

ST 19-06

Tax Type: Sales Tax

Tax Issue: Exemption from Tax (Charitable or Other Exempt Types)

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

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

v.

ABC MINISTRIES

Applicant

**No. XX-ST-XXX
Letter ID XXXXXXXX
DENIAL OF SALES TAX
EXEMPTION**

**Ted Sherrod
Administrative Law
Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Robin Gill, on behalf of the Illinois Department of Revenue; *JOHN DOE*, Treasurer, *ABC MINISTRIES*, *pro se*.

Synopsis:

On September 7, 2018, the Illinois Department of Revenue (hereinafter the “Department”) issued a Taxpayer Notification Sales Tax Exemption Denial denying the request of *ABC MINISTRIES*, (hereinafter “Applicant”), that the Department issue it an exemption identification number so that it could purchase tangible personal property free from the imposition of use tax as set forth in 35 **ILCS** 105/1 *et seq.* On September 18, 2018, the Applicant protested the Department’s decision and requested a hearing. The sole issue to be determined in this matter is whether the Applicant qualifies for an exemption identification number as “a corporation, society, association, foundation or institution organized and operated exclusively for charitable ... purposes...[.]” 35 **ILCS** 105/3-5(4).

Prior to the convening of any evidentiary hearing, the parties agreed to certain stipulations, which are enumerated below, and further agreed to forego an evidentiary hearing in this case and to allow it to be decided based upon the stipulated record including documents and exhibits contained in pages 1 through 44 of the attachments thereto. For the reasons enumerated below, I recommend that this matter be decided in favor of the Department.

Findings of Fact:

I find the facts to be as stipulated between the parties in the “Stipulation of Facts and Waiver of Oral Hearing” (“Stipulation”) filed January 15, 2019, which are as follows:

1. The Applicant has filed a sales tax exemption application. Stipulation (“Stip.”) 1.
2. The Applicant has filed a timely written request, pursuant to 35 ILCS 200/8-35, for a formal hearing of the Department’s denial of its application, setting forth the Applicant’s arguments as to why the denial was incorrect and as to why the denial should be reconsidered and reversed. Stip. 2.
3. The Applicant has filed an appeal based on whether the Applicant is organized exclusively for charitable purposes under section 3-5(4) of the Use Tax Act (35 ILCS 105/3-5(4)) and section 2-5(11) of the Retailers’ Occupation Tax Act (35 ILCS120/2-5(11)). Stip. 3.
4. Attached to the Joint Stipulation of Facts and Waiver of Oral Hearing is the Department’s Exhibit #1, which includes the exemption application, the denial by the Department, the applicant’s request for hearing and other various documents offered by the Applicant. Stip. 4.

In addition to the foregoing facts, based upon the documentary evidence contained in the record, I further find as follows:

5. The presumed correctness of the Department's case is established by the admission into evidence of the Department's Taxpayer Notification Sales Tax Exemption Denial, wherein Applicant's request for exempt status was denied. Department Exhibit ("Ex.") 1, p. 3.
6. The Applicant was incorporated under the General Not-For-Profit Corporation Act of Illinois on January 29, 2018. Department's Ex. 1, p. 13. The Applicant commenced operations prior to its incorporation, in May 2017. Department Ex. 1, p. 10.
7. On September 7, 2018, the Department issued a Taxpayer Notification Sales Tax Exemption Denial denying the request of the Applicant that the Department issue it an exemption identification number so that it could purchase tangible personal property free from the imposition of use tax as set forth in 35 **ILCS** 105/1 *et seq.* Department Ex. 1, p. 3. On September 18, 2018, the Applicant protested the Department's decision and requested a hearing. Department Ex. 1, p. 2.
8. The Applicant's protest and supporting documentation addresses whether the Applicant is organized exclusively for charitable purposes under section 3-5(4) of the Illinois Use Tax Act (35 **ILCS** 105/3-5(4)), and section 2-5(11) of the Retailers' Occupation Tax Act (35 **ILCS** 120/2-5(11)). Department Ex. 1, pp. 2, 6-8.
9. The Applicant's Articles of Incorporation filed January 29, 2018 enumerate the Applicant's purposes as follows:

Article 4. Purposes

The Corporation is organized exclusively for charitable and religious purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"). The purposes for which the corporation is organized are:

- (A) To operate exclusively for charitable and religious purposes with[in] the meaning of Section 501(c)(3) of the Internal Revenue Code, as amended or the corresponding provision of any future United States revenue statute,

including, but not by way of limitation, the making of distributions to organizations that qualify as exempt organizations under 501(c)(3) of the Code.

(B) More specifically, the corporation is organized to provide a Christian rehabilitation program and residential discipleship training for men and women.

Department Ex. 1, p. 16.

10. The Applicant's by-laws dated February 18, 2018 enumerate the Applicant's purposes and activities as follows:

Article 1

Exempt Purposes; Mission

ABC MINISTRIES [Applicant] ...is organized and operated exclusively for charitable and religious purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986 or corresponding provision of any future United States Internal Revenue law (hereinafter, the "Code"). The object of the Corporation is to provide a Christian rehabilitation program and residential discipleship training for men and women who have a desire to follow Jesus Christ. The Corporation shall never be operated for the primary purpose of carrying on a trade or business for profit.

ARTILCE II

Activities

Section 1. Activities. The Corporation's activities shall include but not be limited to offering a Christian rehabilitation program and providing residential discipleship training in the form of "structured accountability" for men and women who have a desire to follow Jesus Christ.

Department Ex. 1, p. 19.

11. The Applicant's by-laws provide that its business affairs shall be managed by a Board of Directors, none of whom shall "receive... compensation for services to the Corporation as directors." Department Ex. 1, pp. 20, 23. However, Board members are authorized to receive reimbursements to cover expenses of attending Board meetings and in the performance of their duties as directors. Department Ex. 1, p. 23. The by-laws provide that the Applicant shall not have any members. Department Ex. 1, p. 20.

12. The Applicant has obtained an exemption from federal income tax pursuant to section 501(a) of the Internal Revenue Code (“Code”), based upon the Internal Revenue Service’s determination that the Applicant qualified as an organization described in section 501(c)(3) of the Code. Department Ex. 1, pp. 2, 4, 5.
13. The Applicant furnishes lodging and religious counseling services to applicants accepted into its rehabilitation program. Department Ex. 1, pp. 9, 12, 16, 19. The people serviced by the Applicant are primarily ex-convicts and ex-felons. Department Ex. 1, p. 10. Program participants ordinarily complete the Applicant’s program in six months. Ex. 1, p. 42. At the discretion of the program’s Director, up to 6 months can be added to a participant’s residency and religious counselling. *Id.*
14. Persons seeking the Applicant’s lodging and religious counselling services must submit an application. Department Ex. 1, pp. 32-37 (Application Form), 38. Persons submitting applications are encouraged to attend church services, Bible study and “Thursday Night Take Back Accountability” sessions. *Id.* Attendance and participation in these activities is mandatory for persons whose applications are accepted to become residents of the Applicant’s lodging and receive religious counseling. *Id.*
15. Persons accepted for the receipt of Applicant’s lodging and other services are required to make a monthly contribution payment of \$XXX. Department Ex. 1, pp. 9, 33 (Policy Guidelines). Fees are ordinarily waived for the first month and are frequently waived for the second. Department Ex. 1, pp. 9, 38. Fee waivers for the 17-month period beginning with the Applicant’s commencement of operations and ending in November 2018 totaled approximately \$XXXXXX. *Id.*

16. Persons to whom the Applicant provides lodging and religious counselling must also pay \$XX per month to cover a portion of the cost of food provided by the Applicant and are required to arrange and pay for all personal medical and dental care. Department Ex. 1, pp. 34, 41. Additional requirements which must be met by program participants as enumerated in the Applicant's handbook include taking part in weekly random drug and sobriety testing, adherence to the Applicant's dress code, mandatory attendance at two church services each Sunday, weekly Bible Study classes, attendance at Thursday night "Take it Back Recovery" meetings and attendance at weekly meetings to discuss the program as a whole and the progress of each resident. Department Ex. 1, p. 33.
17. Persons receiving Applicant's lodging and religious counseling services must be employed. Department Ex. 1, p. 43. They must also agree to place 50% of their employment wages into a personal savings account and pay a tithe of 10% of their monthly wages to a local church of their choosing. *Id.*
18. The Applicant's unaudited financial statement for the period January 29, 2018 through June 30, 2018 shows total income of \$XXXXX. Department Ex. 1, p. 31. Of this amount, \$XXXX came from "program fees" collected from program participants and \$XXXX came from donations. Department Ex. 1, pp. 31, 33. Total expenses for the period were \$XXXXX resulting in net income to the Applicant of \$XXXX. Department Ex. 1, p. 31.
19. The Applicant received 1088 hours of volunteer services from three individuals which the Applicant has classified as contributions and valued at \$XXXXX. Department Ex. 1, p. 11. The value attributed to these services by the Applicant range from \$12 per hour to

\$300 per hour. *Id.* The types of services provided by these volunteers and their job descriptions are not enumerated in the record.

20. The Applicant also received in kind donations which it valued at \$XXX. *Id.* The items provided and the manner in which the Applicant has valued them has not been provided by the Applicant.

Conclusions of Law:

The Retailers' Occupation Tax Act imposes a Retailers' Occupation Tax ("ROT") on persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. A "sale at retail" means any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property to the extent not first subjected to a use for which it was purchased for valuable consideration ... [.]" 35 ILCS 120/1. The Use Tax Act imposes a use tax ("UT") on the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3.

The Applicant seeks an exemption number permitting it to purchase tangible personal property at retail without incurring use tax. The mechanism in the Illinois statutes for procurement of an exemption identification number for ROT purposes is found at 35 ILCS 120/1g, entitled "Exemption identification number." That section of the statute states: "On or before December 31, 1986, except as hereinafter provided, each entity otherwise eligible under exemption (11) of Section 2-5 of this Act and on and after the effective date of this amendatory Act of the 92nd General Assembly each entity otherwise eligible under exemption (9) of Section 2-5 of this Act shall make application to the Department for an exemption identification number." Exemption eleven (11) of section 2-5 of the ROTA (35 ILCS 120/2-5(11)) states:

§ 2-5. Exemptions. Gross receipts from proceeds from the sale of the following tangible personal property are exempt from the tax imposed by this Act:

... (11) Personal property sold to a governmental body, to a corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious, or educational purposes, or to a not-for-profit corporation, society, association, foundation, institution, or organization that has no compensated officers or employees and that is organized and operated primarily for the recreation of persons 55 years of age or older. A limited liability company may qualify for the exemption under this paragraph only if the limited liability company is organized and operated exclusively for educational purposes. On and after July 1, 1987, however, no entity otherwise eligible for this exemption shall make tax-free purchases unless it has an active identification number issued by the Department.

35 ILCS 120/2-5(11).

Therefore, the only way that the Applicant can qualify for an exemption number pursuant to this provision is if it is a government body, a charitable, religious or educational entity, or a not-for-profit entity that is organized and operated primarily for recreation of persons age 55 or older.

The Applicant seeks to qualify for an exemption identification number as a “corporation, society, association, foundation or institution organized and operated exclusively for charitable ... purposes [.]” 35 ILCS 105/3-5(4); 35 ILCS 120/2-5(11). The sole issue in this case is whether the evidence presented by the Applicant establishes that it qualifies for the exemption number it seeks.

The record in this case indicates that the Applicant provides a six to twelve month lodging and religious training and counselling program primarily aimed to rehabilitate ex-convicts pursuant to agreements entered into between program participants and the Applicant. Department Ex. 1, pp. 9, 10, 12, 16, 19, 42. The purpose of the Applicant’s program is “to provide a Christian rehabilitation program and residential discipleship training for men and women.” Department Ex. 1, p. 16. The Applicant is exempt from Federal income tax pursuant to section 501(c)(3) of the Internal Revenue Code. Department Ex. 1, pp. 2, 4, 5.

The first step in determining whether the Applicant qualifies as an “institution of public charity” is to examine the language of its organizational documents. Morton Temple Association v. Department of Revenue, 158 Ill. App. 3d 794, 795-796 (3rd Dist. 1987). The Applicant’s Articles of Incorporation state *inter alia*, that it is organized, and is to be operated exclusively, for charitable and religious purposes. Department Ex. 1, p. 16. However mere “statements of the agents of an institution and the wording of its governing documents evidencing an intention to [engage in exclusively charitable activity] do not relieve such an institution of the burden of proof that ... [it] actually and factually [engaged in such activity].” Morton Temple Association, *supra* at 796. Therefore, “it is necessary to analyze the activities of the [Applicant] in order to determine whether it is a charitable organization as it purports to be in its charter.” *Id.*

A similar rationale applies to the Applicant’s showing that it is exempt from federal income tax pursuant to sections 501(a) and 501(c)(3) of the Internal Revenue Code. Department Ex.1, pp. 2, 4, 5. This exemption, standing alone or taken in conjunction with the statement in the Applicant’s Articles of Incorporation, does not establish that the Applicant actually operates for exclusively charitable purposes. *Cf.* People ex rel County Collector v. Hopedale Medical Foundation, 46 Ill. 2d 450, 464 (1970). Moreover, while this exemption establishes that the Applicant is a “charity” for purposes of section 501(a) pursuant to the federal government’s determination that it meets the criteria set forth in section 501(c)(3) of the Internal Revenue Code, these sections of the federal income tax law do not preempt section 35 **ILCS** 105/3-5(4), 35 **ILCS** 120/2-5(11), or other statutory provisions governing Illinois sales and use tax exemptions. Consequently, neither the Applicant’s federal tax exemption, nor the statement contained in the Applicant’s organizational document concerning its charitable purpose, are dispositive of its entitlement to exemption from use and related taxes under Illinois law.

As noted earlier, the Department denied the Applicant's request for issuance of an exemption identification number on September 7, 2018. Department Ex. 1, pp. 2, 3. The Department's initial tentative denial of the Applicant's application for an exemption identification number is presumed to be correct, and the Applicant has the burden of producing clear and convincing evidence proving that it is entitled to the exemption. See Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455, 459 (2nd Dist. 1995); Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773, 783 (1st Dist. 1987). To prove its case, an Applicant must present more than its testimony denying the Department's determination. Sprague v. Johnson, 195 Ill. App. 3d 798, 803, 804 (4th Dist. 1990). The Applicant must present sufficient documentary evidence to support its claim. *Id.* Moreover, it is well-settled that tax exemption provisions are strictly construed, and all doubts are resolved in favor of taxation. Heller v. Fergus Ford, Inc., 59 Ill. 2d 576, 579 (1975).

In both ROT and UT matters, the Illinois courts apply the same criteria when determining whether a given Applicant is an exempt organization as is applied for purposes of making this type of determination under the Property Tax Code (35 ILCS 200/1-1 *et seq.*). Yale Club of Chicago v. Department of Revenue, 214 Ill. App. 3d 468 (1st Dist. 1991).¹ The criteria to be applied in determining whether a given Applicant is an exclusively charitable organization were first articulated by the Illinois Supreme Court in Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 149, 156-57 (1968). In Methodist Old Peoples Home, the Illinois Supreme Court set forth five factors to be considered in assessing whether an organization is actually an institution of public charity. To qualify, an organization should (1) have no capital stock or shareholders; (2)

¹ In Yale Club of Chicago v. Department of Revenue, 214 Ill. App. 3d 468 (1st Dist. 1991), the court analyzed the taxpayer's claim for educational and charitable exemptions under the Retailers' Occupation Tax Act according to the body of case law developed for analysis of property tax exemptions.

earn no profits or dividends, but rather derive its funds mainly from public and private charity and hold such funds in trust for the objects and purposes expressed in its charter; (3) dispense charity to all who need and apply for it; (4) provide no gain or profit in a private sense to any person connected with it; and (5) appear to place no obstacles of any character in the way of those who need and would avail themselves of the charitable benefits it dispenses. Methodist Old Peoples Home, *supra* at 157.

These factors are not rigid requirements. Rather, they are to be considered with an overall focus on whether, and in what manner, the institution benefits an indefinite number of people, or serves the public interest and lessens the burdens of government. DuPage County Board of Review v. Joint Commission on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461 (2d Dist. 1995). Moreover, an institution need not provide any direct financial assistance to individuals to qualify as a charity. In Methodist Old Peoples Home, the Supreme Court stated, “charity is a gift to be applied ... for the benefit of an indefinite number of persons, persuading them to an educational or religious conviction, for their general welfare – or in some way reducing the burdens of government.” Methodist Old Peoples Home, *supra* at 157 (citing Crerar v. Williams, 145 Ill. 625 (1893)).

Applying these guidelines, I find that the Applicant has not presented clear and convincing evidence that it is, in fact, a charitable organization. One of the guidelines for determining if an organization qualifies as a charity is that its funds must be derived mainly from public and private charity. The Applicant’s unaudited financial statement for the period January 29, 2018 through June 30, 2018 shows that \$XXXX or approximately 51% of the Applicant’s total funding (reported on this financial statement as \$XXXX) is derived from “program fees.” Department Ex. 1, p. 31. The record in this case indicates that “program fees” are required

payments of \$XXX each month that persons accepted for participation in the Applicant’s program must pay in order to remain in the program. Tr. p. 33. The remainder of the Applicant’s funding identified in its unaudited financials, \$XXXX or approximately 49% of its funding, its derived from charitable contributions.

In its letter in support of its application for sales tax exemption, dated January 13, 2009, the Applicant argues that more than 50% of its support is from public or private charity when “in kind” donations of services from volunteer staff and the contribution of items are considered. Department Ex. 1, p. 7. In support of this claim, the Applicant has prepared a summary that shows the following:

Volunteer Hours and In-Kind Items

Volunteer Hours	Period	No. Hours	No. Periods	Total Hours	Hour -Value	Total Value	% of Total
<i>JOE SMITH</i>	month	100	5	500	\$12/Hour	\$6,000	
<i>JOHN</i>	month	100	5	500	\$12/Hour	\$6,000	
<i>JIM</i>	Week	4	22	588	\$300/Hour	\$26,400	
Total Value						\$38,400	65.60%*
In Kind items						\$700	1.19%

Department Ex.1, p. 11 (* 65.60% of Total Support for Applicant)

The record shows that the above-indicated summary was prepared on January 13, 2019 and is not a part of the Applicant’s unaudited financials. *Id.* Significantly, this document is dated the same day as the Applicant’s letter in support of its application for sales tax exemption noted above. See Department Ex. 1, pp. 6-8. The timing of this document strongly suggests that it was made in anticipation of the current litigation. A document is considered to be prepared in anticipation of litigation if it is prepared with an eye toward pending litigation of any kind. See In Re N.W., 293 Ill. App. 3d 794 (1st Dist. 1997); In Re A.B., 308 Ill. App. 3d 227 (2d Dist. 1999). Records made with a view toward possible litigation do not qualify as “made in the

ordinary course of business” and therefore usually constitute inadmissible hearsay evidence. See Kimble v. Earle Jorgenson Co., 358 Ill. App. 3d 400, 415 (1st Dist. 2005). Moreover, the Illinois courts have consistently held that evidence prepared in anticipation of litigation is entitled to no weight. Kelly v. HCI Heinz Construction Co., 282 Ill. App. 3d 36 (4th Dist. 1996); People v. Main Insurance Co., 114 Ill. App. 3d 334 (1st Dist. 1983).

Moreover, the Applicant’s summary noted above neither enumerates the nature of the services that were performed by the persons identified in the schedule as having donated “in kind” services nor indicates how it concluded what the value of these services should be. Nor does the Applicant’s summary explain the nature and cost of the items labelled “in kind” items. As previously noted, the Applicant bears the burden of proving by clear and convincing evidence that the exemption it is seeking applies. Wyndemere Retirement Community, *supra*; Clark Oil & Refining Corp., *supra*. The mere assertion of “in-kind” services and donations without an enumeration of how the value of these items and services was determined or what these items and services are is self-serving testimonial evidence that is neither clear nor convincing. For the foregoing reasons I find that the “in kind” services asserted by the Applicant to be 65.60% of the Applicant’s charitable receipts and donated “in kind” items must be disregarded in determining whether the Applicant’s support is derived mainly from public and private charity.

Disregarding the Applicant’s volunteer services and “in kind” donations of items identified in the summary noted above, I find that only 49% of the Applicant’s funding is from public and private charity. With the record showing that approximately 51% of the Applicant’s overall funding coming from fees charged participants in its program, I find that the Applicant has failed to prove that it derived its funds “mainly” from private and public charity.

Based on the evidence contained in the record, I also conclude that the Applicant has not shown that the benefits provided by the Applicant are dispensed to an indefinite number of persons or that the Applicant does not place obstacles to those who need and would avail themselves of the Applicant's benefits. Before persons are accepted into the Applicant's program they must sign an agreement that they will contribute \$350 a month from their income to the Applicant. Department Ex. 1, pp. 32-37 (Applicant's Housing Application). In order to facilitate meeting this requirement, they must also agree to obtain employment. Department Ex. 1, pp. 37, 43. Any charity dispensed by the Applicant is dispensed only to those who can initially meet the Applicant's monthly fee and employment requirements. Although charging fees for rendering benefits does not destroy the charitable nature of an organization, this is true only to the extent the organization also admits persons who need and seek the benefits offered but who are unable to pay. Small v. Pangle, 60 Ill. 2d 510 (1975). The record in this case contains no evidence that any persons who were unable to contribute the required monthly fee or gain employment were nevertheless accepted for participation in the Applicant's program.

In its letter supporting its application for sales tax exemption dated January 13, 2019, the Applicant references its admissions process outlined in a letter from its Director dated November 8, 2018 as proof that inability to pay is no barrier to participation because the Applicant usually agrees to waive the first and second month's contribution. Department Ex. 1, pp. 6-9. Although this waiver of fees lessens the barriers to participation in the Applicant's program, it does not change the fact that those who cannot agree to make the required monthly contribution are not accepted for participation. This is not dispensing charity to all who need it because a resident who is unable to contribute may be asked to leave after the waiver of fees for the first two months if he or she is still unable to pay. In this respect, in spite of its fee waivers, the

Applicant still places obstacles in the way of those who need and would avail themselves of its charity because of the participants' inability to stay in the Applicant's program more than two months without payment.

The record also contains evidence of additional obstacles to those who need and would avail themselves of the services the Applicant is dispensing. The record indicates that, in addition to agreeing to pay a monthly fee and obtain employment, program participants must also agree to attend church services, Bible study and accountability sessions, tithe from their income to a church of their choosing and arrange for their own health care services. Department Ex. 1, Pp. 40-43 (Applicant's Policy Handbook). Persons that cannot meet these requirements are also barred from participation in the Applicant's program.

In sum, for all of the reasons given above, I must conclude that several key indicia of a charitable institution enumerated in Methodist Old Peoples' Home, *supra* are not met because the record shows that the Applicant does not derive support primarily from public and private charity, and the Applicant has not shown that its benefits are available to an indefinite number of persons or that the Applicant does not place obstacles to those who need and would apply for them.

The record clearly indicates that the Applicant has no stock or shareholders. Moreover, while the Applicant made a small profit, none of its staff members or Directors are paid. For this reason, I conclude that the Applicant is not providing gain or loss in a private sense to any person connected with the organization. The record also shows that the Applicant may indeed be reducing the burden on government by caring for and housing ex-convicts and ex-felons who might otherwise be relying on government. However, in balancing these characteristics favorable to assessing the Applicant as a charitable organization against the characteristics that

do not support a favorable assessment discussed above, I must conclude that the Applicant has failed to prove that it is a charitable organization.

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

Ted Sherrod
Administrative Law Judge

Date: July 19, 2019