2014 IL App (5th) 120570-U

NO. 5-12-0570

IN THE

APPELLATE COURT OF ILLINOIS

FIFTH DISTRICT

ST. CLAIR COUNTY, ILLINOIS,	)	Appeal from the
	)	Circuit Court of
Plaintiff-Appellee,	)	St. Clair County.
	)	
v.	)	No. 11-MR-213
	)	
SCOTT AIR FORCE BASE PROPERTIES, LLC,	)	
	)	
Defendant-Appellant	)	
	)	Honorable
(The Department of Revenue and Brian Hamer,	)	Stephen P. McGlynn,
as Director of Revenue, Defendants).	)	Judge, presiding.

JUSTICE CHAPMAN delivered the judgment of the court.
Justice Goldenhersh concurred in the judgment.
Presiding Justice Welch dissented.

ORDER

¶ 1 *Held*: Administrative agency decision finding an agreement constituted a license, rather than a lease, was erroneous where the agreement fit within the statutory definition of a PPV military public/private residential development lease.

¶ 2 The instant case involves a series of agreements under the Military Housing Privatization Initiative (MHPI) (10 U.S.C. §§ 2871−85 (2006)). Pursuant to those agreements, the Air Force leased a portion of Scott Air Force Base to defendant Scott Air Force Base Properties, LLC (SAFBP), and conveyed title to the improvements on that land

to SAFBP by quitclaim deed. (We note that the Illinois Department of Revenue and its director are also defendants in this matter; however, neither has joined in this appeal. We will refer to SAFBP as "the defendant.") The agreements called for the defendant to renovate existing housing units, build additional units, and manage the housing units as rental property, to be leased primarily to military members assigned to Scott Air Force Base. The defendant filed property tax exemption applications based on the federal government's ownership of the underlying ground. See 35 ILCS 200/15-50 (West 2006). The applications were initially denied; however, a final administrative decision by the Illinois Department of Revenue found that the property was tax-exempt. On administrative review, that decision was reversed by the circuit court of St. Clair County. At issue in those proceedings was whether the defendant's interest in the property constituted a true leasehold or merely a license in the property. See 35 ILCS 200/9-195 (West 2006). The defendant appeals, arguing that the administrative agency correctly determined that it held only a license because the Air Force retained control over the leased property. We affirm the decision of the circuit court.

¶ 3 The MHPI was established as part of the 1996 Defense Authorization Act. *Bessinger v. United States*, 448 F. Supp. 2d 684, 686 (D. S.C. 2006); see 10 U.S.C. §§ 2871−85 (2006). The purpose of the MHPI is to give the military tools to " 'upgrade military housing on an accelerated basis' " through agreements with private entities. *Bessinger*, 448 F. Supp. 2d at 686-87 (quoting 141 Cong. Rec. S18853). The MHPI gives the Department of Defense authority to enter into several different types of agreements with private entities to achieve this goal. *Bessinger*, 448 F. Supp. 2d at 687. In general,

these agreements give the private entities income-earning opportunities or money-saving benefits in exchange for providing housing and related services for military personnel. *Bessinger*, 448 F. Supp. 2d at 686-87. In relevant part, it gives the Department of Defense authority to convey or lease military facilities to private entities for these purposes. *Bessinger*, 448 F. Supp. 2d at 687; see 10 U.S.C. § 2878 (2006).

¶ 4 Pursuant to the MHPI, the Air Force issued a request for proposals (RFP) to renovate existing housing units on Scott Air Force Base, build additional units, and provide property management services for the project. In addition, because the need for housing exceeded the space available on the base, the RFP required bidders to bring additional property to the project. The additional land was needed in order to provide sufficient housing at the desired density. The RFP specifically stated that bidders should assume that their interest in the project would be subject to state and local property tax and that the lessee would be responsible for any such taxes assessed. Bidders were therefore required to take state and local property tax into account in preparing their financial projections.

¶ 5 The defendant was the successful bidder. On January 1, 2006, the parties executed several documents. One of those was a ground lease, under which eight parcels on Scott Air Force Base were leased to the defendant. Seven of the parcels contain housing units, and the eighth parcel contains a maintenance facility. The lease transferred possession of the eight parcels to the defendant, effective January 1, 2006. The term of the lease is for 50 years, with the exception of two parcels, which have shorter lease periods.

¶ 6 The lease contains a provision noting that the improvements on the parcels were conveyed to the lessee by a quitclaim deed, but it defines the "leased premises" to include

both the land subject to the lease and the improvements conveyed separately. Condition 6.1 provides that the "sole purpose" for which the leased premises are to be used is the "design, demolition, construction, renovation, operation[,] and maintenance of a rental housing development *** primarily for use by military personnel and their dependants authorized to live on Scott Air Force Base." Other conditions of the lease provide that the relationship between the parties is "understood and agreed" to be that of landlord and tenant, and that the lessee is to pay any taxes as they became due.

¶ 7 An operating agreement was signed by the parties and incorporated into the lease. That agreement provides that housing units may only be offered to "target tenants" unless occupancy falls below 95%. Target tenants include personnel designated by the wing commander of Scott Air Force Base as "key and essential" and military members with dependants who are eligible for family housing on Scott Air Force Base. If occupancy falls below 95%, units may be offered to single military members, "geographically single" members (that is, military members whose families do not reside with them), and civilian employees of Scott Air Force Base.

¶ 8 On the same day, the parties executed a quitclaim deed conveying the housing units and "ancillary improvements" on the leased parcels to the defendant, along with any personal property included in the improvements. The deed did not convey any interest in the underlying ground. The deed includes a provision noting that it is subject to the conditions of the lease. The deed further provides that title to the improvements will revert to the federal government at the end of the 50-year lease period. Significantly, the deed contains a notation that future tax bills are to be sent to the defendant.

¶ 9 In addition, the parties signed a lock box agreement. The lock box agreement set up several accounts, including an "Imposition Reserve Account." Funds from that account are to be used for paying insurance premiums and property taxes.

¶ 10 On February 25, 2008, the defendant filed applications for property tax exemptions with the St. Clair County Board of Review. On July 10, 2008, the applications were denied. The defendant filed a protest to this decision and requested a hearing before the Administrative Hearings Division of the Illinois Department of Revenue. St. Clair County intervened in the proceedings.

¶ 11 In January 2010, the matter came for a hearing before Administrative Law Judge (ALJ) Kenneth Galvin. At the hearing, Robin Vaughn testified on behalf of the defendant. Vaughn is the executive vice president of the Hunt Development Group, which owns one of the entities that owns defendant SAFBP. Vaughn testified that his company's core business is constructing housing on military bases. He testified that SAFBP is a for-profit entity that was organized specifically for this project. He further testified that all of the related entities involved are also for-profit businesses. Vaughn acknowledged that the RFP expressly required bidders to take into account property taxes when preparing their financial projections, and he acknowledged that the defendant did, in fact, take the tax into account when preparing the financial projections in its bid.

¶ 12 Vaughn described the MHPI bidding process. He explained that a bid has three components–the financial projections, the property management and operations component, and the design and construction component. He further testified that bidding often involves a two-step process. In the first step of that process, the bidders must

demonstrate that they have both the financial ability and the expertise necessary to complete the project. The second step allows qualified bidders to put forth their actual proposals.

¶ 13 Vaughn acknowledged that numerous provisions of the lease and associated agreements address payment of taxes by the successful bidder. For example, condition 8.1 of the lease provides that the lessee is responsible for paying property tax on the project. In addition, the restrictive covenants and use agreement both specify that the project owner is responsible for paying the property taxes. The restrictive covenants define the project owner as the defendant.

¶ 14 Vaughn testified that the private parcel SAFBP was required to bring to the project includes 381 housing units. He acknowledged that these units are subject to the same rules as the housing units located on the base. He testified, however, that SAFBP did not even apply for a tax exemption for that parcel.

¶ 15 Paula Baker, SAFBP's community director, testified in more detail regarding the restrictions imposed on the management of the property by the various agreements. She explained how the requirement of renting to target tenants works. As previously noted, target tenants are people who are required to live on the base because they have been designated "key and essential" and active duty military members with families. Other eligible tenants include single military members assigned to Scott Air Force Base, "geographically single" members assigned to the base, and civilian employees of Scott Air Force Base. If there are units remaining, SAFBP may then rent them to members of the general public; however, these tenants would still need to pass security clearance to be

permitted on the base.

¶ 16 Baker further testified that tenants must be referred through the military housing office, and their rent is determined by their basic housing allowance. Although the defendant can set rent for nonmilitary tenants, it may not charge them less rent than it charges active-duty military tenants. In addition, the defendant may not advertise to the general public without approval. Baker acknowledged that these same restrictions apply to the housing units on the privately owned parcel except for the requirement of passing through security to enter the base.

¶ 17 Baker next testified about oversight of the landscaping. She testified that she chooses landscaping contractors on behalf of SAFBP. However, she explained that the Air Force still has to run background checks on the contractors and their employees to determine whether to allow them on the base. She noted that "the base also has a say in what the scope of work is." In addition, Baker testified that she needs approval before making any landscaping changes that are visible from the home of either of the two four-star generals who live on the base, the parade ground, or the main road into the base.

¶ 18 Finally, Baker testified that all tenant leases have a pet addendum that restricts the size, breed, and number of dogs tenants are allowed to have. She testified that although the addendum is similar to restrictions in typical civilian residential leases, the property manager is ordinarily allowed to determine what those restrictions will be. Such is not the case here. Baker acknowledged that these restrictions are the same for the tenants on the base and the tenants on the privately owned parcel.

¶ 19 The ALJ issued a 59-page recommendation for disposition. He first highlighted

various provisions of the documents that form the parties' agreement. He noted that the lease provides that the sole purpose of the agreement is to provide a rental housing development primarily for military personnel and their dependants. He highlighted various provisions of the lease requiring government approval for design plans and the names of portions of the project.

¶ 20 ALJ Galvin also highlighted the numerous provisions relating to property tax. He pointed to provisions in the RFP, lock box agreement, quitclaim deed, and lease, all of which provide that property tax is to be paid by the lessee. He expressly found that these "glaring and ubiquitous references" indicated that the Air Force "understood and recognized" that the property would be subject to property tax and that the government was "allowing the lease to be taxed."

¶ 21 The ALJ then determined that although the parties' agreement has some characteristics of a lease and other characteristics of a license, the lease does not give the defendant exclusive control and possession over the premises. He explained that while many of the restrictions are due to the need for security on a military base, the agreement imposes additional restrictions and control over things that are not related to the security needs of an Air Force base. He recommended granting the applications for exemptions. On July 18, 2011, the Department of Revenue issued a decision adopting ALJ Galvin's recommended disposition.

¶ 22 The county filed a petition for administrative review. The St. Clair County circuit court reversed the decision of the Department of Revenue. The court noted that the defendant was a sophisticated party and was aware "that a leasehold interest could be

taxed" under Illinois law. See 35 ILCS 200/9-195 (West 2006). As such, the court found it significant that none of the numerous documents involved in the agreement contain any language referring to the agreement as a license. In addition, the court found that the requirements and guidelines related to the management of the rental units were necessitated by the fact that the units were on a military base. This appeal followed.

¶ 23 On appeal from a decision under the Administrative Review Law, we review the administrative agency's final decision, not the decision of the circuit court. *Metropolitan Airport Authority of Rock Island County v. Property Tax Appeal Board*, 307 Ill. App. 3d 52, 55, 716 N.E.2d 842, 845 (1999). We consider the findings of fact of the administrative agency to be *prima facie* true and correct. *Gas Research Institute v. Department of Revenue*, 154 Ill. App. 3d 430, 433, 507 N.E.2d 141, 143 (1987). Neither the circuit court nor this court may disturb those findings unless they are against the manifest weight of the evidence. However, the agency's conclusions of law are subject to *de novo* review. *Metropolitan Airport Authority*, 307 Ill. App. 3d at 55, 716 N.E.2d at 845.

¶ 24 Where resolution of a case turns on the legal effect of a given set of facts and circumstances, it presents a mixed question of fact and law. Thus, the agency's decision is subject to the "clearly erroneous" standard of review. *OKO, LLC v. Illinois Department of Revenue*, 2011 IL App (4th) 100500, ¶ 32, 959 N.E.2d 663 (citing *City of Belvidere v. Illinois State Labor Relations Board*, 181 Ill. 2d 191, 205, 692 N.E.2d 295, 302 (1998)). An agency's decision is clearly erroneous if it leaves the reviewing court "with the definite and firm conviction a mistake has been committed." *OKO*, 2011 IL App (4th) 100500, ¶ 33, 692 N.E.2d 663.

¶ 25 Property owned by the federal government is exempt from state and local property tax. 35 ILCS 200/15-50 (West 2006). However, if tax-exempt property is leased to a party whose property is not exempt from taxation, the property is assessed and taxed as the property of the lessee. 35 ILCS 200/9-195 (West 2006). This distinction has called for courts and agencies to examine the legal effect of the relevant agreements to determine whether they give the lessee a true leasehold interest or merely confer a license. This is because while leaseholds and other interests in real property are taxable, licenses are not. *Metropolitan Airport Authority*, 307 Ill. App. 3d at 56, 716 N.E.2d at 845. The statute does not define a lease, and "revenue collection is not concerned with refinements of title but with the realities of ownership." *Cole Hospital, Inc. v. Champaign County Board of Review*, 113 Ill. App. 3d 96, 99, 446 N.E.2d 562, 564 (1983).

¶ 26 In the context of lease agreements under the MHPI, this analysis is no longer necessary. Our legislature has determined that such agreements confer true leasehold interests if they meet the statutory definition of a "PPV Lease." Section 10-370 of the Illinois Property Tax Code defines a "PPV Lease" (a lease for a military public/private residential development) as a leasehold interest in federal government-owned property "that is leased, pursuant to authority set forth in Chapter 10 of the United States Code, to [an entity] whose property is not exempt" for purposes of designing, constructing, financing, or renovating military rental housing units. 35 ILCS 200/10-370(a) (West 2012). Section 10-380 provides that PPV leases are not exempt from property tax. 35 ILCS 200/10-380 (West 2012). The lease at issue here meets these statutory criteria.

¶ 27 Prior to a recent amendment of section 10-370, the definition of a PPV lease

included only leases for Navy housing developments. Pub. Act 97-942 (eff. Aug. 10, 2012). The amendment, which broadened the definition to include similar leases on all military installations, went into effect more than one year after the ALJ rendered his decision in this matter. Thus, he analyzed whether the agreement conferred a true leasehold interest under cases considering the distinction between a lease and a license in the context of other types of commercial lease agreements. As we have just explained, such analysis is no longer required in the context of MHPI agreements that meet the statutory definition of a PPV lease.

¶ 28 The current version of section 10-370 explicitly makes its provisions retroactively applicable to PPV leases executed on or after January 1, 2006, the exact date of the lease at issue here. 35 ILCS 200/10-370 (West 2012); see also 35 ILCS 200/10-390 (West 2012). In spite of the amendment's express retroactive reach, neither party argues in this appeal that the amended statutes are decisive. We find, however, that these statutes control our decision.

¶ 29 In an administrative review case, neither the circuit court nor this court may consider any "new or additional *evidence* in support of or in opposition to any finding, order, determination or decision of the administrative agency." (Emphasis added.) 735 ILCS 5/3-110 (West 2012). However, the laws regarding the retroactive application of statutory amendments apply in administrative review the same way they apply in other cases. Where, as here, the legislature has expressly indicated that a statutory amendment applies retroactively, that legislative intent must be given effect absent a constitutional prohibition. *Doe A. v. Diocese of Dallas*, 234 Ill. 2d 393, 405, 917 N.E.2d 475, 482

(2009).

¶ 30 The defendant argues in a footnote to its brief that there is a constitutional prohibition here. Specifically, the defendant argues that applying the amendment here would result in an impermissible *ad valorem* tax on personal property. As previously discussed, a license is not an interest in real property. As the defendant correctly notes, our state constitution does not authorize the legislature to impose a tax on personal property interests. See Ill. Const. 1970, art. IX, § 5. We do not find this argument persuasive. As we have previously explained, a leasehold is a taxable interest in real property. The statutory amendment does not provide that a license is taxable; it merely provides a definition for a particular type of lease. That definition includes the agreement at issue here. Thus, pursuant to statute, the agreement is a PPV lease, which gives the defendant a taxable leasehold interest. The administrative decision to the contrary was incorrect as a matter of law.

¶ 31 We acknowledge that the only federal court decision that has addressed this issue reached a contrary conclusion from the one we reach today. See *Atlantic Marine Corps Communities, LLC v. Onslow County, North Carolina*, 497 F. Supp. 2d 743 (E.D. N.C. 2007). However, we do not believe that case compels us to reach a different conclusion. That case, like this case, involved a 50-year ground lease along with a conveyance of the improvements on the leased land. There, unlike here, the Department of the Navy actually held an ownership interest in the business entity created for the project. *Atlantic*, 497 F. Supp. 2d at 748. However, this fact did not appear to be a significant factor in the court's decision.

¶ 32 A more significant difference is the North Carolina statute at issue there. That statute provided that property ceded to the federal government by the State of North Carolina is exempt from state and local property tax " 'so long as the said lands shall remain the property' " of the federal government " 'and no longer.' " *Atlantic*, 497 F. Supp. 2d at 756 (quoting N.C. Gen. Stat. § 104-07). The case did not involve any statute similar to the Illinois statutes making PPV leases and other leasehold interests in otherwise exempt property taxable (35 ILCS 200/9-195 (West 2006); 35 ILCS 200/10-380 (West 2012)). Onslow County did *not* argue that the agreement there conferred only a license; rather, the county argued that the agreement was "the equivalent of a sale, transferring equitable title" to the private company. *Atlantic*, 497 F. Supp. 2d at 756.

¶ 33 In rejecting this argument, the *Atlantic* court first acknowledged that the company, rather than the Navy, was in possession of the property and controlled the day-to-day operations of the property. *Atlantic*, 497 F. Supp. 2d at 757; see also *Bessinger*, 448 F. Supp. 2d at 691 (reaching the same conclusion in a different context). However, the court found that the Navy retained sufficient control that the agreement was not the equivalent of a sale. Because the agreement did not give the limited liability company the "equitable title" to the property, the federal government retained its primary jurisdiction and control over the property, and it was not subject to taxation. *Atlantic*, 497 F. Supp. 2d at 758. Here, as we have explained, the agreements gave the defendant a leasehold interest, which is a taxable interest in real property under Illinois law. The tax status of the property here does not depend on finding sufficient relinquishment of control to effectuate a transfer of "equitable title" to the property. Thus, the rationale in *Atlantic* does not require us to reach

a different result. Moreover, this court is not obliged to follow the decision of a federal district court applying the law of a different state.

¶ 34 For the reasons stated, we affirm the order of the circuit court reversing the decision of the Department of Revenue.

¶ 35 Circuit court affirmed; agency decision reversed.

¶ 36 PRESIDING JUSTICE WELCH, dissenting:

¶ 37 I dissent. I strongly believe that the evidence presented to the Department supports only one finding, the finding reached by the Department, that the agreement between the parties conveyed only a *license* to use the property, and not a leasehold. As the majority correctly points out, a license conveys only an interest in *personal* property, and not an interest in *real* property.

¶ 38 However, the majority continues that it need not decide whether the agreement conveyed a license or a lease because section 10-370 of the Property Tax Code denominates all such agreements as leases, and therefore taxable real property under the Property Tax Code. Indeed, section 10-370 appears to do just that and, in my opinion, thereby violates our state constitution's ban on personal property taxes.

¶ 39 Article 9, section 5, of the Illinois Constitution of 1970 abolished all *ad valorum* personal property taxes. Ill. Const. 1970, art. IX, § 5. Our legislature cannot, constitutionally, simply "rename" or "reclassify" a license, which is personal property, as a leasehold, which is real property, and then tax it as real property. To do so subverts our

constitution's express prohibition against taxes on personal property.

¶ 40 If the agreement between the parties conveyed only personal property, which I believe it did, that property cannot constitutionally be subjected to an *ad valorum* tax. To the extent section 10-370 of the Property Tax Code attempts to impose a tax on the licensed property, it is unconstitutional. Accordingly, I dissent from the majority opinion. I would find that the agreement conveyed only a license to use the property for a specific purpose and that it is therefore not subject to taxation under the Property Tax Code.