

ST 10-16

Tax Type: Sales Tax

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

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

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

v.

**ABC PUBLIC
TRANSPORTATION, NFP
Taxpayer**

Docket # 10-ST-0000

Claim for Exemption Number

RECOMMENDATION FOR DISPOSITION

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; George C. Wood of Hartweg, Turner & Wood, P.C. for ABC Public Transportation, NFP

Synopsis:

ABC Public Transportation, NFP (“taxpayer”) sent an application to the Department of Revenue (“Department”) for an exemption identification number in order to purchase tangible personal property at retail free from the imposition of retailers’ occupation and use taxes. The Department denied the application, and the taxpayer timely protested the denial. An evidentiary hearing was held during which the issue presented was whether the taxpayer is organized and operated 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 ILCS 120/2-5(11)).

The taxpayer operates a public bus system, which is used primarily by seniors and disabled people. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer is an Illinois not-for-profit corporation that was organized on March 24, 2009. (Taxpayer Ex. #1, pp. 4-6)
2. The taxpayer provides public transportation to residents of all of DeWitt, Ford, Iroquois, and Livingston Counties, and it provides public transportation to residents of rural Kankakee and McLean Counties. (Taxpayer Ex. #8 pp. 2, 4, 6, 8, 10, 12; Tr. p. 11)
3. According to its articles of incorporation, the taxpayer is organized for civic and charitable purposes. (Taxpayer Ex. #1, p. 4)
4. The taxpayer's specific purpose is "to enhance access of people in non-urbanized areas to healthcare, employment, education, public services, shopping, recreation, and other transportation services and to encourage coordination of programs and services in order to improve public transportation and to improve services to the transportation disadvantaged. While these services are intended to benefit all populations, target populations include the elderly and those with disabilities in the greatest economic need." (Taxpayer Ex. #1, p. 2; Tr. pp. 16, 19)
5. Persons of all ages and income levels may ride the taxpayer's buses. All buses are equipped with lifts for easy wheelchair access. (Taxpayer Ex. #8 pp. 2, 4, 6, 8, 10, 12)
6. The taxpayer primarily operates a "demand response" system, which means the taxpayer has published routes, and individuals call to make reservations on those routes.

Reservations can be made by calling one of two toll free phone numbers. (Taxpayer Ex. #4, p. 1, #8 pp. 2, 4, 6, 8, 10, 12; Tr. pp. 38, 42)

7. The taxpayer also operates two “deviated fixed” routes: one is in Pontiac, Illinois and stops at 19 set stops each hour, and the other is between Kankakee and Momence, Illinois and runs a set route each hour. In addition, if a person has a special medical need that cannot be accommodated through the scheduled days of service, the person can call the taxpayer and make special arrangements. (Taxpayer Ex. #4, pp. 1-2, #8, pp. 3, 5, 7, 9, 11)
8. Passengers are picked up at central community locations. Pick-ups at home are possible on a limited basis. Buses arrive at scheduled times, and persons riding on scheduled days can request more than one stop in the destination city with no additional charge. (Taxpayer Ex. #8 pp. 2, 4, 6, 8, 10, 12)
9. The taxpayer accepts Medicaid and insurance billings. When a person calls for a reservation, the taxpayer asks the person to complete a registration form, but it is not a requirement to ride the bus. The taxpayer obtains information from the passenger, including whether Medicaid will pay for the rides. If the passenger is a Medicaid recipient, the taxpayer will attempt to collect the fees from the State. (Taxpayer Ex. #8, pp. 3, 5, 7, 9, 11; Tr. pp. 38, 43)
10. The round trip charges that are advertised in the taxpayer’s brochures vary between \$2.00 for bus stop service within Pontiac, Illinois or rural Kankakee County to \$15.00 for a trip from Iroquois County to Champaign/Urbana. The average charge is \$5.00 on scheduled days within a county and \$7.00 for scheduled days outside a county. (Taxpayer Ex. #8 pp. 2, 4, 6, 8, 10, 12)

11. With respect to the charges, the brochures for DeWitt, Ford, Livingston, and McLean Counties state that “[t]hese are **suggested donations** for persons 60 years of age and over. These are **fees** for anyone less than 60 years of age” (emphasis in original). The brochure for Iroquois County does not include this language but states “[a]sk about special fares for children under 12.”¹ The brochure for Kankakee County does not include anything about reduced charges or suggested donations. (Taxpayer Ex. #8 pp. 2, 4, 6, 8, 10, 12)
12. The taxpayer’s by laws do not include a fee waiver policy. (Taxpayer Ex. #1, pp. 7-17; Tr. p. 39)
13. The taxpayer previously operated as a program under the not-for-profit entity XYZ Retirement Community, Inc. (“XYZ”) since 1979. (Taxpayer Ex. #1, pp. 33, 54)
14. While the taxpayer operated under XYZ, it was required to maintain its financial information on a calendar year basis. After it became a separate entity, the taxpayer changed from a calendar year to a fiscal year; the initial fiscal year of the corporation was July 1, 2009 to June 30, 2010. (Dept. Ex. #1, p. 8; Taxpayer Ex. #1, p. 14)
15. During the past several years, the taxpayer has maintained separate bank accounts, financial records, budgets and assets from XYZ. (Taxpayer Ex. #1, p. 33)
16. The audited financial statements for the year ending December 31, 2008 showed the following for the years 2008 and 2007 under the Statement of Activities²:

2008	2007
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PUBLIC SUPPORT AND REVENUE

¹ The testimony indicated that the fares in Iroquois County are now the same as those in DeWitt, Ford, Livingston, and McLean Counties because the taxpayer now receives Title III funding for Iroquois County. (Tr. pp. 21-22; 26, 34-35)

² The audit for the fiscal year ending June 30, 2010 had not been started at the time of the hearing. (Tr. p. 46)

Federal Title III grants	\$ 49,106	23,425
Section 5311 operating grants ³	607,237	392,280
Downstate public transportation operating assistance grant	372,895	116,185
Program income	158,926	126,806
Local contributions		
Churches, civic groups, local governments, and individuals	31,890	61,112
United Way of McLean County	-	50,800
Other United Way	5,000	4,500
In-kind donations	556,511	66,666
Interest Income	<u>729</u>	<u>772</u>
 Total Income	 1,782,294	 842,546

PROGRAM EXPENSES

Salaries, fringe benefits and payroll taxes	344,204	214,768
Fuel and lubricants	148,656	81,740
Rent – buildings and other	32,105	29,877
Rent – transportation equipment	215,575	184,971
Maintenance	74,749	41,591
Registration and licenses	706	150
Insurance	94,978	67,663
Depreciation	11,340	10,409
Tires	7,185	3,387
Utilities	1,886	1,304
Supplies	5,966	1,851
Professional and technical services	109	-
Interest	16,402	15,546
Miscellaneous	4,327	-

MANAGEMENT AND GENERAL EXPENSES

Salaries, fringe benefits and payroll taxes	227,668	151,989
Rent	12,927	8,955
Temporary help	1,023	-
Telephone	15,661	9,965
Office supplies	20,431	9,641
Professional services	16,675	16,236
Bad debt	-	11,553
Miscellaneous	<u>14,094</u>	<u>8,555</u>

³ These grants are administered by the Illinois Department of Transportation pursuant to section 5311 of the Federal Transit Act of 1991. (Taxpayer Ex. #8, p. 15)

Total expenses	1,266,667	870,151
CHANGE IN NET ASSETS (Taxpayer Ex. #4, pp. 9-10)	515,627	(27,605)

17. The audited financial statements include the following under a note titled “Receivables”:

The allowance for doubtful accounts is established as losses are estimated to have occurred through a provision for bad debts charged to earnings. Losses are charged against the allowance when management believes the uncollectibility of a receivable is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for doubtful accounts is evaluated on a regular basis by management and is based on historical experience and specifically identified questionable receivables. The evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Management believes their estimated allowance for doubtful accounts of \$4,968 and \$11,553 at December 31, 2008 and 2007, respectively, are reasonable. (Taxpayer Ex. #4, p. 13)

18. The audited financial statements also include the following under a note titled “Grant Revenues”:

Grants which are in substance purchase of service agreements, rather than contributions, are recognized as revenue when the grant expenses are incurred. The Federal Title III, downstate public transportation operating assistance, and Section 5311 grants are accounted for as purchase of service agreements. Any such grant funds received in advance are reflected as deferred grant revenues in the accompanying statement of financial position. (Taxpayer Ex. #4, p. 13)

19. The taxpayer has no capital, capital stock, or shareholders and is exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code pursuant to a determination made by the IRS. (Taxpayer Ex. #1, pp. 4-6, 18-19)

CONCLUSIONS OF LAW:

The Use Tax Act (“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(4) of the Act provides a list of tangible personal property that is exempt from the tax, and includes the following:

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 and 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 ("ROTA") (35 ILCS 120/1 *et seq.*) contains a similar provision. See 35 ILCS 120/2-5(11).

In order to determine whether the taxpayer is organized and operated exclusively for charitable purposes, the following guidelines are considered: (1) whether the organization's gift benefits an indefinite number of people, persuading them to an educational or religious conviction, for their general welfare or in some way reducing the burdens of government; (2) whether the organization has no capital, capital stock or shareholders and earns no profits or dividends; (3) whether the organization's funds are derived mainly from public and private charity and are held in trust for the objects and purposes expressed in its charter; (4) whether charity is dispensed to all who need and apply for it and without obstacles of any character in the way of those who need and would avail themselves of the charitable benefits dispensed; (5) whether the organization does not provide gain or profit in a private sense to any person connected with it; and (6) whether the primary purpose for which the property is used and not any secondary or incidental purpose is charitable. Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 139, 156-57 (1968); Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455, 459 (2nd Dist. 1995). These factors are balanced with an overall focus on whether and how the organization serves the public interest and lessens the State's burden. Du Page County Board of Review v. Joint Commission on Accreditation of Healthcare

Organizations, 274 Ill. App. 3d 461, 466 (2nd Dist. 1995). Whether an institution has been organized and is operating exclusively for an exempt purpose is determined from its charter, bylaws and the actual facts relating to its method of operation. *Id.*

It is well-settled that tax exemption provisions are strictly construed in favor of taxation. Heller v. Fergus Ford, Inc., 59 Ill. 2d 576, 579 (1975). All facts are construed and all doubts are resolved in favor of requiring the tax to be paid. *Id.* The taxpayer has the burden of proving by clear and convincing evidence that it is entitled to the exemption. Wyndemere, supra; Gas Research Institute v. Department of Revenue, 154 Ill. App. 3d 430, 436 (1st Dist. 1987). To prove its case, a taxpayer must present more than its testimony denying the Department's determination. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217 (1st Dist. 1991); Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990). The taxpayer must present sufficient documentary evidence to support its claim. *Id.*

The taxpayer argues that it qualifies for an exemption because it meets the guidelines in Methodist Old Peoples Home, supra. The taxpayer states that according to the testimony, no one has been denied transportation if they are unable to pay the fee. The taxpayer also states that an organization that charges fees does not lose its charitable character if no profit is made and the amounts are applied toward the charitable purpose. Decatur Sports Foundation v. Department of Revenue, 177 Ill. App. 3d 696, 711 (4th Dist. 1988). The taxpayer claims that it does not earn a profit, and all its money is applied towards its charitable purpose. In addition, less than 1% of its income is actually from fees; the majority of its income is from public funding, and nobody over 60 is charged a fee. "Charging fees and rendering benefits to persons not poverty-stricken does not destroy the charitable nature of an organization, but this is only true to the extent that the organization also admits persons who need and seek the benefits offered but are unable to pay."

Wyndemere, at 460. The taxpayer believes that it provides benefits to those who are unable to pay.

The taxpayer also states that to qualify for an exemption, the charitable benefit must either relieve the public of an obligation that it would have to such beneficiaries, or it must confer some benefit on the public. Gas Research Institute, at 435, citing 86 Ill. Admin. Code §130.2005(i)(2). The taxpayer contends that with respect to reducing a governmental burden, one must first prove a government duty exists. See Rogy's New Generation, Inc. v. Department of Revenue, 318 Ill. App. 3d 765, 772 (1st Dist. 2000). In the present case, the taxpayer claims that both state and federal law provide grants and subsidies for non-urban public transportation systems, and the taxpayer is reducing the governmental burden of providing public transportation. Furthermore, the taxpayer contends that under the new healthcare legislation, public transportation is mandatory.

Notwithstanding the taxpayer's averments, the evidence does not support a finding that the taxpayer meets most of the guidelines in Methodist Old Peoples Home, *supra*. Although the taxpayer does not have capital, capital stock or shareholders, the evidence does not show that its income is derived mainly from public or private charity. During 2008, the taxpayer received a total of \$593,401 from donations, which is approximately 33% of the total income of \$1,782,294. Other than a small amount of interest income, the remaining income was from grants and program income. "Grant" income may be public charity; to determine whether it is, a distinction is made between payments from the government that are contributions and payments from the government that are fees received pursuant to contracts for service. If the income is a government contribution rather than payment for services, it is considered to be public charity.

In the present case, one of the notes to the taxpayer's audited financial statements indicates that the grant income that the taxpayer received was payment for services rather than a contribution. The note states, in part, that "[g]rants which are in substance purchase of service agreements, rather than contributions, are recognized as revenue when the grant expenses are incurred. The Federal Title III, downstate public transportation operating assistance, and Section 5311 grants are accounted for as purchase of service agreements." Because these grants are considered to be purchases of service agreements, the income cannot be considered public charity. Furthermore, the fact that the taxpayer's income is ultimately used for its charitable purposes does not warrant a finding that the taxpayer operates for charitable purposes. See Salvation Army v. Department of Revenue, 170 Ill. App. 3d 336, 344 (2nd Dist. 1988).

Even though the taxpayer's primary funding source is not public or private charity, this factor, by itself, is not dispositive. Provena Covenant Medical Center v. Department of Revenue, 384 Ill. App. 3d 734, 746 (4th Dist. 2008), *aff'd*, 236 Ill. 2d 368 (2010), citing American College of Surgeons v. Korzen, 36 Ill. 2d 340, 348 (1967). Nevertheless, the taxpayer has failed to meet other factors that courts have considered to be essential criteria. The court in Provena, *supra*, stated that the criteria of dispensing charity to all who need and apply for it and placing no obstacles in their way "go to the heart of what it means to be a charitable institution." Provena at 750.

Although the testimony indicated that the taxpayer provides rides to those who are unable to pay (tr. p. 25), the documents that were presented at the hearing do not reflect this policy. The bylaws do not include a provision that the taxpayer will waive fees for those who cannot afford to pay them. The brochures that were provided indicate that the fees are "suggested donations" for those who are 60 years of age or older, but this policy does not apply to riders in Kankakee

County, and anyone in all of the counties who is under 60 years of age is expected to pay the fees. If the taxpayer has a policy, as it claims, of waiving fees for anyone who is unable to pay them, then the taxpayer's failure to notify the public of this policy is considered an obstacle in the way of those seeking charity. See Alivio Medical Center v. Department of Revenue, 299 Ill. App. 3d 647, 652 (1st Dist. 1998).

Other evidence suggests that the taxpayer may not follow a policy of waiving fees. The taxpayer indicated that it "walk[s] a fine line" (tr. pp. 22, 39) with respect to the fee waiver policy because the taxpayer is "required by [its] federal funding source to attempt to collect fares." (Tr. p. 39) The taxpayer "would not be able to operate without state and federal money" (tr. p. 38), and the taxpayer, therefore, attempts to collect fees from its passengers. The charging of fees does not automatically disqualify an organization as charitable as long as it furnishes its services to those who are unable to pay. Small v. Pangle, 60 Ill. 2d 510, 515-516 (1975). The taxpayer, however, has not clearly established that it allows free rides for those who are unable to pay. The taxpayer's Statement of Activities includes a "Bad debt" expense, which was \$11,553 for the year 2007. The note to the financial statements states, in part, that "[I]osses are charged against the allowance when management believes the uncollectibility of a receivable is confirmed." Writing off a bad debt is not the same as providing charity. Alivio Medical Center, *supra*. The taxpayer did not provide any evidence explaining the circumstances surrounding these write-offs, such as whether the receivable was for a passenger who had the ability to pay the fees. Because the taxpayer's Statement of Activities includes a bad debt expense and not a charitable expense, it appears that the taxpayer attempts to collect fees from all of its passengers, regardless of their ability to pay. Charity is a gift (Methodist Old Peoples Home, at 156), and

whether the taxpayer's "free services" are gifts rather than debt that cannot be collected has not been clearly established.

As previously mentioned, exemption provisions are strictly construed, and all doubts must be resolved in favor of taxation. See Wyndemere, *supra*. There is uncertainty in the record concerning the extent of the taxpayer's charitable acts. The evidence presented by the taxpayer does not clearly and convincingly show that the taxpayer provides charity to everyone who needs it and that it does not place obstacles in the way of those seeking charity. The taxpayer undoubtedly provides a useful service to the residents of the communities in which it operates. The taxpayer's operations are laudable, but laudable acts do not necessarily constitute charity. See Rogers Park Post No. 108, American Legion v. Brenza, 8 Ill. 2d 286, 291 (1956). Because the evidence presented in this case falls short of showing clearly and convincingly that the taxpayer is organized and operated exclusively for charitable purposes, the request for an exemption must be denied.

Recommendation:

For the foregoing reasons, it is recommended that the taxpayer's request for an exemption identification number be denied.

Linda Olivero
Administrative Law Judge

Enter: November 10, 2010