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Article 16

Real Property - Taxation - Lease of Exempt Property to Private Parties

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Pennsylvania now finds itself in a very anomalous position, in that if the mother of an illegitimate child is considered a fit person for custody, the putative father cannot visit the child. If the possibility exists that the welfare of the child might be enhanced by granting the putative father visitation privileges, that possibility is now relegated to a minor status. This is certainly not within the trend of decisions that other courts have followed,[23] but rather is a minority position.

Majority jurisdictions, when faced with this issue, will tend to take the view that a great deal of thought should be given to the trial court's discretion as to the disposition of visitation privileges by the putative father, in that only there can it be detected whether this illegitimate child would be benefited or harmed by such visitation privileges.

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[23] See *supra* notes 8, 9, 15, 16, 17, and 18.

REAL PROPERTY–TAXATION–LEASE OF EXEMPT PROPERTY TO PRIVATE PARTIES

The Illinois State Toll Highway Commission leased to Standard Oil Company certain sites along the toll road for use as restaurants and gasoline stations. The county where the property is located assessed a tax on the Standard Oil leaseholds, on the basis of Section 26 of the Illinois Revenue Act[1] which provides that when tax exempt real estate is leased to one not entitled to an exemption, the leasehold estate and the property attached to it are considered to be real estate of the lessee.[2] The Highway Commission commenced an action to enjoin the assessment, arguing that since the lease provided for a reduction in the rent by such a tax, the burden of the assessment would fall upon the Commission which is a tax-exempt body.[3] The trial court accepted the Commission's argument, and entered a decree enjoining the assessment. The county appealed urging that there are many decisions holding that land which is leased to private parties by tax exempt entities is taxable under Section 26, and that in the light of such decisions, the legislature showed an intention to assess such property by not amending Section 26 specifically to exempt such leaseholds. The Illinois Supreme Court upheld the decree of the trial court on the basis that the legislature intended Section 18 of the Toll Highway Act,[4] which exempts all prop-

[1] Ill. Revenue Act § 26, ILL. REV. STAT. ch. 120, § 507 (1963).

[2] *Ibid.*

[3] Toll Highways Act § 18, Ill. Rev. Stat. ch. 121, § 314 (1963).

[4] *Ibid.*

erty belonging to the Commission, to exempt the type of leasehold in question. *Illinois State Toll Highway Commission v. Korzen*, 32 Ill. 2d 338, 205 N.E.2d 433 (1965).

This case illustrates, for the first time in Illinois, the tax consequences of a state leasing property to a private party to be used for a public purpose. The Illinois Supreme Court declared that the issue in the case was whether the legislature intended Section 18 of the Toll Highway Act to exempt such leaseholds from taxation, or whether the legislature's failure specifically to exempt such leaseholds showed an intent that the leaseholds should be assessed under Section 26 of the Revenue Act. In order to evaluate the court's interpretation of the statutes involved, as applied to this unusual fact situation, it is necessary to delve into the history of the court's stand on tax exemptions, analyze the decisions in analogous cases, and examine the view that other states have taken in similar circumstances.

According to the Constitution of the State of Illinois, the object of taxation is "to provide such revenue as may be needful."[5] In the spirit of the theory that every person shall bear equally the burden of the cost of government, the constitution provides that taxes are to be levied in such a manner "that every person and corporation shall pay a tax in proportion to the value of his, her or its property."[6] In the light of these constitutional provisions and similar provisions in the other state constitutions, exemptions from taxation are not favored in Illinois or any other jurisdiction. An alleged constitutional or statutory grant of exemption from taxation will be strictly construed in favor of taxation and against the taxpayer and the exemption. In Illinois, and at least nine other jurisdictions, it has been held that all cases of doubt as to the legislative intention, or as to the inclusion of particular property within the terms of the statute, will be resolved against the claimed exemption.[7] Such a privilege of immunity cannot be made out by inference or implication, but must be "plainly and unmistakenly" granted.[8] The court, in *People ex. rel. Gill v. Trustees of Schools*,[9] revealed the logic behind the strict construction policy towards exemptions as follows:

> If the courts permit, by illogical interpretation of the constitutional provision exempting property, a liberal rather than a limited construction of the statute passed under it, and thereby enlarge the field of exempt property, a substantial injury is inflicted upon other property owners by diminishing the

[5] ILL. CONST. art. 9, § 1.

[6] *Id.* at § 3.

[7] People *ex. rel.* Marsters v. Rev. Saleyni Missionaries, 409 Ill. 376, 99 N.E.2d 186 (1951).

[8] People *ex. rel.* Gill v. Lake Forest University, 367 Ill. 103, 106, 10 N.E.2d 667, 669 (1937).

[9] 364 Ill. 131, 4 N.E.2d 16 (1936).

amount of property which carries the expense of government rather than distributing such charge equally so far as practicable.[10]

The Illinois constitution provides that the "property of the state, counties, and other municipal corporations, both real and personal, and such other property as may be used exclusively for agricultural and horticultural societies, for school, religious, cemetery and charitable purposes, may be exempted from taxation; but such exemption shall be only by general law."[11] By statute, Illinois exempts from taxation all property of every kind belonging to the state of Illinois[12] and municipal property used for municipal or public purposes.[13] The Commission cited the almost identical language used by the legislature in granting the analogous tax exemptions given to the state and to the Commission[14] and argued that for that reason, the Commission was entitled to as broad an interpretation of the Commission's statutory grant of exemption as the court had given to the state's statutory grant of exemption. The court, however, has never considered the scope of the state's statutory grant of exemption in the light of an exact or similar fact situation. Wherever the case involved a lease by the state to a private party, the property was used for a purely private purpose. In all these cases, the court ruled against the claimed exemption.[15] In considering other claims for exemptions, such as municipal, charitable or educational institutions, the court has consistently held that a lease to a private party to be used for private purposes was not exempt.[16] Even where the proceeds from said lease were used exclusively to promote the exempted entity, the court has refused to allow an exemption.[17] There are, however, cases wherein such institutions themselves have employed the property in a private manner and retained the tax exemption. In all these cases, the court has applied the "primary use" doctrine.[18]

[10] *Id.* at 135, 4 N.E.2d at 18.

[11] ILL. CONST. art. 9, § 3.

[12] Ill. Revenue Act, ILL. REV. STAT. ch. 120, § 500.5 (1963).

[13] *Id.* at § 500.6.

[14] *Supra* notes 3, 12.

[15] La Salle County Mfg. Co. v. City of Ottawa, 16 Ill. 418 (1855); Carrington v. People, 195 Ill. 484, 63 N.E. 163 (1902).

[16] City of Chicago v. University of Chicago, 302 Ill. 455, 134 N.E. 723 (1922); People *ex. rel.* Marsters v. Rev. Saleyni Missionaries, *supra* note 7; Turnverin "Lincoln" v. Bd. of Appeals of Cook County, 358 Ill. 135, 192 N.E. 780 (1934); People v. International Salt Co. of Ill., 233 Ill. 223, 84 N.E. 278 (1908); People *ex. rel.* Paschen v. Hendrickson Pontiac, 9 Ill. 250, 137 N.E.2d 381 (1956).

[17] City of Chicago v. Ames, 365 Ill. 529, 7 N.E.2d 294 (1937); People *ex. rel.* Gill v. Trustees of Schools, 364 Ill. 131, 4 N.E.2d 16 (1936); People v. Chicago Theological Seminary, 174 Ill. 177, 51 N.E. 198 (1898).

[18] People v. Freeport Masonic Temple, 347 Ill. 180, 179 N.E. 672 (1931); People *ex. rel.* Gill v. Lake Forest University, 367 Ill. 103, 10 N.E.2d 667 (1937); People v.

In *People ex. rel. Goodman v. University of Illinois Foundation*, the primary use doctrine was defined in the following manner:

> Where the principal and primary purpose to which property is employed is for a public educational, charitable, municipal or other exempt purpose, the mere fact that income is incidentally . . . derived from its use for a nonexempt purpose does not necessarily render the property taxable.[19]

In all cases where the primary use argument was applied successfully in retaining the exemption, the private use was by the same institution which qualified for the exemption originally, but was never by a private party who had leased the property.[20] There have been several notable cases involving municipalities. In *Sanitary District of Chicago v. Young*,[21] and in *People v. Sanitary District of Chicago*,[22] the municipality had employed the sanitary canal to produce electricity which it proceeded to sell to the public. In both instances the Sanitary District claimed a tax exemption for the property upon which the enterprise was carried on under the application of the primary use doctrine. In both instances, the court ruled that the property used for the production of electricity was not exempt. In the case of the *City of Mattoon v. Graham*,[23] the court was confronted with the situation of municipality leasing out property under which was situated a subterranean lake from which the municipality drew its water. The court stated that:

> [W]here a tract is used for two purposes or "double purposes" one of which would exempt it from taxation and the other not, it is permissible to assess and levy tax against the part of the property devoted to a use not exempt from taxation.[24]

The state attempted to apply the primary use doctrine to the facts at hand. Excluding the cases involving the municipalities, previous decisions dealing with the application of the primary use doctrine would support an exemption only if the Commission itself operated the restaurants and gasoline stations. At any rate, in the instant case,[25] the Commission itself was not assessed, but the lessee was assessed under authority of Section 26. The Commission had entered the case on behalf of the lessee because of a

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Y.M.C.A. of Chicago, 365 Ill. 118, 6 N.E.2d 166 (1936); Krause v. Peoria Housing Authority, 370 Ill. 356, 19 N.E.2d 193 (1939); People *ex. rel.* Goodman v. University of Illinois Foundation, 388 Ill. 363, 58 N.E.2d 33 (1944).

[19] People *ex rel.* Goodman v. University of Illinois Foundation, *supra* note 18 at 371, 58 N.E.2d at 37.

[20] *Supra* note 17.

[21] 285 Ill. 351, 120 N.E. 818 (1918).

[22] 307 Ill. 24, 138 N.E. 209 (1923).

[23] 386 Ill. 180, 53 N.E.2d 955 (1944).

[24] *Id.* at 181, 53 N.E.2d at 958.

[25] State Toll Highway Commission v. Korzen, 32 Ill. 2d 338, 205 N.E.2d 433 (1965).

provision in the lease which reduced the rent paid by the lessee to the Commission by the amount of any ad valorem tax assessed on the lessee. Therefore, the Commission contended, any tax assessed on the lessee was in reality assessed on the Commission. As the county correctly retorted, this provision in the lease agreement was purely a business judgment on the part of the makers in no way affecting the status of the lessee with respect to its tax liability.

It is clear that the property would have remained exempt had the Commission operated the facilities itself instead of leasing them. Yet, the property is still being used for the primary purpose with respect to the general public. It is being used in the same manner as the act envisioned, and as the Commission itself would have used the property. The question arises as to why it should not remain exempt. The property is bestowing a benefit upon the public and, as such, the use is public. However, with respect to the lessee, the property is serving primarily a private use. The lessee's primary motive is to make a profit. The lessee in achieving his objective must necessarily compete with other service facilities located off the toll road. Besides having the obvious advantage of being the only services available on the toll road, the lessee seeks the added advantage of an exemption from taxes which his competitors are required to pay merely because his activity benefits the public. The fact that the use of the property is in the public interest or for the public benefit does not necessarily mean that the use is a public use. Where representatives of a "civic league" purchasing land for a city park with money raised by private subscriptions took title in their own name, the land was not exempt from taxation, even though the owners were willing to deed it to the city immediately.[26] In that case, there was no profit motive whatever, yet, the property was taxed.

Section 26 makes the lessee of exempt property the owner of such property for the purpose of assessing taxes. Section 26 does not look into the use of the land to determine its character, but looks merely to the user. Here, the lessee was a private party whose own property was not exempt. By all previous Illinois authority, the leasehold was not exempt.[27] Both the traditional policy of the court towards statutory grants of exemption and specific decisions of the court involving the application of Section 26 were against the granting of an exemption in this case. However, the court, in adopting the argument put forth by the Commission, was in keeping with the new trend established by recent decisions in several jurisdictions which have also considered the problem of dual-aspect leases of exempt property.

The Commission cites a New Jersey case[28] involving almost identical

[26] People v. City of Toulon, 300 Ill. 408, 133 N.E. 707 (1921).

[27] *Supra* note 14.

[28] Walter Reade, Inc. v. Township of Dennis, 36 N.J. 435, 177 A.2d 752 (1962).

facts as authority for a decision granting an exemption. The only significant distinction between the two fact situations was the language employed in the statutes granting the exemptions to the respective commissions. The New Jersey Toll Highway Act was more specific in describing the scope of the grant. The statute provided as follows:

> The Authority shall not be required to pay any taxes or assessments upon any project or any property acquired or used by the Authority under the provisions of this act or upon the income therefrom, and every project and any property acquired or used by the Authority under the provisions of this act and the income therefrom . . . shall be exempt from taxation.[29]

This statute, although it doesn't specifically exempt leasehold interests from taxation, does embody in its language a more express intent to exempt such leaseholds than the general, vague exemption created by the Illinois statute.

Ohio has passed a Toll Highway Act[30] exempting "all property" belonging to said Toll Highway Commission which could conceivably conflict with a constitutional provision authorizing exemptions for public property used exclusively for any public purpose.[31] Although there are no decisions as of yet, one commentator discusses the hypothetical problem of the tax status of "oases" and comes up with four possible solutions, namely,

> 1) Concessions could indicate a non-exclusive use of the property . . . thus denying the exemption. . . .
> 2) . . . Service station-restaurant property could be classified as entities separate from the roadbed; therefore, an exemption allowance could be made for all property except the actual plats leased to the service stations and restaurants.
> 3) Service stations could be considered necessities and thus exempt . . . while the restaurants might be held taxable, either because they are not necessities or because they house strictly profit making souvenir shops. . . .
> 4) . . . these concessions could be considered incidental and necessary to the operation of the turnpike and therefore carry the exemption along with it.[32]

The author emphasizes that any decision of the court would be based upon the court's interpretation of the word "exclusively" as it is used in the constitutional restriction on granting exemptions. He further states that "[t]he trend in public property cases seems to be that there must be an exclusive public use, whose main objective is a public purpose, and not merely public benefit, convenience or welfare."[33] This statement

[29] N.J. STAT. ANN., ch. 16 § 27:12B-16 (1952).

[30] OHIO REV. CODE, § 5537.20 (1953).

[31] OHIO CONST. art XII, § 2.

[32] Note, 14 OHIO ST. L.J. 344 (1953).

[33] *Ibid.*

would indicate that the "oases" are merely a public benefit, convenience or welfare not meriting an exemption.

Decisions in several jurisdictions which involved the status of property serving a dual purpose, public-private, turned upon the presence or absence of public regulation of the activity. The decisive issue in these cases was the necessity of public control of privately operated parking facilities to ensure their devotion to a public use and thus to justify the exercise of eminent domain, expenditure of public funds, or the granting of a tax exemption. A Massachusetts case involved the granting of a tax exemption.[34] A statute was passed authorizing the city of Boston to lease property for the construction and operation of a garage to ease the public nuisance of traffic congestion. The leasehold was made exempt by a special amendment to the statute. Operators of private garages in the city brought an action to force the city to assess taxes against the lessees of the municipal garage. It was contended that the operators of the municipal garage should not be exempted because the operators of private garages which compete with the municipal garage were assessed, and the garage is not a public use since it is not regulated and controlled by the city. The independent operators claimed that it was necessary for the city to control the rates to be charged and the quality of service to be rendered by such a privately operated parking facility to ensure its devotion to a public use. The Massachusetts court allowed the exemption to stand, stating that "the absence of regulation had no tendency to indicate that the garage scheme was for other than a public purpose."[35] Both a California case[36] and an Indiana case[37] involved the exercise of the power of eminent domain by the municipalities.

The California court decided that the acquisition of land by the city to be leased to private individuals to construct a parking garage without the city retaining power to control rates and quality of service was not a proper exercise by the city of its constitutional power of eminent domain because it was for a private and not a public use.[38] Under similar circumstances the Indiana court said it was necessary for the statute authorizing the lease of property to private parties to grant power to the city to control rates and quality of service in order for the lease of property obtained through the power of eminent domain to be constitutional.[39]

Although the Massachusetts, California, and Indiana cases do not involve fact situations analogous to the case in point, they are all acutely

[34] Cabot v. Assessors of Boston, 335 Mass. 53, 138 N.E. 2d 618 (1956).

[35] *Id.* at 67, 138 N.E.2d at 627.

[36] City and County of San Francisco v. Ross, 44 Cal. 2d 52, 279 P.2d 529 (1955).

[37] Folty v. City of Indianapolis, 234 Ind. 656, 130 N.E. 2d 650 (1955).

[38] *Supra* note 36.

[39] *Supra* note 37.

concerned with the problem of dual aspect uses of public property leased to private individuals. It would appear from the facts and decisions of these cases, that, if faced with the tax problem created by the "oases," California and Indiana would not favor an exemption, while Massachusetts would allow the exemption to stand. As noted earlier, Ohio would probably continue strictly to construe the "exclusive" requirement of its constitution[40] and disallow an exemption. New Jersey, on the other hand, under almost identical circumstances, approved of the exemption. The only other jurisdiction to have considered the problem of dual aspect uses was New York, which, through a liberal application of the primary use doctrine, has approved of such an exemption.[41] Without any decisions to indicate otherwise, it must be presumed that remaining jurisdictions continue to construe constitutional and statutory grants of exemption against the party to be taxed and the exemption. Illinois, in following the view of the Massachusetts, New York, and New Jersey courts, represents the new trend. The real purpose behind this new trend is not merely the recognition of supremacy of the primary use doctrine based on the benefit bestowed upon the public but, more importantly, a recognition of the expanding use of publicly-owned property in a proprietary manner to serve public ends. In discussing a New York case which had supported an exemption in a dual aspect situation, one commentator stated that:

> [T]he tone of the case indicates the court is attempting to ease the restrictions on incidental use of state property for a private purpose.[42]

As more jurisdictions are confronted with this still novel problem of dual aspect leases, they will begin to adopt the view of the Illinois court. It is inevitable that, as the scope and functions of city and state government expand to meet the increasingly complex problems of industrialization and urbanization, the courts will be confronted with many more cases involving the dual aspect use of public property.

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[40] *Supra* note 31.

[41] State Insurance Fund v. Hamblin, 31 Misc. 2d 977, 222 N.Y.2d 732 (1961).

[42] Note, 13 SYRACUSE L. REV. 617 (1962).

SALES–IMPLIED WARRANTY–BLOOD RECEIVED FROM A BLOOD BANK

Plaintiff's wife entered St. Mary's Hospital for treatment of an ailment. While being treated, she required several blood transfusions which were administered by the hospital using whole blood supplied by the defendant