

ST 16-07

Tax Type: Sales Tax

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

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
OREGANO, ILLINOIS

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

ABC Business,
Taxpayer

No. XXXX
ID# XXXX
SALES TAX EXEMPTION

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Paula Hunter on behalf of the Illinois Department of Revenue; John Doe, Executive Director, on behalf of ABC Business, *pro se*.

Synopsis:

This matter is before this administrative tribunal pursuant to the protest of a “Denial of Sales Tax Exemption” letter issued by the Illinois Department of Revenue (“Department”) on December 5, 2014. ABC Business (“Taxpayer”) applied to the Department for an exemption identification number so that it could purchase tangible personal property at retail free from the imposition of use and related taxes as set forth in 35 ILCS 120/1g.

The issue to be determined at hearing is whether the Taxpayer 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); 35 ILCS 120/2-5(11). A hearing to consider this matter was held at the Department's offices on May 18, 2016. After reviewing the evidence adduced at hearing, it is my recommendation that the Department's denial of sales tax exemption be affirmed. In support of this determination I make the following findings of fact and conclusions of law.

Findings of Fact:

1. The Department's case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Department's "Denial of Sales Tax Exemption" letter dated December 5, 2014. Department Exhibit ("Ex.") 1.
2. ABC Business ("Taxpayer") was incorporated under the General Not-For-Profit Corporation Act of Illinois on December 10, 2013. Taxpayer's Ex. 2. Its Executive Director is John Doe. Taxpayer's Ex. 8.¹
3. The purpose of the Taxpayer is to attract new business to a specific area of Oregon identified as "Basil" and to retain and expand existing businesses in this area. Transcript of Hearing May 18, 2016 ("Tr.") pp. 8, 15, 16. A by-product of this objective is intended to be the creation and retention of jobs so as to improve the quality of life for Basil residents. *Id.* With respect to the foregoing, the Taxpayer's mission statement states as follows:

ABC Business's mission is to revitalize business, both industrial and commercial, in the Basil community. The focus of the organization is to bring new business to the area and the retention and expansion of existing businesses. Through this focus existing and new jobs will be created making the overall community healthier. This task will be accomplished through the use of city, county, state and federal programs and incentives.

¹ The record contains no by-laws or other evidence of the composition of the Taxpayer's officers and directors and no documents indicating the amount of compensation paid to John Doe or to other officers and directors of the Taxpayer.

Taxpayer's Ex. 8

4. The Taxpayer participates as an agency of, and is funded, in part, by the City of Oregon's Local Industrial Retention Initiative Program ("LIRI"). Tr. pp. 8, 16-18; Taxpayer's Ex. 4, 5. During the hearing in this case, the Taxpayer caused to be admitted into the record a "Local Industrial Retention Initiative Program Description" which states, in part, as follows:

The City of Oregon Department of Planning and Development (DPD) contracts with not for profit organizations as delegate agency partners for the Local Industrial Retention Initiative (LIRI) program.

LIRI agencies provide assistance to industrial businesses primarily in the City's Industrial Corridors (place-based LIRIs) or in targeted industry sectors (sector-based LIRIs) with the purpose of retaining those businesses in the City and supporting the Industrial Corridors.

Each of the 13 LIRI agency calls on industrial companies primarily in the city's 26 industrial corridors on behalf of DPD to offer assistance and market city programs and development sites. ...

LIRI agencies assess businesses, identify resources, provide project support and act as counselors and ombudsmen to resolve a variety of business issues.

Taxpayer's Ex. 4

Examples of how LIRI agencies help businesses indicated in the "Program Description" include:

- Identifying and securing funding for property, business and workforce development
- Finding the right location and fill key property vacancies
- Attaining permits and business licenses and act as liaison with City departments
- Helping find resources to grow businesses such as expanding sales both locally and internationally

- Providing guidance on city and policy issues that impact industrial companies
Id.

Subsequent to its incorporation, the Taxpayer entered into a contract with LIRI to provide these or similar services to businesses located in the Basil area. Tr. pp. 8, 16-18.²

5. The Taxpayer is also partially funded by a “block grant contract” with the Herb County Development Block Grant Program. Tr. pp. 22-27; Taxpayer’s Ex. 8. The purpose of this contract is to fund the Taxpayer’s efforts to foster economic development in Herb County. Taxpayer’s Ex. 8. During the reporting period October 1, 2014 through September 30, 2015, the Taxpayer received \$XXXX from this program and used these funds to create or retain XX jobs in various communities located in Herb County. *Id.*³
6. The Taxpayer obtained an exemption from federal income tax on May 12, 2014. Taxpayer’s Ex. 1. The Internal Revenue Service granted this exemption pursuant to sections 501(a) and 501(c)(3) of the Internal Revenue Code (“Code”) (exempting corporations operated exclusively for charitable purposes) based upon its determination that the Taxpayer qualified as an organization described in section 501(c)(3) of the Code. *Id.*
7. The Taxpayer was initially organized as a membership organization having 6 classes of membership for “Industrial Clients” and 5 classes of membership for “Commercial Clients.” Tr. p. 35, 40; Department Ex. 2.

² The record in this case does not include a copy of any contract between LIRI and the Taxpayer, and does not enumerate how much the Taxpayer received from LIRI for the performance of services pursuant to its affiliation with this organization.

³ The record in this case does not include a copy of any contract between the Herb County Community Development Block Grant program and the Taxpayer.

Conclusions of Law:

The Retailers' Occupation Tax Act ("ROTA") 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 Taxpayer 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 statutes 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).

Accordingly, the only way that the Taxpayer 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 Taxpayer 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 Taxpayer establishes that it qualifies for the exemption number it seeks.

The Taxpayer bears the burden of proving by “clear and convincing” evidence that this exemption applies. Evangelical Hospital Corp. v. Department of Revenue, 223 Ill. App. 3d 225, 231 (2nd Dist. 1991). Moreover, there is a presumption against exemption such that any doubts are to be resolved in favor of taxation. Van’s Material Co. Inc. v. Department of Revenue, 131 Ill. 2d 196 (1989). The Taxpayer’s burden of proof requires it to produce more than self-serving oral testimony in support of its claims. Brown Specialty Group v. Allphin, 75 Ill. App. 3d 845 (3d Dist. 1979). In order for the Taxpayer to prevail, corroboration of supporting testimony favoring the Taxpayer should include documentary evidence. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990).

In both ROT and UT matters, the Illinois courts apply the same criteria when determining whether a given taxpayer 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 Oregano v. Department of Revenue, 214 Ill. App. 3d 468 (1st Dist. 1991).⁴ The criteria to be applied in determining whether a given taxpayer 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, *supra*, 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, capital stock or shareholders; (2) 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 its dispenses. Methodist Old Peoples Home at 157. These factors are not rigid requirements. Rather, they are guidelines to be considered with an overall focus on whether the institution 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

⁴ In Yale Club of Oregano 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.

individuals to qualify as a charity. In Methodist Old Peoples Home, the Supreme Court stated that “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 at 156, 157. Accordingly, the law does not limit charity to the provision of financial assistance.

Applying these guidelines, I find that the record in this case supports a finding that the Taxpayer meets several of the criteria for determining whether it qualifies as a charity. During the hearing, the Department conceded that the Taxpayer has no capital or capital stock and that it does not have any shareholders. Tr. p. 49.

While a finding that the Taxpayer possesses the foregoing characteristics supports the Taxpayer’s claim to be a charitable organization, the record before me is deficient in a number of critical respects. First, the Taxpayer failed to provide any current financial books or records of the organization. The only financial records provided (Taxpayer’s Ex. 10, 11) pertain to the first seven months of the Taxpayer’s existence and only reflect the initial capitalization of the Taxpayer by its corporate sponsors. Tr. p. 40.

The Taxpayer’s profit and loss statement for this period states that the Taxpayer derived all of its revenues from dues paid by its members. Taxpayer’s Ex. 10. Organizations that derive income mainly from member dues and serve primarily to benefit members do not meet the requirements of Methodist Old Peoples Home and, therefore, are not charitable organizations. Oregano Patrolmen’s Association v. Department of Revenue, 171 Ill. 2d 263, 272 (1996). Accordingly, were the

aforementioned financial records indicative of the Taxpayer's current financing, the Taxpayer clearly would not qualify as a charity.

However, during the hearing, John Doe, the Taxpayer's Executive Director, testified as follows:

ABC Business had no revenue stream and for us to maintain being in existence, the businesses came to me and said we will support you. That charter member fee, it was established to get seed money for the organization. Once the contracts were engaged, the dynamics changed ...[.]

Tr. p. 40. Emphasis added

Based upon this testimony, I conclude that the financials provided by the Taxpayer that are included in the record, reflecting the initial capitalization of the Taxpayer, do not reflect the Taxpayer's current sources of revenue. The record indicates that these current sources of revenue are primarily contracts with the City of Oregon and Herb County. Tr. pp. 8, 16-18, 22-28; Taxpayer's Ex. 4, 5, 8.

In the absence of evidence of the Taxpayer's current financials, it is impossible to determine whether the Taxpayer derives its funds "mainly from public and private charity." Methodist Old Peoples Home at 157. The record only contains anecdotal references to LIRI and the Herb County Development Block Grant Program, funding sources identified in the record that are related to the Taxpayer's economic development efforts that commenced financing the Taxpayer subsequent to its incorporation and initial capitalization. Tr. p. 40. With respect to testimony concerning funding by these organizations, the record is ambiguous since it contains no financials showing the level of funding provided by these organizations and no contracts with these organizations.

Moreover, amounts paid pursuant to contracts with the City of Oregon and Herb County in exchange for the provision of services are obviously not charitable contributions, but rather payments received by the Taxpayer in the ordinary course of the Taxpayer's business. The Taxpayer presumably obtained these government contracts and funding that generate a substantial portion of the Taxpayer's revenues through arms-length negotiations in the commercial market place to provide its services. Consequently, in the absence of documentary evidence to the contrary, the revenues the Taxpayer receives from its government contracts must be characterized as government payments for services rendered rather than charitable donations. In sum, based on the record presented in this case, the revenues generated by the Taxpayer's contracts with government entities must be deemed to be attributable to revenues from business transactions rather than charitable sources specified in Methodist Old Peoples Home.

Other guidelines from Methodist Old Peoples Home are that a charity provides services that benefit an indefinite number of people, dispense its benefits to all who need or apply for it, and place no obstacles in the way of those who need the benefits it dispenses. The record in this case does not establish that the Taxpayer's activities evidence these characteristics of a charity by benefitting an indefinite number of people and by placing no obstacles limiting those eligible for the receipt of its benefits.

Testimony presented at the hearing in this case establishes that a substantial portion of the Taxpayer's revenue is from government funding. However, no government contracts were introduced into the record. As a consequence, the record does not show whether government funding permits the Taxpayer to make its services available to all persons that need or apply for them. Moreover, the Taxpayer introduced

no documentary evidence indicating whether, and to what extent, it provides services to all such persons who are not covered by its contracts with the city and county. It is clear from these facts that the Taxpayer has failed to prove that its programs serve an “indefinite number of persons.”

An additional guideline from Methodist Old Peoples Home is that a charity not provide gain or profit in a private sense to any person connected with it. The Taxpayer clearly would not meet this criterion if it were determined that compensation paid to the Taxpayer’s executives was so high that they could be considered the primary beneficiaries of the Taxpayer’s activities. Lutheran General Health Care v. Department of Revenue, 231 Ill. App. 3d 652, 661 (1st Dist. 1992). On this point, the information provided by the Taxpayer fails to conclusively show that the fees it earns from providing services do not inure primarily to benefit officers and others engaged in managing the organization.

I do not doubt that the Taxpayer provides an extremely valuable service. However, grants of tax exemption are not based upon the value of the service being provided alone because each grant of exemption deprives the entire community of funds needed to provide other necessary services to everyone. Thus, tax exemption is the exception rather than the rule, and statutes providing exemptions must be strictly construed in favor of taxation. Provena Covenant Medical Center et al v. Department of Revenue, 236 Ill. 2d 368 (2010).

CONCLUSION

Taken as a whole, the preceding analysis establishes that the Taxpayer has failed to prove that it qualifies as an institution of public charity in light of criteria enumerated in Methodist Old Peoples Home and other applicable case law. Therefore, the Department's determination denying the Taxpayer's exemption identification number request should be affirmed.⁵

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's determination denying the Taxpayer's request for a sales tax identification number be affirmed.

Ted Sherrod
Administrative Law Judge

Date: June 29, 2016

⁵ During the hearing, the Taxpayer also argued that the Department's finding that it is not a charity is refuted by its charter identifying it as a not-for-profit corporation and by the fact that it is exempt as a charitable organization under sections 501(a) and 501(c)(3) of the Internal Revenue Code. Tr. pp.13-15. However, "the wording of governing documents ...do not relieve ...an institution of the burden of proof that ... [it] actually and factually [engaged in charitable activity]." Morton Temple Association v. Department of Revenue, 158 Ill. App. 3d 794, 796 (3d Dist. 1987). A similar rationale applies to the Taxpayer's showing that it is exempt from federal income tax pursuant to section 501(a) and 501(c)(3) of the Internal Revenue Code. This exemption, standing alone or taken in conjunction with the Taxpayer's Articles of Incorporation, does not establish that the Taxpayer actually operates for exclusively charitable purposes under Illinois rather than federal legal criteria for making this determination. People ex rel. County Collector v. Hopedale Medical Foundation, 46 Ill. 2d 450, 464 (1970).