

ST 11-15

Tax Type: Sales 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 FOUNDATION,
Applicant.**

) Docket No. XXXXXXXX
)
) Sales Tax Exemption
)
)
) Julie-April Montgomery
) Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: John Doe of Big, Bigger & Biggest, Ltd. for ABC Foundation; John Alshuler, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

The Illinois Department of Revenue (“Department”) twice denied ABC Foundation’s (“Applicant”) request for an exemption so that it could purchase tangible personal property at retail, free from imposition of the retailers’ occupation tax. The Applicant protested the Department’s Second Denial of Sales Tax Exemption (“Denial”) and requested a hearing.

At issue is whether the Applicant qualifies for the charitable exemption stated in section 2-5(11) of the Retailers’ Occupation Tax Act (“ROTA”) (35 ILCS 120/1 *et seq.*). August 10, 2010 Order. The Applicant submitted documentary and testimonial evidence. The Department presented documentary evidence. Following the submission of all

evidence and a review of the record, it is recommended that the Denial be affirmed. In support thereof, are made the following findings of fact and conclusions of law.

Findings of Fact:

1. The Department's case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Denial letter dated September 1, 2009. Department Ex. No. 1; Tr. p. 8.
2. The Internal Revenue Service ("IRS") classifies the Applicant as a section 501(c)(3) entity exempt from federal income tax. Applicant Ex. No. 1 (August 20, 2008 IRS letter); Tr. p. 11.
3. The Applicant's stated purpose is to operate as a charitable entity that funds programs which provide children/youth education and practical support; create solutions on key community/social issues; and provide access to continuous learning that is both academic and practical for adults. Applicant Ex. No. 1 (Articles of Incorporation, Art. 4, sec. 1, Bylaws Art. I, sec. 3); Tr. pp. 11-13.
4. The Applicant has a funding grant program. In 2009, the Black & White Clubs of Chicago, Red Club ("Club") was awarded \$350,000 under this program. Applicant Ex. Nos. 2 (Application for Funding), 4 (Jane Doe Affidavit of Applicant's 2009 income and expenses); Tr. pp. 13-14, 19, 29.
5. The Applicant's \$350,000 grant to Club funds the following programs: Character and Leadership Development; Education and Career Development; Health and Life Skills; the Arts; Sports, Fitness and Recreation; the ABC Scholarship program; and the Emergency Fund. Applicant Ex. No. 2.
6. The Applicant has a "Painting a Brighter Future" program in which up to 40

- gallons of paint can be awarded to public or private elementary and/or high schools that are at least 10 years old. Ninety (90) schools received this award in 2009. Tr. pp. 16, 24-26.
7. The Applicant provided thirty-five (35) scholarships to ABC employees' children as well as forty-three (43) scholarships to the children of the owners of ABC retail stores in 2009. Tr. pp. 16, 23.
 8. The Applicant has a web site that publicizes its various programs. Tr. pp. 15, 27.
 9. ABC's 5,000 retail member stores assist in advertising the Applicant's grant programs. Tr. p. 15.
 10. While the Applicant's golf fund raiser is open to the public, ABC's vendors and outside service providers are the Applicant's main targets for this event. Tr. p. 27.
 11. In 2009, the Applicant received \$754,958 from a golf-outing fundraiser and \$109,619 in donations for a grand total of \$864,577. Applicant Ex. No. 4; Tr. pp. 18-20.
 12. In 2009, the Applicant spent \$30,306 on its management and operations, as well as, \$322,524 on production of the golf-outing fundraiser for a grand total of \$352,830 in expenses. Applicant Ex. No. 4.
 13. In 2009, the Applicant distributed \$350,000 as a funding grant to Club, \$99,800 in scholarships and \$48,875 for paint to schools for a grand total of \$498,675. *Id.*
 14. The Applicant's directors and officers are paid no salaries and cannot participate in the award projects of Applicant like the scholarship program. Applicant Ex. No. 1 (Articles of Incorporation, Art 5, sec. (3), Bylaws, Art. VIII, sec. 4); Tr. pp. 20-21, 23.

15. The Applicant has no capital, capital stock or shareholders. Tr. pp. 18, 31.
16. The Applicant's directors and officers can be party to a contract or transaction in which they have a financial interest if such contract or transaction is deemed fair to the Applicant when "authorized, approved or ratified." Applicant Ex. No. 1(Bylaws, Art. VI, sec. 1).
17. It is within the Applicant's "Absolute discretion" to determine who will receive financial assistance. Applicant Ex. No. 1(Bylaws, Art. XI, sec. 7).

Conclusions of Law:

The ROTA (35 ILCS 120/1 *et seq.*) imposes tax upon persons engaged in sales of tangible personal property at retail. 35 ILCS 120/2. Section 2-5 of this Act provides a list of sales that are exempt from tax, and includes "[p]ersonal property sold to...a corporation, society, association, foundation, or institution organized and operated exclusively for charitable...purposes." 35 ILCS 120/2-5(11).

It is well established in Illinois that there is a presumption against exemption and therefore, "exemptions are to be strictly construed" with any doubts concerning the applicability of an exemption "resolved in favor of taxation." Van's Material Co. Inc. v. Department of Revenue, 131 Ill. 2d 196 (1989). The Department's Denial of a request for an exemption is presumed correct, and an applicant has the burden of clearly and conclusively proving entitlement to the exemption. Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455, 459-60 (2nd Dist. 1995). To prove its case, an applicant must present more than testimony which denies the Department's determination. An applicant must present sufficient documentary evidence to support its exemption request. Sprague v. Johnson, 195 Ill. App. 3d 798 (4th Dist. 1990). In fact, the

applicant bears the burden of proving by “clear and convincing” evidence the exemption applies. Evangelical Hospitals Corp. v. Department of Revenue, 223 Ill. App. 3d 225 (2nd Dist. 1991).

Although it was a case that involved a property tax exemption, Illinois courts have used the guidelines set forth in Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 149 (1968), to determine whether an entity qualifies as exempt from ROTA. Wyndemere Retirement Community, *supra* at 459-460. These guidelines are that the entity: 1) benefit an indefinite number of people for their general welfare or in some way reduces the burdens of government; 2) has no capital, capital stock, or shareholders; 3) earns no profit or dividends, but rather derives its funds mainly from private and public charity, and holds them in trust for the objects and purposes expressed in the organization's charter; 4) does not provide gain or profit in a private sense to any person connected with it; 5) dispenses charity to all who need and apply for it; and 6) places no obstacles in the way of those seeking the benefits. Korzen, *supra* at 156-157. These are guidelines for the assessment of whether an entity is a charity, but they are not definitive. These guidelines are balanced with an overall focus on whether and how the organization serves the public interest and lessens the State’s burden. DuPage County Board of Review v. Joint Commission on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461, 466 (2nd Dist. 1995). In addition, the entity’s primary purpose must be charitable. Korzen, *supra* at 157.

An “exclusively” charitable purpose need not be interpreted as the entity’s sole purpose but rather is interpreted to mean the primary purpose, and not a purpose that is incidental or secondary. Gas Research Institute v. Department of Revenue, 154 Ill. App.

3d 430 (1st Dist. 1987). Whether the entity has been organized and is operating exclusively for an exempt purpose is determined from its charter, bylaws and the actual facts that relate to its method of operation. DuPage County Board, *supra* at 466.

At hearing, the Department introduced a copy of its Denial under the certificate of the Director of Revenue. Department Ex. No. 1; Tr. p. 8. The Applicant then responded with documents and testimony which it believed would show its entitlement to the exemption and compliance with the Korzen guidelines.

The first Korzen guideline addresses whether a benefit is conferred on an indefinite number of persons for the general good so that government's burden is relieved or lessened. Guidance on this point is found in a Department regulation which provides:

i) Other Conditions Necessary for Being Exclusively Charitable

2) The Supreme Court has stated that a charitable purpose may refer to almost anything which promotes the well-being of society and which is not forbidden by law; but to qualify as a charity, the purchaser must be organized and operated to benefit an indefinite number of the public. There may be restrictions on the group to be benefited (such as an organization for women, for children, for the aged, etc.), but the service rendered to those eligible for benefits must, nevertheless, in some way relieve the public of a duty which it would have to such beneficiaries or otherwise confer some benefit on the public. 86 Ill. Admin. Code, sec. 2005(i)(2).

Pursuant to this regulation, schools 10 years or older represent a permissible grouping. However, this regulation and the first Korzen guideline also require that the Applicant's grant of paint relieve or lessen a public duty or confer a public benefit. The Applicant presented no evidence regarding the relief or lessening of a public duty or conference of a public benefit as a result of its paint program.

The Applicant also provides the children of ABC employees and owners of ABC retail stores who are under 22 years of age scholarships. Only members of the ABC family –employees and retail store owners and their children—benefit from the scholarship program because the parent saves money when a scholarship is awarded to their child and the child awarded the scholarship has funds for school. The primary beneficiaries of the ABC Foundation’s scholarships are members of the ABC family who are the employees and owners of ABC stores as well as their children and not the general public. As only members of the ABC family benefit from the scholarship program, the Applicant will not be entitled to an exemption. Morton Temple Association, Inc. v. The Department of Revenue, 158 Ill. App. 3d 542 (1987). It is also clear that the scholarship program is not organized and operated to benefit an indefinite number of the public consistent with Department regulation section 2005(i)(2) of 86 Ill. Admin. Code and Korzen, *supra*. Lastly, only one Black and White Club received funds from the Applicant but no evidence was presented to show the standards utilized to determine Club’s eligibility for such funding. This lack of standards means that the record does not reveal whether or not the award was given to a permissible grouping.

The lack of a permissible grouping for most of the Applicant’s programs along with the fact that the Applicant’s various awards were not shown to confer a benefit to an indefinite number of persons nor provide relief or the lessening of a public duty or conference of a public benefit shows that the first Korzen guideline is not met. This is significant because the Illinois Appellate Court has found this particular guideline to be “more than a guideline; [because] it describes what charity essentially is.” Provena Covenant Medical Center v. Department of Revenue, 384 Ill. App. 3d 734, 743 (4th Dist.

2008) *aff'd*. 236 Ill. 2d 368 (2010), and as such, the fact that this guideline is not met weighs heavily against the Applicant.

The parties agree the Applicant has no capital, capital stock or shareholders. Tr. pp. 18, 31. Hence, the second Korzen guideline is met.

With respect to the third Korzen guideline the record reveals that the Applicant receives all of its revenue from a golf-outing fundraiser, donations and contributions. Applicant Ex. No. 4; Tr. p. 20. These monies are used to achieve the Applicant's purpose as expressed in its bylaws to provide education to children/adults and create solutions for community/social issues. Applicant Ex. No. 1; Tr. p. 13. In 2009, the Applicant fulfilled these stated purposes by the award of scholarships and a funding grant, as well as, the provision of paint to schools. Applicant Ex. No. 4; Tr. pp. 18-20. During this same period, the Applicant used approximately ninety-seven percent (97%) of its revenue, after expenses, to achieve these purposes. Applicant Ex. No. 4; Tr. pp. 20, 29. In light of all of this, it is found that the Applicant: 1) spent the vast majority of its net revenue on its programs; 2) obtained its funding through public/private charity; and 3) used the vast majority of its income for the purposes stated in its bylaws. However, it is not clear what these remaining excess revenues of three percent (3%) or \$13,072 in the Applicant's coffers after expenses were to be expended on, held for or represented. While one may set aside funds for contingency purposes or even operations, no evidence was presented to show that this was the case with regard to these monies by the Applicant. *See Quad Cities Open, Inc. v. The City of Silvis*, 208 Ill. 2d 498 (2004). Neither was there an explanation given as to either the purpose or disposition of this money. In addition, it is doubtful that said funds were used for the Applicant's operating expenses inasmuch as

the Applicant stated it expended \$30,306 for its management and operations and \$322,524 on the production of its golf fundraiser thereby fully accounting for its expenses. Moreover, it is unknown whether these funds were earmarked for the Applicant's programs. The record is also unclear as to whether these funds were retained to further the Applicant's charitable purposes. In the absence of financial records that answer these questions the doubt regarding this money is resolved in favor of taxation. It therefore cannot be concluded that the third Korzen guideline is met. This, however, is a guideline which the Appellate Court finds "wan[ing] in importance." Provena at 743.

The Applicant's officers and directors do not participate in the Applicant's paint, scholarship and money grant programs. Applicant Ex. No. 1; Tr. pp. 20-21, 23. Moreover, the Applicant's officers and directors do not receive salaries. Id. However, it cannot be found that the fourth Korzen guideline requiring the Applicant not provide profit or gain in a private sense to any person connected with it is met. This is because only the children of ABC employees and retail store owners may participate in, and as such qualify for, the scholarship program so that only those having a membership connection with the Applicant benefit from the scholarship program. In fact, the record reveals that 156 individuals associated with the Applicant (78 employees/retail store owners and 78 of their children) gained from this program in 2009.

In addition, no evidence was presented to show whether or not the Applicant's officers and/or directors were party to a contract or transaction with the Applicant in which they had a financial interest, as such involvement is permitted by the bylaws.

The fifth and sixth Korzen guidelines have been deemed “closely related” and “essential criteria” by the Illinois Appellate Court. Provena at 750. So it will be significant whether the Applicant meets these guidelines.

Examination of Applicant’s paint program reveals that not every school that applied for paint received paint. Standards that determined who would receive paint and how much paint would be received were not disclosed. There is nothing in the record to explain why only 90 schools were chosen when 245 schools applied for paint. There is no indication of what procedures the Applicant used to ascertain an applicant’s need for paint. Without knowledge of the standards utilized for such selections it cannot be concluded that all in need who applied received paint. This is of importance because the Applicant had excess funds during the year at issue which could have been given to some of the schools seeking paint who were rejected.

The Applicant also presented no evidence as to the standards utilized for selection of scholarship recipients and the Club nor evidence as to the basis for a determination of the amounts of money to be awarded for scholarships and a money grant. In light of this lack of evidence regarding standards it cannot be determined how it was decided whether one should receive one of the Applicant’s scholarships or money awards as well as whether all in need who applied to the Applicant’s programs received a scholarship or money award.

The Applicant failed to show that all in need who applied to their programs were granted the particular award –be it paint, a scholarship or money grant. Inasmuch as exemptions are “strictly construed in favor of taxation and against exemption; the exemption claimant must prove clearly and conclusively its entitlement ... [with] all

debatable questions resolved in favor of taxation.” Wyndemere Retirement Community, *supra* at 459. In light of this, it must be found that the Applicant does not meet the fifth Korzen guideline which is an essential criterion.

- The lack of standards for the Applicant’s awards of paint, scholarships and money grants also leaves unanswered whether or not the Applicant’s selection standards, whatever they may be, posed barriers to those who applied. No information was presented on how the Applicant decided who would receive an award under one of its programs. No information was put forth on who applied for paint and money grants and was denied. The record does not reveal whether preference was given to certain types of schools for paint? Were scholarships awarded to a subgroup within the ABC family such as to managers’ children? What was the basis for selection of the money grant so that only one Black and White Club benefitted? How was a determination made of the amounts to be awarded? Inasmuch as the Applicant presented no evidence as to the standards utilized to select paint awardees, scholarship recipients and money grantees, it cannot be clearly and convincingly found that no barriers to such awards existed. In fact, the record is clear that a barrier exists for scholarships because they are only awarded to those with a specific ABC connection –children of ABC employees and retail store owners. The record also implies the existence of a barrier for paint awards because not all applicants for paint became recipients. Hence, the sixth Korzen guideline, which is another essential criterion, is not met.

The Department avers that the restriction of scholarships to only children with a ABC association does not reflect a “gift dispensed to all who need or apply for it.” Tr. p. 33. The Applicant responds that the “pool [of scholarship applicants] was sufficiently large to constitute a charitable class.” Tr. p. 39. In addition, the Applicant implies that the limitation of scholarship awardees to children with a ABC association poses obstacles that are not significant when a large charitable class exists. Tr. pp. 7, 39. But the Applicant presented no evidence as to how many children formed the scholarship class. However, the Applicant made clear that its scholarship awards were limited to children in the ABC community. Tr. p. 28. As previously stated, restrictions can be placed on a group that is to benefit from charity pursuant to Department regulation section 2005(i)(2) of 86 Ill. Admin. Code which requires the restriction be very broad -- like women, men, everyone under 22 years of age. The grouping’s applicants must also not have any connection with the awarder. Korzen, *supra* at 157. In this case the Applicant has not created a permissible class for its scholarship program nor is the Applicant independent of such class as required. In addition, whether the Applicant has permissible classes or not for its paint and money grant programs, it cannot be said that the Applicant is independent of such programs’ applicants. Moreover, because the Applicant provided no evidence of standards for the giving of its award that explain how an applicant becomes an awardee, be it for a scholarship, paint or money grant, it cannot be found that money grants and paint awards are made to all who need and apply for them without obstacles. However, the record is clear that the scholarship program has obstacles because a potential awardee must be a child associated with ABC.

When evaluating the Applicant's primary purpose it should be noted that the Appellate Court has stated whether one's primary purpose is charitable to be "*sine qua non*" or an indispensable requisite or condition. Provena at 743. The Applicant's articles of incorporation and by-laws state that it will operate exclusively for charitable purposes. Applicant Ex. No. 1; Tr. p. 13. Hence, the Applicant's stated primary purpose is charitable. But the Applicant must do more than talk of having a primary charitable purpose, it must also present evidence that its activities are in fact charitable. Korzen at 542. In 2009, the Applicant made donations of paint to various schools; awarded scholarships; and presented a financial grant to Club. All of these activities are consistent with the Applicant's stated goal of having a primary purpose that is charitable.

However, the Applicant did not produce evidence to establish that it met five of the six Korzen guidelines. All of this outweighs the fact that the Applicant's stated primary purpose and activities are charitable.

Inasmuch as all but one of the Korzen guidelines have been met, it must be found that the Applicant has not presented clear and convincing evidence that it qualifies for the Illinois sales tax exemption as a charitable organization. Hence, the Applicant's request for exemption must be denied.

Conclusion:

In light of the above, it is recommended that the Department's Denial of the Applicant's application for exemption be affirmed.

November 17, 2011

Julie-April Montgomery

Julie-April Montgomery
Administrative Law Judge

