

## Leasing Lite - Tax Prorations in Commercial Leases in Illinois

One provision that is often overlooked when negotiating commercial leases is that related to the handling of real estate taxes. This can become an issue - especially when a property with tenants is being sold, and the lease language is less than clear as to each tenant's obligations to pay real estate taxes (*i.e.*, is it on an accrual or cash basis?).

This brings to mind an issue that arose during a recent commercial real estate sale transaction in which I was representing the Seller of an investment property comprised of a multi-tenant retail strip mall in Illinois. It is important to note that in Illinois real estate taxes are paid one year in arrears. So in this transaction, the 2018 taxes assessed against the property were payable by the tenants in 2019. The triple net leases contained language requiring the tenants to pay the landlord for their proportionate share of the real estates taxes and other expenses. The specific real estate tax provision in the leases read along the lines of "Tenant shall pay to Landlord, as additional rent, its *pro rata* share of Real Estate Taxes relating to the Building for each calendar year commencing in the calendar year in which the Term Commencement Date occurs and continuing thereafter through the Lease Expiration Date." This is referred to as a "cash-basis lease" or "cash-basis" tax reimbursement.

The purchase agreement for the sale transaction stated that the Seller shall pay all taxes, general and special, and all assessments, which are a lien on the Property and can be paid on or prior to the Closing Date, except that a credit shall be

given to Purchaser at Closing for all general real estate taxes attributable to the period prior to the Closing, which cannot be paid on or prior to the Closing.

This language leaves the question as to whether tax reimbursement payments to be made by tenants after the Closing under a cash-basis lease should be credited against the taxes accruing before the Closing. This would result in a reduction of the tax proration to the Purchaser. Clearly this would be how the Seller would want this issue to be resolved. However, the Purchaser may quell this argument with a variety of responses, such as this is not custom practice in Illinois, or a tax escrow is required by its lender and using this approach will not provide for enough money to fund the escrow.

So who prevails? In the commercial real estate transaction mentioned above, the Seller prevailed – but there is no right answer as to how to handle the closing credit issue. What is important to remember is two-fold: First, each party needs a clear understanding of the economic ramifications of how the real estate taxes are handled. Second, commercial leases need to clearly state if the real estate taxes are to be paid on a cash or accrual basis.

There are other issues relating to real estate taxes that one should take into account when negotiating commercial leases, as follows:

- Is the proportionate share for taxes based on all space in the building/center (or is there a gross-up provision if all space is not leased)?
- What is the time frame for submitting evidence of real estate tax bills, or for contesting them?

- Who has the right to contest or appeal taxes, and who pays costs associated with the appeal?
- How will the parties handle the payment of any special assessments?
- Is there any construction that will lead to reassessment of the taxes and increased real estate tax costs?
- Will the taxes be handled on a cash basis or on an accrual basis?

Needless to say, it is important for both the attorney's and the client's sake not to gloss over the real estate tax provisions when negotiating commercial leases.

---

Jodi L. Henninger  
Clingen Callow & McLean, LLC  
2300 Cabot Drive, Suite 500  
Lisle, Illinois 60532  
[www.ccmlawyer.com](http://www.ccmlawyer.com)  
(630) 871-8550

*The author, publisher, and distributor of this CCM Alert is not rendering legal or other professional advice or opinions on specific facts or matters. Under applicable rules of professional conduct, this communication may constitute Attorney Advertising.*

© 2019 Clingen Callow & McLean, LLC. All rights reserved.

ccmlawyer.com