

PT 07-6

Tax Type: Property Tax

Issue: Charitable Ownership/Use

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

DC REAL ESTATE, LLC.
Applicant

v.

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

No. 05-PT-0066
(05-45-2)

PIN 06-32-200-007

John E. White
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Allison Mulder, Warner Norcross & Judd, LLP, appeared for DC Real Estate, LLC; John Alshuler, Special Assistant Attorney General, appeared for the Illinois Department of Revenue

Synopsis:

This matter arose after DC Real Estate, LLC (DC) protested the Illinois Department of Revenue's (Department) denial of its application for a non-homestead property tax exemption for property DC owned during calendar year 2005, and which is situated in Kane County, Illinois. The issue is whether the property is exempt pursuant to § 15-35 of Illinois' Property Tax Code (PTC).

The parties agreed to submit a stipulated record in lieu of hearing, which record included a stipulation of facts and exhibits. I have reviewed that record, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the Department's denial be upheld.

Findings of Fact:

1. The property that is the subject of the dispute is situated in Elgin, Kane County, Illinois. Stip. ¶ 1.
2. Deborah Cho (Cho) purchased the property on December 30, 1999. Stip. ¶ 2.
3. DC is an Illinois Limited Liability Company (Brief in Support of Applicant's Request for Property Tax Exemption (DC's Brief), Attachment¹ (hereinafter, Attachment), p. 47 (copy of Cho's Affidavit Concerning Profit, dated 2/17/05), and Cho is the sole member of DC. Stip. ¶ 4; *see also* 810 ILCS 180/5-1(c).
4. Cho sold the Property to DC on December 30, 2003. Stip. ¶ 3.
5. At some undisclosed time, Cho was also the president of the DaVinci Academy (DaVinci). Attachment, p. 35 (undated list of DaVinci's School Board and Administration).
6. DaVinci is an Illinois not-for profit corporation that operates a private elementary school for gifted children, serving pre-kindergarten through eighth grades. Stip. ¶ 7; Attachment, p. 36 (copy of Illinois Secretary of State form NFP-105.10 (Statement of Change of Registered Agent), dated August 21, 2001).
7. DC leases the property to DaVinci. Stip. ¶ 5; Attachment, pp. 2-10 (copy of lease, including two exhibits thereto).

¹ When the parties submitted their stipulated record, the Department also agreed that DC would be able to attach to its brief documents previously tendered to the Department regarding its application. DC thereafter submitted a multiple-page evidentiary attachment (Attachment) to its brief, which includes several different documents. Several of the documents in the Attachment, however, include the same exhibit designation. For example, the Lease between DC and DaVinci is identified as Exhibit A to DC's Brief (DC's Brief, p. 2), but the Lease itself includes an exhibit A (a property description), which is also included within the Attachment. In an attempt at clarity, therefore, when I cite to a document included within the Attachment, I will, at the first cite, describe the document to which I refer, and thereafter cite to the particular page number(s) of the Attachment where the document(s) may be found.

8. DaVinci commenced operations on September 5, 2000 (Stip. ¶ 5), and operates in a 29,826 square foot building located on the property. Stip. ¶ 6.
9. The original lease term began on January 1, 2004 and terminated on December 31, 2004, with automatic annual renewals. Stip. ¶ 8; Attachment, p. 2 (¶ 2).
10. DaVinci pays DC an annual rent of \$100.00. Stip. ¶ 10; Attachment, p. 2 (¶ 4).
11. DaVinci's academic school year runs from Labor Day until early June. Summer months are used for building maintenance, administrative functions and professional development for teachers. Stip. ¶ 9; Attachment, p. 14 (copy of text of affidavit of use).
12. On February 17, 2005, DC filed a form PTAX-300, Application for Non-homestead Property Tax Exemption – County Board of Review Statement of Facts, naming itself as the owner of the property and the applicant (hereinafter, DC's 2/17/05 application). DC's 2/17/05 application requested a property tax exemption for the property pursuant to 35 ILCS 200/15-35. Stip. ¶ 14; Stip. Ex. 2 (copy of 2/17/05 application).
13. The Kane County Board of Review (Kane County Board) approved DC's 2/17/05 application on June 10, 2005. Stip. ¶ 15.
14. The Department denied DC's 2/17/05 application on August 18, 2005, stating that: 1) the property was not in exempt ownership; and 2) the property was not in exempt use. Stip. ¶ 16.
15. DaVinci had previously filed an exemption application to request an exemption for the same property for calendar year 2004, pursuant to 35 ILCS 200/15-35.

Stip. ¶ 11; Stip. Ex. 1 (copy of the DaVinci's 5/24/04 application). That form listed DaVinci as the owner of the property. Stip. Ex. 1.

16. The Kane County Board of Review (Kane County Board) approved DaVinci's 2004 application on October 26, 2004 (Stip. ¶ 12), but the Department denied it, stating that: 1) the property was not in exempt ownership; 2) the property was not in exempt use; and 3) DaVinci was not the owner of the property, but was rather the lessee. Stip. ¶ 13.
17. Neither the parties' stipulation of facts, nor the docket in this matter, include any indication that a protest was filed after the Department denied DaVinci's application for property tax exemption for 2004. Thus, the dispute here involves only DC's exemption application for the 2005 calendar year.
18. The lease contains the following pertinent provisions:

3. Use of Property. Tenant shall use the Property only for the operation of its school. Accordingly, the Property may be used for all reasonable uses associated with school activities, including, but not limited to, classroom administration activities, classroom instruction, athletic events and activities, and other typical school curricular and extra-curricular functions. No other use shall be made of the Property by Tenant without the written consent of the Landlord.

6. Construction Liens. Tenant shall keep the Property free from any liens arising out of any work performed thereon, materials furnished thereto or obligations incurred by Tenant. Tenant shall indemnify, defend and hold Landlord harmless against all liability, loss. Damage, costs and all other expenses arising out of claims for work performed or materials furnished to or for the benefit of Tenant.

7. Repairs and Maintenance. Tenant shall keep and maintain the Property, and every part thereof, including, but not limited to, all structural, nonstructural, interior and exterior portions of buildings and improvements located upon the property, in good and sanitary order, condition and repair, and will deliver the same to Landlord at the expiration of the Term in as good a condition as when received, except

for reasonable use and wear thereof, and unrepaired damage or destruction as controlled by the provisions of Paragraph 11 hereof.

8. Alterations and Additions. Tenant may not alter or add to the Property without Landlord's prior written consent, which consent shall not be unreasonably withheld. Landlord shall have no obligation to make any alteration or addition to the Property during the Term. All right, title and interest to any alterations or additions to the Property during the Term, except for trade fixtures and removable equipment, shall be the property of Landlord and shall be deemed to be a part of the Property, and shall remain on, and be surrendered with, the Property upon the termination of this Lease, without cost or expense to the Landlord.

13. Assignment and Subletting. Tenant may not assign this Lease or sublet all or any part of the Property at any time during the Term of this Agreement without the prior written consent of the Landlord, which may be withheld for any reason.

Attachment, pp. 2-5.

Conclusions of Law:

Article IX of the 1970 Illinois Constitution generally subjects all real property to taxation. Eden Retirement Center, Inc. v. Department of Revenue, 213 Ill. 2d 273, 285, 821 N.E.2d 240, 247 (2004). Article IX, § 6 permits the legislature to exempt certain property from taxation based on ownership and/or use. Ill. Const. Art. IX, § 6 (1970). One class of property that the legislature may exempt from taxation is "property used exclusively ... for school ... purposes." Ill. Const. Art. IX, § 6 (1970).

Pursuant to the authority granted under the Illinois Constitution, the General Assembly enacted § 15-35 of the Property Tax Code (PTC), which provides, in relevant part:

Sec. 15-35. Schools. All property donated by the United States for school purposes, and all property of schools, not sold or leased or otherwise used with a view to profit, is exempt, whether owned by a resident or non-resident of this State or by a corporation incorporated in any state of the United States. *****

35 ILCS 200/15-35.

The Department denied DC's exemption application after determining that the property was not in exempt ownership, and was not in exempt use. Stip. ¶ 16. The burden of proving the right to exemption rests upon the party seeking it. Chicago Patrolmen's Assoc. v. Department of Revenue, 171 Ill. 2d 263, 271, 664 N.E.2d 52, 56 (1996). That means that here, DC has the burden to show that the property was property "of a school," that the property was not sold or leased or otherwise used with a view to profit, and that the property was used exclusively for school purposes. 35 ILCS 200/15-35.

There is no dispute over the last point, since the parties have stipulated that the property has, since 2001, been used by DaVinci to operate its private elementary school for gifted students. Stip. ¶¶ 5-7. But there is a dispute regarding the other elements.

As to the profit issue, the Department has stipulated that DaVinci is a not-for-profit organization, and that the amount DaVinci pays to lease the property from DC is \$100.00 annually. If rent charged were the only issue relevant to whether property is owned, leased or used for profit, the amount of rent stipulated here might well be evidence from which I could conclude that DC is not leasing the property with a view toward profit. But the amount of rent charged is not the only factor relevant to the question of profit, as that term is used within the PTC's exemption provisions. In DuPage Co. Bd. of Review v. Joint Comm. on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461, 654 N.E.2d 240 (2d Dist. 1995) (hereinafter, Joint Comm.), the court made the following distinction between the popularly understood

definition of profit, with the better understanding of the term, when used within the PTC's exemption provisions:

The circuit court's reliance on a dictionary definition of "profit" contradicts our supreme court case law interpreting "profit" as it relates to a not-for-profit corporation. Our supreme court has noted that the determining feature of "profit" with respect to a charitable institution is whether there is inurement of benefit to a private individual. (*People ex rel. County Collector v. Hopedale Medical Foundation* (1970), 46 Ill.2d 450, 452-53, 264 N.E.2d 4.) This court has interpreted "profit" in regard to eligibility for a real estate tax exemption as a benefit inuring to members that is not available to nonmembers. See *Du Page Art League*, 177 Ill.App.3d at 901, 127 Ill.Dec. 287, 532 N.E.2d 1116 (the plaintiff's members impermissibly profited from the organization because only members were allowed to show and sell their art work in the organization's galleries, giving "a distinct advantage not afforded to nonmembers").

Joint Comm., 274 Ill. App. 3d at 470-71, 654 N.E.2d at 246-47.

Here, the issue is whether DC owned, leased, or used the property with a view toward profit, even though the income it received from leasing the property amounted to only \$100 per year. The record shows the following: Cho previously owned the property; Cho organized DC as an Illinois LLC; Cho is DC's sole member; Cho sold the property to DC; and that Cho also was (and perhaps remains) the President of DaVinci. DC argues that "the fact that Ms. [Cho] is both the president of DaVinci as well as the sole member of DC also dictates a finding that the nominal rent payments do not remove the Property from exempt use. Because the same individual is involved in virtually all aspects of running and operating the Property, the payment of such a nominal amount between the nearly identical entities demonstrates even more clearly DaVinci's not-for-

profit use.” DC’s Brief, pp. 7-8. But I cannot agree with DC’s view of what must be concluded from the facts of record.

Cho chose to organize DC as an Illinois LLC. Illinois law provides that an LLC can organize for any legitimate business purpose (805 **ILCS** 180/5-5(a)(2)), and I will presume that DC has a lawful business purpose in owning the property and leasing it to DaVinci. I acknowledge that Illinois’ Limited Liability Company Act allows an LLC to conduct a non-profit business (*see* 805 **ILCS** 180/1-5 (“‘Business’ includes every trade, occupation, profession, and other lawful purpose, whether or not carried on for profit.”)), but since DC has not offered into evidence its articles of organization, I will not presume that DC’s business purpose was to operate as a non-profit entity. Further, Cho chose to sell the property to DC, and then have DC lease the property to DaVinci, instead of leasing it herself to DaVinci. 810 **ILCS** 180/5-1(c) (“A limited liability company is a legal entity distinct from its members”).

The benefits traditionally associated with conducting a business as an LLC lie within the structure of the entity itself, which “creat[es] a hybrid form of doing business that combines some of the advantages of S corporation status and partnerships (pass-through tax treatment for income) with the limited liability and flexible ownership structure of the corporate form.” Todd M. Young, Illinois Institute for Continuing Legal Education, *Organizing and Advising a Small Business* § 9.8. “The driving force for organizing a limited liability company is the desire to achieve pass-through tax treatment, while at the same time enjoying limited liability.” Charles W. Murdock, *American Bar Assoc., Limited Liability Companies In The Decade Of The 1990s: Legislative And Case Law Developments And Their Implications For The Future*, 56 *Bus. Law.* 499, 499 (Feb.

2001). “The allure of the limited liability company is its unique ability to bring together in a single business organization the best features of all other business forms — properly structured, its owners obtain both a corporate-styled liability shield and the pass-through tax benefits of a partnership.” PB Real Estate, Inc. v. DEM II Properties, 719 A.2d 73, 74 (Conn. App. Ct. 1998) (*citing* Uniform Limited Liability Company Act, prefatory note (1995)).

Under the circumstances, it is not unreasonable to conclude that arranging to have title to property placed in the hands of a presumptively for-profit business entity provides some distinct and discreet benefit to the LLC itself, and to its sole member. That is the essence of profit, at least for property tax exemption purposes. Joint Comm., 274 Ill. App. 3d at 470-71, 654 N.E.2d at 246-47.

In its brief, DC describes itself as “a holding company formed for the sole purpose of owning the property.” DC’s Brief, p. 4. But again, this is argument, not evidence. There is no documentary evidence in this record, such as DC’s articles of organization, which reveals such a purpose. DuPage Art League v. Department of Revenue, 177 Ill. App. 3d 895, 899, 532 N.E.2d 1116, 1118-19 (2d Dist. 1988) (“Whether a party has been organized and is operating exclusively for a purpose exempt from real estate tax is to be determined from its charter and bylaws and the actual facts relating to its method of operation.”). Nor do I agree with DC’s argument that it is “simply a shell of the school.” DC’s Brief, p. 10. DC is an entity that is separate and distinct from the non-profit entity that leases and uses the property. DC is also an entity that is distinct from its sole member. 810 ILCS 180/5-1(c). That DC is a single member LLC might support an inference that Cho controls DC, but there is no evidence whatever

to support a conclusion that DaVinci controls DC. DC has the burden to show that it, or its sole member, derives no profit from owning or leasing the property; it is not the State's burden to show that some particular profit has been made. Chicago Patrolmen's Assoc., 171 Ill. 2d at 271, 664 N.E.2d at 56. Given the separate ownership of DC and DaVinci, and the absence of evidence that DC is organized and operated as a non-profit business, DC has not established that the property is not owned or leased by DC with a view toward profit.

The final element for an exemption under PTC § 15-35 is whether the property is of a school. The parties stipulate that DC owns the property, and DC is not a school. To counter the undisputed fact that a school does not own the property, DC essentially argues that DaVinci should be considered the equitable or beneficial owner of the property, and DC a mere title-holder. DC's Brief, pp. 8-11.

DC primarily relies on Christian Action Ministry as supporting its claim that DaVinci is the beneficial owner of the property. DC's Brief, pp. 8-9. But the facts in Christian Action Ministry are not at all similar to the facts here. There, the applicant purchased property from an owner that also acted as the mortgagee. Christian Action Ministry v. Department of Local Government Affairs, 74 Ill. 2d 51, 61, 383 N.E.2d 958, 963 (1978). The Department argued there that only legal ownership — title — satisfied the exemption. The Illinois Supreme Court, however, recognized property law's longstanding view that, in an installment land contract situation, beneficial ownership in the property vested in the purchaser/borrower, with legal title alone remaining with the mortgagee. Christian Action Ministry, 74 Ill. 2d at 61-63, 383 N.E.2d at 963-64. In other words, in such a situation, the Court held that, for property tax exemption purposes, a

purchaser of property pursuant to an installment land contract would be treated as the owner of the property for property tax purposes.

DC also cites Northern Illinois University Foundation v. Sweet, 237 Ill.App.3d 28, 603 N.E.2d 84 (2nd Dist. 1992) (hereinafter, NIU Foundation), to support its argument that the property is in exempt ownership. DC's Brief, p. 6. But that case supports the Department, not DC. One of the issues in NIU Foundation was whether property owned by the NIU Foundation, a non-profit organization, could be considered property "of the State." NIU Foundation, 237 Ill. App. 3d at 29, 603 N.E.2d at 86.

The facts in NIU Foundation were that an individual had granted property to the Foundation via a quitclaim deed. *Id.* at 31-32, 603 N.E.2d at 86-87. That deed contained numerous covenants and restrictions that ran with the land and inured to the benefit of the grantor and his successors for a 25-year period. *Id.* One of the covenants required the Foundation to use the proceeds of its sale of the property for specific purposes, and another required the Foundation to obtain a fair market price for the property in the event it sought to sell the property within a given time period. *Id.* at 31-32, 603 N.E.2d at 87. The Foundation leased the property to Northern Illinois University (NIU), a public university, and the lease included the covenants and restrictions that ran with the property. *Id.* at 33, 603 N.E.2d at 88. Under the lease, NIU paid rent of \$1 per year, and it was also required to pay the costs of acquiring the property. *Id.* NIU was also required to assume the expense of maintaining the property and paying the cost of insurance and utilities, and NIU could not make improvements over \$25,000 to the property without the written consent of the Foundation. *Id.*

When applying those facts to the law, the appellate court wrote:

In the case at bar, in view of the numerous restrictions placed on the property by the grantor as to its use, control and sale, as well as the possibility of reverter to the grantor, a third party, we agree with the legal conclusion of the ALJ that the property cannot be considered property belonging to the State for tax purposes. The covenants and restrictions inure to the benefit of Scheinfeld, a third party, which retains substantial control over the uses and future disposition of the property. By contrast, NIU, which does not hold legal title, can exercise only very limited control of the property, control that is more in the nature of a tenancy rather than an owner of the fee simple-despite its close association with the NIU Foundation, which merely holds the legal title under conditions established by the grantor. Furthermore, in its appellate brief, the plaintiff Foundation concedes that it is the taxpayer in this case and is an entity wholly separate and apart from NIU itself.

Control of the property and the right to its benefits are more significant than legal title alone in determining the liability for real estate taxes. [citations omitted] 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. Because of the significant limitations imposed by Scheinfeld on the use and future disposition of the property, we hold that the property does not belong to the State for tax purposes. The [Foundation's] request for the exemption was properly denied on that basis, and the ALJ's decision was not against the manifest weight of the evidence.

NIU Foundation, 237 Ill. App. 3d at 35, 603 N.E.2d at 89-90.

The record here does not establish that DaVinci enjoyed the primary incidents of ownership of the property. First, while the lease conveyed to DaVinci quiet possession of the property, the lease was also one for a particular purpose. Attachment, pp. 2, 5 (¶¶ 3, 15). The right of possession granted pursuant to a lease for a particular purpose is significantly narrower than the right granted pursuant to a lease granting possession for

any, or all, lawful purposes. First Trust & Savings Bank v. Economical Drug Co., 250 Ill. App. 112 (1st Dist. 1928).

DC also controlled DaVinci's right to alter, add to, or improve the property. Attachment, p. 3 (¶ 8). Further, and except for trade fixtures and removable equipment, any improvement that DC might allow DaVinci to make to the property would be the property of DC. *Id.* And unlike in Cole Hospital, Inc. v. Champaign County Board of Review, 113 Ill. App. 3d 96, 446 N.E.2d 562 (1983), here, DaVinci has no express option to purchase the property. Nor did DaVinci enjoy any right to alienate (i.e., sell) any part of the property outright. Attachment, p. 5 (¶ 13). DC absolutely controlled DC's right to assign or sublet its right of possession of any part of the property (*id.*), which control is perfectly consistent with the lessor's grant of possession of property only for a particular purpose. Economical Drug Co., 250 Ill. App. 112.

In sum, DaVinci enjoyed only the right to use the property for a particular purpose, DC controlled DaVinci's ability to change or improve the property, and DaVinci lacked any authority to alienate the property. Based on these facts, I conclude that DaVinci did not enjoy the primary incidents of ownership over the property, and that it cannot, therefore, be considered the owner of the property for tax purposes. NIU Foundation, 237 Ill. App. 3d at 35, 603 N.E.2d at 89-90; Wheaton College, 155 Ill. App. 3d at 946, 508 N.E.2d at 1137.

Conclusion:

I recommend that the Director finalize the Denial previously issued, and that the property remain on the tax rolls for 2005.

Date: 1/23/2007

John E. White
Administrative Law Judge