September 29, 2008 states that Paragraphs 4, 10, 11, and 13 of the Lease are 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.

**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.**<sup>1</sup> 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

---

<sup>1</sup> This paragraph replaces the section of the original Lease that was titled "Right of First Refusal" (Joint Ex. B, p. 3)

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.

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. (Joint Ex. E)

18. 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. (Joint Ex. E)

19. 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 Old Kings Orchard Community Center, an Illinois not-for-profit corporation, that Huston-Patterson Corporation will pay for directly, or reimburse to Old Kings Orchard Community Center, any costs incurred or associated with maintaining insurance on the real and personal property associated with Old Kings Orchard 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 Old Kings Orchard Community Center, any costs incurred or associated with major maintenance of the real property leased by Old Kings Orchard Community Center at 815 N. Church St., Decatur, Illinois. This pledge shall be effective *so long as the real property leased by Old Kings Orchard Community Center remains exempt from real estate taxation.* (emphasis added; Joint Ex. C, p. 1)

20. 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 Old Kings Orchard Community Center, an Illinois not-for-profit corporation, that Huston-Patterson Corporation will pay for directly, or reimburse to Old Kings Orchard Community Center, any costs incurred or associated with maintaining insurance on the real and personal property associated with Old Kings Orchard 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 Old Kings Orchard Community Center, any costs incurred or associated with major maintenance of the real property leased by Old Kings Orchard 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 Old Kings Orchard Community Center and OKO, LLC for the property at 815 N. Church St., Decatur, Illinois.* (emphasis added; Joint Ex. C, p. 2)

21. The Lease states that the Lessee, the Community Center, is responsible for paying all utilities, maintenance, and insurance, and the Lessor, OKO, is responsible for paying the property taxes. (Joint Ex. B, pp. 1-2)

22. The Lease states that the Lessee, the Community Center, covenants “[n]ot to assign this Lease or to sublet the whole or any part of the Premises to any for profit entity without the written consent of the Lessor.” The Lessee also covenants “[n]ot to make or allow any unlawful, improper, or offensive use of the premises, nor any use of the premises other than the not-for-profit activities referenced in Paragraph 1.” (Joint Ex. B, p. 2)

23. During 2009, Huston-Patterson Corporation paid all the insurance and maintenance costs on the property. OKO, LLC paid all the utility costs on the

property, and the Community Center did not make any rent payments for the property. (Affidavit of Kathy Carter)

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 (1<sup>st</sup> 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 15-65 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.... (35 ILCS 200/15-65(a)).

Property may, therefore, be exempt under this section 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 v. Department of Revenue, 171 Ill. 2d 263, 270 (1996); Methodist Old People's Home v. Korzen, 39 Ill. 2d 149, 156-157 (1968).

When determining whether property is owned by a charitable institution, 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 (2<sup>nd</sup> 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).

OKO argues that pursuant to the Lease that was in effect during 2009, the Community Center still "owns" the property for tax purposes. OKO believes that the sale-leaseback arrangement between OKO and the Community Center did not divest the Community Center of its indicia of ownership, and the property still qualifies for an exemption. 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 (4<sup>th</sup> Dist. 1983) and Coles-Cumberland Professional Development Corporation v. Department of Revenue, 284 Ill. App. 3d 351 (4<sup>th</sup> Dist. 1996) in order to construct the sale-leaseback arrangement to maintain the Community Center's ownership. OKO states that the Lease provides that the Community Center will never have to pay rent or property taxes as long as the Community Center maintains its tax exempt activities on the property; there is no security deposit, and the Community Center has the exclusive right to purchase the property at any time during the Lease for fair market value. Also, Mr.

Kowa has pledged to pay for all maintenance and insurance associated with the property, and the Community Center has never had to pay rent, property taxes, insurance, or maintenance expenses.

OKO contends that paying rent is not an indicia of ownership, and if Mr. Kowa required the Community Center to pay for rent, maintenance and insurance, then he would be making a profit and run afoul of the proscriptions set out in Coles-Cumberland, *supra*. OKO states that Mr. Kowa has not realized any profit, and under the Lease, the Community Center is responsible for maintenance and insurance.

OKO claims that the Community Center has the exclusive right to purchase the property at any time, and there is no requirement in case law that the right to alienate the property be unconditional. See Henderson County Retirement Center, Inc. v. Department of Revenue, 237 Ill. App. 3d 522 (3<sup>rd</sup> Dist. 1992). OKO states that the Community Center made extensive efforts to obtain alternative funding before resorting to the lease-back arrangement, and the reason for the conveyance was to prevent foreclosure proceedings. OKO believes that the Community Center's exclusive right to purchase the property at any time and its extensive efforts to obtain alternative funding are indicia of ownership. The intent is charitable, and the property should be exempt.

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.<sup>2</sup> There was no provision for a security deposit, and the hospital had the absolute right to

---

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

purchase the property at ten times the annual rent on the 11<sup>th</sup> and 16<sup>th</sup> 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 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 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 Coles-Cumberland, *supra*, 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 one-time 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 in good repair, purchase casualty and liability insurance, and pay all property taxes. The lease granted the lessee the unrestricted right to build and own improvements on the land. 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. If the lessee defaulted in its monthly maintenance payments, the lessor could terminate the lease. The court found that ownership of the property remained with the lessor. The court noted that the lessee has no power to force the sale of the property; the lessor is 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 cannot be assigned without approval from the lessor, and the lease was undertaken primarily for the benefit of the lessor.

In the present case, the evidence fails to show clearly and convincingly that the Community Center is the “owner” of the property. Although the sale-leaseback arrangement was entered into due to financial reasons, the arrangement was not a “financing device” that allows the Community Center to retain ownership. Unlike the

facts in Henderson and Cole Hospital, OKO has the contractual responsibility to pay the real estate taxes, and the rent may be waived if the Community Center continues its not-for-profit activities. Mr. Kowa, through Huston-Patterson, has pledged to pay for the maintenance and insurance throughout the duration of the Lease. The Community Center does not have a substantial monetary interest in the property that would indicate that the Lease is a financing device.

Looking at the realities of ownership, OKO is the owner of the property. OKO controls the use of the property by conditioning several provisions of the Lease on the Community Center continuing its not-for-profit activities on the property. The Community Center cannot assign or sublease the property without OKO's written consent, and the Community Center cannot use the property for anything other than its not-for-profit activities. Under the Lease, Mr. Kowa, through OKO and Huston-Patterson, controls the property in order to ensure that the Community Center continues its activities on the property. Mr. Kowa decided to take responsibility for the property and its upkeep rather than make a donation to the Community Center because he believed that would enhance the chances of the center actually staying open. His control has unfortunately divested the Community Center of its ownership for purposes of the property tax exemption.

Recommendation:

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

Linda Olivero  
Administrative Law Judge

Enter: April 25, 2011