

ST 13-12

Tax Type: Sales Tax

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 BUSINESS, LLC d/b/a
XYZ CENTER**

Taxpayer

Docket # XXXX

Claim for Exemption Number

RECOMMENDATION FOR DISPOSITION

Appearances: Robin Gill, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Sarah J. Taylor of Barrett, Twomey, Broom, Hughes & Hoke, LLP for ABC Business, LLC d/b/a XYZ Center.

Synopsis:

ABC Business, LLC d/b/a XYZ Center (“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 an intermediate and skill care nursing home and senior living facility in Happy Town, Illinois. The Department contends that the taxpayer does not operate its facilities exclusively for charitable purposes. 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 limited liability company that was organized on April 6, 2001. (Taxpayer Ex. #1, p. 1)
2. The taxpayer operates an intermediate and skill care nursing home and senior living facility known as XYZ Center, which is located in Happy Town, Illinois. Happy Town is in Anywhere County, and there are currently no other skilled care nursing facilities in that county. (Dept. Ex. #1, pp. 15, 17; Taxpayer Ex. #1, p. 1; Tr. p. 10)
3. The sole member of the taxpayer is Delightful Ministries, which is an Illinois not-for-profit company that operates a church. (Taxpayer Ex. #1, pp. 1-2; Tr. p. 13)
4. Delightful Ministries owns the real estate where the taxpayer operates its facility, and the taxpayer pays rents to Delightful Ministries. (Dept. Ex. #1, p. 36; Tr. pp. 11, 15)
5. According to its Amended Operating Agreement, the purposes for the taxpayer are as follows:

1.3.1 The Company is organized and operated exclusively for exempt purposes under section 501(c)(3) of the Internal Revenue Code of 1986 (or the corresponding provision of any future United States Internal Revenue law and referred to below as the "Code").

1.3.2 The Company is more specifically organized to operate an intermediate and skill care nursing home and senior living facility. (Taxpayer Ex. #1, p. 1)

6. The same purposes are included in the Articles of Amendment that were filed for the taxpayer with the Secretary of State. (Dept. Ex. #1, pp. 38-41)

7. The Articles of Amendment include the following:

No part of the net earnings of the limited liability company shall inure to the benefit of, or be distributable to its members, trustees, officers, or other private persons, except that the limited liability company shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the above purposes....(Dept. Ex. #1, p. 40)

8. The taxpayer has a Charitable Policy as follows:

It is the policy of XYZ Center to provide services to Residents in need without regard to race, age, sex, financial status or religion as long as their needs can be met while staying within all guidelines outlined in the State Operations Manual and the Illinois Administrative Code.

If a Resident is unable to pay for services, consideration will be made by the Administrative team to provide services to the resident at a reduced rate or at no charge. Some areas that can be considered are, but not limited to, therapy services, waived insurance co-payments, or nursing supplies/services.

If it is determined a Resident is in need of charitable services, an assessment of need and related costs will be developed to insure the facility can meet the need, both in service delivery as well as financially. (Dept. Ex. #1, p. 7; Taxpayer Ex. #4)

9. The brochure for the taxpayer's facility does not include the taxpayer's Charitable Policy. (Dept. Ex. #1, pp. 15-16)

10. The taxpayer's Charitable Policy as stated in Finding of Fact #8 is posted on the wall of the taxpayer's facility next to the bulletin board, which is near the entrance to the facility. (Taxpayer Ex. #5; Tr. pp. 16, 19-22)

11. The taxpayer's facility has 69 beds. At the time of the hearing, the taxpayer had 44 residents. It usually has between 40 and 45 residents. Although its capacity is 69, its

dining room can only accommodate 50 to 55 residents. (Dept. Ex. #1, pp. 12, 16; Tr. pp. 33-34, 56)

12. Most of the taxpayer's residents qualify for Medicaid, Medicare, or both. (Dept. Ex. #1, pp. 11-12; Tr. pp. 23, 55, 57)

13. The taxpayer's income includes payments from Medicare, Medicaid, insurance and private pay residents. At the time of the hearing, 6 residents were private pay. (Dept. Ex. #1, pp. 11-12; Tr. pp. 26, 43, 58-59)

14. During 2011, the daily private pay rate was \$96.00. Beginning January 1, 2012, the daily private pay rate was \$99.00. This rate included everything except medications. (Dept. Ex. #1, p. 11; Tr. p. 51)

15. Medicare pays a daily rate for residents who qualify, and they stay up to 100 days (depending on how long they need care). The first 20 days are paid completely by Medicare. Days 21-100 have a daily co-pay of \$144.50. (Dept. Ex. #1, p. 11; Tr. p. 23)

16. If a Medicare, Medicaid, or private pay resident has supplemental insurance, the insurance generally will pay for the co-pay. (Dept. Ex. #1, p. 11; Tr. pp. 51, 56)

17. The taxpayer has never had a resident for whom it has had to waive the room and board fee. (Tr. pp. 23, 55)

18. The taxpayer's un-audited Income Statement¹ for the year ending December 31, 2011 shows the following:

Income	
Resident Revenue	\$2,056,921.27
Less Resident Refunds ²	(10,263.91)
Total Sales	2,046,657.36

¹ The taxpayer's accountant compiled the Income Statement based on information that he received from the taxpayer's management, but he did not audit or review the information. (Dept. Ex. #1, p. 33)

² If a resident had paid in advance and went home early, then the taxpayer would refund a portion of the payment. (Tr. p. 26)

Operating Expenses

Activities	1,404.64
Activity Consultant	1,250.00
Attorney Fees	2,950.00
Auto & Truck Expense	475.69
Advertising	1,228.08
Billing Service Fees	1,204.08
Biohazard Expense	985.95
Continuing Education	476.60
Contracted Services	12,916.55
Contributions ³	937.24
Dietary Consultant	3,721.40
Dietary Food	82,645.01
Dietary Supplements	8,328.26
Dietary Supplies	5,684.33
Dietary-Chemicals Dishwasher	2,982.65
Document Shredding Exp.	118.98
Dues & Subscriptions	3,843.80
Employee Expenses	1,463.13
Employee Benefits & Pensions	332.23
Equipment Rental	8,548.45
FICA Expense	76,507.79
SUTA Expense	16,660.39
Federal Civil Money Penalty	3,250.00
Funeral Expense ⁴	1,263.38
Hazardous Waste Removal	486.00
Housekeeping Supplies	13,735.62
Illinois Bed Tax ⁵	37,778.00
Insurance – Building	6,654.40
Insurance – Gen. Liability	50,326.48
Insurance – Health Insurance	62,274.46
Insurance – Worker’s Comp.	54,351.34
Isolation Expense	218.80
Janitorial Expense	590.00
Labor, Salaries & Wages ⁶	1,028,823.73
Laundry Chemicals	6,454.04
Laundry Supplies	49.44
Lawn Care	2,670.00
Licenses, Permits & Fees	578.00
Maintenance Expense	6,842.94

³ The taxpayer did not explain this expense.

⁴ The taxpayer will send flowers or a plant to the family of a resident who passed away. (Tr. p. 28)

⁵ This tax is \$1.50 per day per bed. The taxpayer has 69 beds. (Tr. p. 28)

⁶ The individual salary amounts were not provided, but the taxpayer indicated that it had 60 employees. (Dept. Ex. #1, p. 12)

Maintenance – Contracted	7,734.42
Marketing Expense	1,673.84
Meals & Entertainment	80.22
Medical Director	5,500.00
Medical Records Consultant	1,225.00
Medicare A Expense	517.94
Medicare A Lab Fees	4,639.09
Medicare D Insurance	500.80
Miscellaneous Expense	85.00
Monthly Board Members Meeting	610.96
Nursing Equipment	947.63
Nursing Supplies	30,337.21
Office Supplies & Expense	5,867.11
Pest Control	1,200.98
Pharmacy Expenses ⁷	64,429.01
Postage & Mailing Expense	1,100.52
Professional Fees	550.00
Reference Materials	44.00
Rent Expense ⁸	12,552.22
Repairs & Maintenance	5,796.80
Resident Expenses	13,783.57
Resident Expense Med A	1,915.96
Sales & Use Tax	1,041.00
Seminars, Training & Meetings	117.18
Social Service Consultant	1,250.00
State Survey Fine	3,250.00
Supplies Expense	95.26
Taxes Property & Other	40,029.50
Technical Support Services	579.72
Telephone	7,071.52
Therapy Services – Med A	80,643.29
Therapy Services – Med B	87,519.67
Therapy Supplies (Non-Billable)	262.47
Travel	143.97
Trash	2,115.00
Utilities	<u>71,216.59</u>
Total Operating Expenses	1,967,439.33
Operating Income (Loss)	79,218.03
Other Expenses	
Interest Expense	<u>4,541.14</u>
Net Income	\$ <u>74,676.89</u>
(Dept. Ex. #1, pp. 9-10; Taxpayer's Ex. #6)	

⁷ Most of this expense is reimbursed by Medicare. (Tr. pp. 63-64)

⁸ The testimony indicated that the taxpayer currently pays rent in the amount of \$1,000 a month. (Tr. pp. 39-40)

19. The net income amount of \$74,676.89 for 2011 includes a loan of \$70,000 from a line of credit that the taxpayer obtained while awaiting payment from the State of Illinois for Medicaid. (Dept. Ex. #1, p. 5; Tr. pp. 30-31)
20. In 2012 the taxpayer began paying an Illinois Provider Tax, which is \$6.07 per day per resident. The tax was retroactive to May of 2011, but the taxpayer was not billed for it until 2012. This tax is in addition to the Bed Tax. (Taxpayer Ex. #7; Tr. pp. 34-35)
21. The taxpayer put the following advertisement in the local newspaper in order to obtain donations to support its facility:

XYZ Center in Happy Town, the only nursing home facility in Anywhere County, reminds area residents that we are a non-profit organization.

During this special time of the year, we ask for any financial donations from the communities in Anywhere County.

Please feel free to stop by anytime to experience the facility firsthand.

Send or drop contributions to
XYZ Center
Happy Town, IL XXXX

All contributions are tax deductible. Check with your tax preparer.
(Dept. Ex. #1, p. 8; Tr. p. 41)

22. 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 on March 15, 2011. (Dept. Ex. #1, pp. 26-27; Taxpayer Ex. #3; Tr. pp. 15-16)

23. Delightful Ministries is exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code pursuant to a determination made by the IRS on December 21, 2009. (Taxpayer Ex. #2)

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). Therefore, in order to receive the exemption identification number, the taxpayer must be “organized and operated” exclusively for charitable purposes. See also 86 Ill. Admin. Code §130.2005(j)(3). The term “exclusively” is not interpreted literally to mean the entity’s sole purpose; it is construed to mean the primary purpose. Yale Club of Chicago v. Department of Revenue, 214 Ill. App. 3d 468, 473 (1st Dist. 1991); Gas Research Institute v. Department of Revenue, 154 Ill. App. 3d 430, 436 (1st Dist. 1987).

In order to determine whether the taxpayer is organized and operated exclusively for charitable purposes, the following factors are considered: (1) whether the benefits derived are for 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, earns no profits or dividends, but rather derives its funds mainly from public and private charity and holds them in trust for the objects and purposes expressed in its charter; (3) whether the organization dispenses charity to all who need and apply for it, does not provide gain or profit in a private sense to any person connected with it, and 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; and (4) whether the primary purpose of the organization, not any secondary or incidental purpose, is charitable. Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455, 459 (2nd Dist. 1995) (citing Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 139, 156-57 (1968)).⁹ 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.*

The taxpayer has the burden of proving by clear and convincing evidence that it is entitled to the exemption. Rogy's New Generation, Inc. v. Department of Revenue, 318 Ill. App. 3d 765, 771 (1st Dist. 2000); Wyndemere, *supra*; Gas Research Institute, *supra*. It is well-settled that tax exemption provisions are strictly construed in favor of taxation. *Id.*; Heller v. Fergus Ford, Inc., 59 Ill. 2d 576, 579 (1975). All facts are construed and all doubts are resolved in favor of taxation. *Id.* To prove its case, a taxpayer must present more than its testimony denying the Department's determination. Sprague v. Anywhere, 195 Ill. App. 3d 798, 804 (4th Dist. 1990);

⁹ Because these factors are also used to analyze charitable exemptions from property taxes, cases involving property taxes will also be cited. See Wyndemere, *supra*.

Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296 (1st Dist. 1981). The taxpayer must present sufficient documentary evidence to support its claim. *Id.*

The taxpayer provides a valuable service to the community, but the evidence presented does not show clearly and convincingly that it is organized and operated exclusively for charitable purposes under the guidelines of Methodist Old Peoples Home, *supra*. Although the taxpayer meets part of the guidelines by being a non-profit organization that has no capital, capital stock, or shareholders, all of the taxpayer's income is from "Resident Revenue," which includes income from Medicare, Medicaid, supplemental insurance, and private pay residents. Most of the residents qualify for either Medicare or Medicaid, and only 6 residents are private pay. The taxpayer, therefore, does not derive its funds primarily from charitable contributions.

The taxpayer's office manager explained that the taxpayer has tried to raise funds through donations, but the process has been difficult because many people are not familiar with nursing homes or do not like to think about them. The taxpayer is also located in a rural, economically depressed area, and the people in the community do not have a lot of money to donate to a nursing home. The taxpayer occasionally receives donations from a resident's family, and it receives small donations to its activity fund. (Tr. p. 38) The taxpayer put an ad in the local newspaper to solicit donations, and it sent 75 letters to car dealers and companies to raise money for (or receive a donation of) a new van for transportation. (Tr. p. 40) The taxpayer did not receive any money or a van in response.

Although the taxpayer has tried to obtain charitable donations, the fact remains that the taxpayer's Income Statements do not show any income from charitable contributions. All of the taxpayer's "Resident Revenue" is derived by providing a service in exchange for compensation from Medicare, Medicaid, private insurance, or direct pay. The fact that a taxpayer's primary

funding source is not public or private charity is not, by itself, 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)). In the present case, however, the taxpayer has failed to meet other guidelines.

The evidence raises doubt that the taxpayer's "charitable services" benefit an indefinite number of people because the taxpayer's policy indicates that it will provide charity only to the extent that it is financially able to do so. The charitable policy includes the following provision:

If it is determined a Resident is in need of charitable services, an assessment of need and related costs will be developed to insure the facility can meet the need, both in service delivery as well as financially. (Dept. Ex. #1, p. 7; Taxpayer Ex. #4)

In Wyndemere, *supra*, the taxpayer's charity was subject to its ability to afford it and remain financially viable. *Id.* at 457. The court found that providing charity in relation to the taxpayer's financial circumstances was not providing it to an indefinite number of people and was not dispensing it to all who need it. *Id.* at 460.

The evidence also raises doubt concerning the extent of the taxpayer's charitable acts and the amount of charity that the taxpayer provides. The taxpayer contends that most of its charity consists of waiving the Medicare and Medicaid co-pays. With respect to Medicare, the taxpayer receives full payment from Medicare for the first 20 days, and days 21-100 have a daily co-pay of \$144.50. Generally supplemental insurance pays for the co-pay, but Medicaid does not pay for the Medicare A or B co-pay. If a resident does not have supplemental insurance and is on Medicaid, then the taxpayer will waive the co-pay as a "charitable service." (Dept. Ex. #1, p. 11) Even though the 2011 Income Statement does not include an expense for charitable services, the taxpayer claims that its charitable services during 2011 included waiving Medicare A co-pays in

the amount of \$29,007 and Medicare B co-pays in the amount of \$4,014. (Dept. Ex. #1, pp. 11-12)

It is difficult to consider the waiver of the daily co-pay of \$144.50 to be charity because that amount is higher than the daily private pay rate of \$96, and the taxpayer still receives a significant amount of money from Medicare. The taxpayer receives full payment from Medicare for the first 20 days, and although the taxpayer did not disclose exactly how much it received from Medicare, the taxpayer indicated that the co-pay portion was 20%. (Tr. p. 49) During 2011, the taxpayer received a total of \$2,046,657.36 as Resident Revenue for an average of 45 residents, which means that the taxpayer receives a significant amount of money for each of its residents even without the co-pays. It is also important to note that in Riverside Medical Center v. Department of Revenue, 342 Ill. App. 3d 603 (3rd Dist. 2003), the court found that discounted care that was provided through Medicare and Medicaid was not charity because the discounts were given pursuant to contractual arrangements. Riverside, at 610.

Another reason why the co-pay waivers are not necessarily charitable is because the taxpayer's office manager said that if a bill is sent to a resident for a co-pay and the resident does not pay it in 3 or 4 months, then the taxpayer will "write it off." (Tr. pp. 24, 58) It is not clear whether the amounts written-off are included in what the taxpayer claims to be "charitable services," but expecting payment and writing off the amount only when it cannot be collected means that the taxpayer is writing off a bad debt. Nearly every appellate court in this state has found that writing off a bad debt is not the same as providing charity. Provena, at 761; Riverside, at 609; Alivio Medical Center v. Department of Revenue, 299 Ill. App. 3d 647, 652 (1st Dist. 1998); Highland Park Hospital v. Department of Revenue, 155 Ill. App. 3d 272, 280 (2nd Dist. 1987). Charity is a gift (Methodist Old Peoples Home, at 156), and whether the

taxpayer's "charitable services" are gifts rather than debt that cannot be collected has not been clearly established. If the taxpayer waives co-pays only because it is unable to collect the money, then it is not providing charity.

Even if it is assumed that the co-pay waivers are charity, the waivers during 2011 were such a small percentage of the taxpayer's revenue that they do not warrant a finding that the taxpayer's primary purpose is charitable. The Medicare A and B co-pay waivers totaled \$33,021, which is 1.6% of the total revenue of \$2,046,657.36. Charity is not merely helpfulness, but generosity; "to be charitable, an institution must give liberally." Provena, at 750. In Riverside, *supra*, the court found that the charity care was only 3% of the budget, and the primary use of the medical clinic was not charitable but was to provide care to patients who could pay (either individually or through Medicare, Medicaid, or private insurance). Riverside, at 609. In Provena, *supra*, the court found that it was reasonable to infer that charity was not dispensed to all who needed it when the hospital spent only .7% of its revenue on charity care. Provena, at 756.

The other expenses that the taxpayer claims were "charitable services" also were not significant enough to find that the taxpayer primarily operates as a charitable organization. The taxpayer stated that in 2011 it paid \$1,350 for non-covered medications, \$1,328 for IV supplies, and \$887 for therapy, which totals \$3,565. (Dept. Ex. #1, p. 12) This total amount is only .2% of the taxpayer's revenue of \$2,046,657.36. In addition, the taxpayer indicated that it sometimes pays for salon services, provides spending money, or provides things like creams and lotions. (Tr. pp. 29-30) Although a specific amount was not given for these expenses, it is not likely that the amount would be significant in comparison to its income. The few charitable acts performed

by the taxpayer simply do not support a finding that the taxpayer primarily operates for charitable purposes.

Another indication that the taxpayer is not primarily a charitable organization is the fact that the taxpayer has never had to waive the room and board fee for a resident. The office manager explained that this has not been necessary because the residents generally qualify for either Medicare or Medicaid. (Tr. pp. 23, 55) Although the taxpayer does not use a collection agency, charge interest, or attempt to collect from residents who cannot pay (Tr. pp. 24, 36, 57), the office manager said that she did not foresee the need for a collection policy because the way the system works, “it pretty well pays.” (Tr. pp. 58-59) She said that the taxpayer only has to write-off the co-pays a couple times a year because the residents either have supplemental insurance or they pay as private pay. (Tr. p. 59) The primary activity of an organization must be charitable in order to receive the exemption. Gas Research Institute, *supra*. From the evidence presented, it appears that the taxpayer’s primary activity is to provide skilled nursing care for which it receives compensation.

There is uncertainty in the record concerning the extent of the taxpayer’s charitable acts. As previously stated, the taxpayer must prove its entitlement to the exemption by clear and convincing evidence. See Wyndemere, *supra*; Rogy’s New Generation, Inc., *supra*. Exemption provisions must be strictly construed, and all doubts and debatable questions are resolved in favor of taxation. Wyndemere, *supra*. Providing a long-term skilled nursing care facility for the community is certainly an important service. The taxpayer’s operations are laudable, but laudable acts do not necessarily constitute charity. Rogers Park Post No. 108, American Legion v. Brenza, 8 Ill. 2d 286, 291 (1956); Turnverein Lincoln v. Board of Appeals of Cook County, 358 Ill. 135, 144-145 (1934). Because the evidence fails to meet the clear and convincing

standard for showing that the taxpayer is organized and operated exclusively for charitable purposes, the 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: August 9, 2013