

ST 19- 04

Tax Type: Sales Tax

Tax Issue: Exemptions from Tax (Charitable and Other exempt types)

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

ABC ORGANIZATION

APPLICANT

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

No. [REDACTED]
Sales Tax Exemption

**Kelly K. Yi
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. John Smith, for ABC Organization; Mr. Robin Gill, Assistant General Counsel, for the Department of Revenue of the State of Illinois.

SYNOPSIS: On April 25, 2018, the Department of Revenue of the State of Illinois (“Department”) issued a Sales Tax Exemption Denial to ABC Organization (“ABC” or “Applicant”) denying its request that the Department issue it an exemption identification number so that it could purchase tangible personal property at retail free from the imposition of retailers’ occupation tax as set forth in 35 ILCS 105/1 *et seq.* Taxpayer protested the Department’s decision and requested an administrative hearing.¹ In lieu of a hearing, the parties subsequently submitted a “Joint Stipulation of Facts and Waiver of

¹ Of the two sales exemption applications Applicant has filed, at issue is the application filed on March 12, 2018. Dept. Ex. 1; App. Ex. pp.3-4.

Oral Hearing,” (“Stipulation”) along with Department Exhibit 1, inclusive of the exemption application, denial by the Department, and Applicant’s request for hearing, and a Taxpayer’s Exhibit, consisting of 75 pages of various documents in support of its claim. Stipulation p.2. Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department. The following Findings of Fact and Conclusions of Law are made in support of this recommendation.

FINDINGS OF FACT:

1. The Department’s case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Department’s denial of exemption dated April 25, 2018. Stipulation p.2; Dept. Ex. 1.
2. Applicant was originally organized as a not-for-profit Illinois corporation in July 2002 for social purposes. App. Ex. p.9.
3. Its original bylaws show that it was initially organized to promote ABC’s interests in Anywhere, Illinois, designed to educate and inform the larger community about ABC traditions and culture, and to enable greater engagement of the ABC community in public affairs. App. Ex. p.13.
4. On February 1, 2018, Applicant amended its articles of incorporation with Illinois Secretary of State declaring itself a charitable organization. App. Ex. p.35.
5. Applicant is exempt under Section 501(c)(3) of the Internal Revenue Code for federal income tax. App. Ex. pp.1, 37.
6. Its current bylaws adopted in January 2018 show it is organized exclusively for charitable, religious, educational and scientific purposes, including for such purposes,

- c. World-Fest: Present ABC culture, cuisine, and entertainment in a global community setting. App. Ex. p.28
 - d. Benefit Dinner: Raise funds through sponsorship and ticket sales to benefit a locally-based charitable organization. App. Ex. p.28
 - e. Annual Celebration: Provide a forum for celebrating Applicant’s annual accomplishments and promote interaction among community members. App. Ex. p.28
12. “Special Activities” are held to mark events or occasions of significant cultural, social or historic importance. App. Ex. p.28
13. Ticket purchases are required for adults to attend Applicant’s various events and food is available for purchase at some events. App. Ex. pp.18-25.
14. Applicant has received a yearly donation of \$ [REDACTED] from a local bank from 2012-2018 for a total of \$ [REDACTED]. App. Ex. pp.45-75
15. Applicant’s 2018 revenues are as follows:

Corporate contribution – bank	\$ [REDACTED]
Investment interest income	\$ [REDACTED]
<u>Special events income</u>	<u>\$ [REDACTED]</u>
Total	\$ [REDACTED]

Applicant’s 2018 expenses are as follows:

Charitable donations	\$ [REDACTED]
Business registration fees	\$ [REDACTED]
Contract services	\$ [REDACTED]
Rent, parking, utilities	\$ [REDACTED]
Operations	\$ [REDACTED]
Bank fees	\$ [REDACTED]
<u>Insurance</u>	<u>\$ [REDACTED]</u>
Total	\$ [REDACTED]
Net income	\$ [REDACTED]

App. Ex. p.73

16. Applicant has an all-volunteer board and no paid staff. App. Ex. pp.7, 14, 29.

Conclusions of Law:

The Use Tax Act (35 **ILCS** 105/1 *et seq.*) imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 **ILCS** 105/3. Section 3-5 of the Act provides a list of tangible personal property that is exempt from tax, and includes the following: “(4) Personal property purchased by a governmental body, by a corporation, society, association, foundation or institution organized and operated exclusively for charitable, religious or educational purposes...[.] On or after July 1, 1987, however, no entity otherwise eligible for this exemption shall make tax-free purchases unless it has an active exemption identification number issued by the Department.” 35 **ILCS** 105/3-5(4). Section 2-5(11) of the Retailers’ Occupation Tax Act (35 **ILCS** 120/1 *et seq.*) contains a similar provision. (See 35 **ILCS** 120/2-5(11)).

Applicant has requested an exemption identification number pursuant to these provisions, which the Department has denied on the basis that it did not demonstrate that it met the requirements. Dept. Ex. 1. The Department’s denial of an applicant’s claim for an exemption identification number is presumed to be correct, and the applicant has the burden of clearly and conclusively proving its entitlement to the exemption. See Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455 (2nd Dist. 1985). To prove its case, an applicant must present more than just testimony denying the Department’s determination. Sprague v. Johnson, 195 Ill. App. 3d 798 (4th Dist. 1990). Rather, the applicant must present sufficient documentary evidence to support its claim. *Id.*

It is well established in Illinois that there is a presumption against exemption and that therefore, “exemptions are to be strictly construed” with any doubts concerning the

applicability of the exemptions “resolved in favor of taxation.” Van’s Material Co. Inc. v. Department of Revenue, 131 Ill. 2d 196 (1989). The applicant bears the burden of proving “by clear and convincing” evidence that the exemption applies. Evangelical Hospitals Corp. v. Department of Revenue, 223 Ill. App. 3d 225 (2nd Dist.1991).

An examination of the record establishes that Applicant has not demonstrated, by the presentation of exhibits and argument, evidence sufficient to warrant an exemption from sales tax as an association organized exclusively for charitable purposes. Accordingly, under the reasoning given below, the determination by the Department denying Applicant a sales tax exemption number should be affirmed. In support thereof, I make the following conclusions:

In Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 149 (1968) (“Korzen”), the Illinois Supreme Court outlined several factors to be considered in determining whether an entity is an institution of public charity: (1) the benefits derived are for an indefinite number of persons [for their general welfare or in some way reducing the burdens on government]; (2) the organization has no capital, capital stock or shareholders; (3) funds are derived mainly from private and public charity, and the funds are held in trust for the objects and purposes expressed in the charter; (4) the charity is dispensed to all who need and apply for it, and does not provide gain or profit in a private sense to any person connected with it; and (5) the organization does not appear to place obstacles of any character in the way of those who need and would avail themselves of the charitable benefits it dispenses. Korzen at 157. These factors are balanced with an overall focus on whether and how the organization serves the public interest and lessen the State’s burden. See DuPage County Board of Review v. Joint Comm’n on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461 (2nd Dist. 1995). Thus, the issue before this tribunal is whether Applicant is

“an institution of public charity” under the terms of Korzen. I conclude, based on the documentary evidence presented, that it is not an “institution of public charity.”

In determining whether an organization is charitable in its purpose and therefore exempt from taxation, it is proper to consider provisions of its charter. Rotary International v. Paschen, 14 Ill. 2d 387 (1957). To be exempt from taxes under the UTA and the ROTA, an institution must be organized and operated “exclusively” for charitable purposes. 35 ILCS 105/3-5(4) and 35 ILCS 120/2-5(11). An “exclusively” charitable purpose need not be interpreted literally as the entity’s sole purpose; it should be interpreted to mean the primary purpose, and not a merely incidental or secondary purpose or effect. Gas Research Institute v. Department of Revenue, 154 Ill. App. 3d 430 (1st Dist. 1987). In determining whether an institution is exempt from taxation, the test is whether its primary purpose is charitable. People v. Young Men’s Christian Ass’n of Chicago, 365 Ill. 118 (1936). It is well settled in Illinois that incidental acts are legally insufficient to establish that the applicant is “exclusively” or primarily a charitable organization. Rogers Park Post No. 108 v. Brenza, 8 Ill. 2d 286 (1956).

According to its bylaws, Applicant’s mission is to organize activities that attract widespread participation from the ABC community and to preserve and advance the interests of local ABC community through educational, cultural, and social activities that serve as venues for inter-community interaction. App. Ex. p.28. In January 2018, Applicant changed its description of the organization in the bylaws declaring itself a charitable organization, but despite the change, its vision, mission, and activities have remained the same. App. Ex. pp.13, 28. All its events since inception, consisting of a Movie Night, an ABC Fest, a World Fest, a Benefit Dinner, and an Annual Celebration, have remained primarily social. Of the five social events specifically noted in the bylaws,

only one event is dedicated to raise funds for charity. App. Ex. pp.1, 9-10, 12-17, 18-25, 27-33. Similarly, Applicant's assertion that "[e]ver since ABC's inception in 2002, its *primary purpose* has been charitable" is not supported by evidence. App. Brief, p.1. Instead, the evidence shows that Applicant was organized in 2002 as a not-for-profit Illinois corporation for "social" purposes. App. Ex. pp.8-9.

It's unclear what Applicant is asserting as its primary charitable purpose because it conflates the primary and secondary purpose in applying the Korzen characteristics. Applicant asserts that "[t]he result (*or primary purpose*) of each year's activities is a series of gifts to various charities," but also asserts that its various social events benefit an indefinite number of persons because all events are open to the public. App. Brief p.1. Whether Applicant means that cash donations to charities are the result of its primary purpose of holding social events or vice versa is unclear. If Applicant is arguing the former, it wouldn't qualify as an institution of public charity since it lacks a primary charitable purpose. As such, in giving a benefit of doubt to the *pro se* Applicant, I address the latter apparent argument that Applicant's purported primary charitable purpose is to give cash donations to various charities with funds raised through social events.

One may infer that an organization would invest most efforts towards its primary purpose. Applicant presented no evidence that it spends most of its efforts in fundraising to benefit federally tax-exempt organizations, its purported primary charitable purpose. App. Brief p.1. Under Activities in the bylaws, out of five events, only one event, Benefit Dinner, is dedicated to raise funds to benefit a Peoria-based charitable organization. App. Ex. p.28. Of several event flyers in the record, only ABC Fest event flyer indicates that "\$1 of each admission ticket benefits the St. Jude's Hospital Charity." App. Ex. pp.19, 25. No other event flyers advertise Applicant's fundraising efforts towards the purported

primary charitable purpose. App. Ex. pp.18-24. These event flyers headline “Unlimited fun guaranteed!!,” “Showcasing ABC’s colorful diversity in Cuisine, Fashion, Artifacts, Textiles, Jewelry & Culture,” “Come Together to Celebrate...Its [REDACTED] Time!!,” or “Bring your Family & Friends along for an afternoon of extravagant Fun, Music, Dance, ...!!!.” App. Ex. pp.18-24. These flyers evidence that the emphasis is on the social and cultural celebration of ABC community, rather than as charity fundraisers. Fundraising through ticket and food sales at social events have not resulted in a net gain towards a purported primary charitable purpose of fundraising and donating to charity. App. Ex. pp.45-75. The evidence shows that Applicant’s annual donations to charities have not exceeded the sole \$ [REDACTED] annual donation received from a local bank and ranged from as low as \$ [REDACTED] to \$ [REDACTED]. App. Ex. pp.45-75. Stated differently, while Applicant has donated a total of \$ [REDACTED], equivalent to 28% of the total revenues of \$ [REDACTED] over the years, none of the funds from program fees went towards benefitting charitable organizations. App. Ex. pp.45-75. Based on the documentary evidence presented, I find that Applicant’s primary purpose is not charitable but social.²

The first Korzen characteristic is whether the organization benefits an indefinite number of persons for their general welfare or in some way reducing the burdens on government. Korzen at 157. Applicant’s purported primary purpose does not provide benefits to indefinite number of persons. Rather the cash donations benefit only the charitable organizations Applicant selects. App. Ex. p.64. As Applicant lacks a primary charitable purpose and the cash donation to charity is merely a secondary charitable

² Having concluded that Applicant lacks a primary charitable purpose, the remaining issues are moot. However, in the event of an administrative review, I address the remaining issues premised on Applicant’s apparent argument that raising funds to give cash donations to various charities is its primary charitable purpose. App. Brief p.1.

purpose, incidental to its primary social purpose, there is no easing of a government burden from the primary charitable purpose. Accordingly, I conclude that Applicant has not met its burden of demonstrating by clear and convincing evidence (see Evangelical Hospitals, 223 Ill.App.3d at 231, 165 Ill. Dec. 570, 584 N.E.2d 1004) that it meets the first Korzen characteristic.

The parties agree that Applicant possesses the second Korzen characteristic of a charitable organization that it has no capital, capital stock or shareholders. Dept. Brief p.4. The third Korzen characteristic is whether funds are derived mainly from private and public charity, and the funds are held in trust for the objects and purposes expressed in the charter. Korzen at 157. Applicant's financial statements show that only 42% ██████ of total funds ██████ raised during 2012-2018 have been derived from donations, \$ ██████ each year from a local bank. App. Ex. pp.45-75. The remaining 58% ██████ of funds came from program fees such as event entry fees and food/drinks sales. App. Ex. pp.18-25, 45-75. Applicant asserts that because the remaining funds originated from the event fees from the public, they came from the "public." App. Brief, p.1. This is based on a misunderstanding of the law. The laws governing sales tax exemption require that funds come from charitable donations, not from program fees. As such, I find that Applicant has failed to meet by clear and convincing evidence the third Korzen characteristic.

The fourth Korzen characteristic is a two-prong inquiry: 1) whether the organization dispenses charity to all who need and apply for it; and 2) whether the organization provides gain or profit in a private sense to any person connected with it. Korzen at 157. Assuming, *arguendo*, that Applicant's primary charitable purpose, as claimed, is to dispense cash funds to various organizations, there is no evidence that Applicant offered the same cash donations to anyone who need and asked for it. Instead,

the record reveals that Applicant selects recipient organizations at a board meeting. App. Ex. p.64. The cash donations are not based on need or who applies for it. As such, the evidence supports a finding that Applicant does not possess the first-prong of the fourth Korzen characteristic of a charitable organization. As Applicant has an all-volunteer board and no paid staff, it meets the second-prong of the fourth Korzen characteristic that the organization provides no gain or profit in a private sense to any person connected with it. App. Ex. pp.29, 45-75.

The fifth and final Korzen characteristic of a charitable organization is whether the organization places obstacles of any character in the way of those who need and would avail themselves of the charitable benefits it dispenses. Korzen at 157. In asserting that cash donations given to various organizations as the primary charitable purpose, Applicant argues that it does not dictate how the donated funds to these charities are used. App. Brief p.1. This argument is misplaced. The relevant law is not concerned with what happens after charity is given. The law is concerned with whether there are any obstacles placed upon those who need and apply for it. As noted above, Applicant presented no evidence that these cash donations are available to anyone who need and apply for it. Instead, Applicant chooses the recipients of these cash donations, rather than the people or organizations in need applying for this charity. App. Ex. p.64. Also, no evidence was presented that availability of these funds were known to the public or that Applicant made efforts in any capacity to advertise to the public availability of these funds. If people who need cash donations do not know of its availability, they obviously cannot avail themselves of it.

When charity is not advertised, it is impossible to conclude that charity is dispensed to all who need it. Those who need charity may not apply because it is not advertised, and

they do not know that it is available. In Highland Park Hospital v. Department of Revenue, 155 Ill. App. 3d 272 (2d Dist. 1987), the court found that an immediate care center did not qualify for a charitable exemption because, *inter alia*, the advertisements for the facility did not disclose its charitable nature. The court stated that “the fact is that the general public and those who ultimately do not pay for medical services are never made aware that free care may be available to those who need it.” *Id.* at 281. Similarly, the court in Alivio Medical Ctr., supra, denied a charitable exemption to a medical care facility in noting, *inter alia*, that “[A]livio does not advertise in any of its brochures that it provides charity care, nor does it post signs stating that it provides such care.” Alivio Medical Ctr. at 652. In the instant case, there is no evidence that the public was made aware of availability of cash donations, as was selectively offered to charitable organizations of Applicant’s choosing. App. Ex. p.64. This is an obstacle to receiving benefits and prevents a conclusion that charity is dispensed to all who need it. A charity dispenses charity and does not obstruct the path to its charitable benefits. Eden Retirement Center v. Dept. of Revenue, 213 Ill. 273, 287 (2004). I conclude that Applicant has failed to meet by clear and convincing evidence the fifth Korzen characteristic of a charitable organization.

The fourth and fifth Korzen characteristics that a charitable organization dispense charity to all who need and apply for it and place no obstacles in their way, are “more than guidelines.” They are “essential criteria” and “go to the heart of what it means to be a charitable institution.” Provena Covenant Medical Center v. Department of Revenue, 384 Ill. App. 3d 734, 750 (4th Dist. 2008), aff’d, 236 Ill. 2d 368 (2010). Although Applicant meets the second and second-prong of the fourth Korzen characteristics, without it meeting the “essential criteria” above, I find that Applicant is not an institution of public charity.

Tax exemptions are inherently injurious to public funds because they impose lost revenue costs on taxing bodies and the overall tax base. To minimize the harmful effects of such lost revenue costs, and thereby preserve the Constitutional and statutory limitations that protect the tax base, statutes conferring property tax exemptions are to be strictly construed in favor of taxation. People ex rel. Nordland v. Home for the Aged, 40 Ill. 2d 91 (1968). Great caution must be exercised in determining whether property is exempt to ensure that “sound principles” are preserved, unwarranted exemptions from taxation are avoided and that only the limited class of properties meant to be exempt receives the exempt status that the Legislature intended to confer. Otherwise, any increases in lost revenue costs attributable to unwarranted application of the charitable exemption will cause damage to public treasuries and the overall tax base. In this case, Applicant bears the burden of proving “by clear and convincing” evidence that the exemption applies. Evangelical Hospitals Corp. v. Department of Revenue, 223 Ill. App. 3d 225 (2nd Dist.1991). Applicant has failed to prove by clear and convincing evidence that it is an exclusively charitable organization, as required for exemption under Illinois statutes, and that it falls within the limited class of institutions meant to be exempt for charitable purposes.

For the above stated reasons, I recommend that the Department’s determination denying the Applicant a sales tax identification number be affirmed.

:

ENTER: October 11, 2019

Kelly K. Yi
Administrative Law Judge