

UT 18-03

Tax Type: Use 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, INC.

Taxpayer

**Docket No. XX-XX-XXX
Letter ID: XXX
Claim for Exemption Number**

RECOMMENDATION FOR DISPOSITION

Appearances: Robin Gill, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; John Gibbons, Attorney at Law, for ABC, Inc.

Synopsis:

ABC, Inc. (“ABC” or “taxpayer”) sent a request 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 request, 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 provides employment for people who have

barriers to finding jobs (*e.g.*, people with physical or mental disabilities, veterans, or people with criminal backgrounds). The Department contends that the taxpayer is not organized and operated 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 not-for-profit corporation that was organized on March 25, 2014. (Dept. Ex. #1, pp. 18-19)
2. According to its bylaws, the taxpayer's purpose is stated as follows:

Section 1

[ABC] shall offer Affirmative Enterprise opportunities for people with disabilities working alongside disadvantaged individuals. An Affirmative Enterprise has a mix of employees with and without disabilities to offer role model mentoring in a production and work setting.

Section 2

The Corporation shall hire and employ people of any race, color, age, religion, sex (including pregnancy), national origin, disability, and genetic information. The Corporation shall not discriminate on the basis of race, color, age, sex (including pregnancy), national origin, disability, or genetic information in administration of its policies, hiring practices, promotion practices, benefits, and Corporation administration programs. (Dept. Ex. #1, p. 20)

3. ABC is considered to be an "affirmative industry" which means that it is a business that targets hiring people who have physical or mental disabilities or other barriers to employment, such as a criminal background. It allows these people to establish a work history in order to either advance at ABC or more easily transition into the competitive job market. It also allows them to become independent members of the community. (Tr. pp. 13-16, 21-22)

4. Some of the job duties for the taxpayer's employees include light assembly work and co-packaging for local businesses and industries. The co-packaging work consists of receiving large pallets of goods (*e.g.*, packages of soap, bottles of water or soft drinks, etc.) from the manufacturers. The pallets are dis-assembled by the ABC workers and re-packaged into smaller quantities, bundled arrangements, or displays. They are then shipped to distributors or retail outlets. (Dept. Ex. #1, p. 4)
5. The taxpayer began its operations on January 1, 2015. (Dept. Ex. #1, p. 12; Tr. p. 29)
6. COOK, Inc. ("COOK") is a separate organization that provides day services to people with disabilities. It has programs that help the individuals learn life skills to function better in the community. The programs at COOK include introducing them to employment skills in order to eventually place them in jobs in the community. (Tr. p. 11)
7. COOK has 2 shelter workshops from which it helps to transition people to work at ABC. (Tr. pp. 51-52)
8. At COOK, the work opportunities are usually 4 or 4½ hours a day. At ABC, employees typically work an 8 hour shift, and the work pace is faster than at COOK. Employment is the key focus at ABC. (Tr. pp. 15-16)
9. The goal at ABC is to operate as much like a business as any other business in the community and to facilitate a business atmosphere rather than a social service one. (Tr. pp. 14-17)

10. The majority of people who work at ABC have some type of barrier to employment, but other individuals work there as well. The idea is to give the disabled or disadvantaged people different role models to work with and make the workplace as real and as integrated as possible. (Tr. pp. 17-19)
11. The goal of ABC is to make the people who have barriers to employment successful at working at a job. If initially the employment at ABC does not work out for them, they are given multiple chances to come back again. (Tr. pp. 13-18)
12. COOK has a contract with ABC to perform several services for ABC. Some of the services performed during 2015 were the following:
- On the job coaching – individual time with clients as needed to build job retention skills/reinforce employer expectations
 - Business development – identifying and securing the competitive employment type project work needed to operate
 - Human resources – recruiting clients; orientation or expectations of employees in competitive employment position
 - Information technology – operation of the technical infrastructure needed to operate as a business
 - Finance – paying bills, billing customers and generating financial statements for management review
 - Maintenance – maintaining the operating facility. (Dept. Ex. #1, p. 6; Tr. pp. 36, 40)
13. ABC (through COOK) advertises open positions through the local newspaper, radio stations, public fairs, the chamber of commerce, and word of mouth. ABC also works with the veterans department and the Department of Rehabilitation Services to recruit employees. ABC also recruits people from COOK. ABC

recruits its supervisory staff the same way it recruits the people who have barriers to regular employment. (Tr. pp. 30, 53)

14. Potential employees can apply either online or through the human resources department for ABC. (Tr. p. 30)

15. The taxpayer provided an un-audited income statement for the year 2016, which shows the following as income:

Contributions	\$XX,XXX.XX
Program Revenue	
Contract Revenue	XXX,XXX.XX
Production Revenue	XXX,XXX.XX
Interest & Dividends	.XX
Other Income	X,XXX.XX
Total Revenue	\$X,XXX,XXX.XX (Taxpayer Ex. B)

16. The entire Contribution amount of \$XX,XXX.XX is the discounted cost of services from COOK. In other words, it is the difference between the actual cost of COOK's services and the amount that ABC paid for the services. For 2016, this contribution amount is approximately 6.5% of total revenue. (Tr. pp. 37-41)

17. ABC does not receive any public funding. (Tr. pp. 26-27)

18. Contract Revenue includes income for services for which there is a written contract, such as performing janitorial services for MID-STATE County. Production Revenue includes income for services for which there is not a formal contract. This includes the re-packaging of items or the assembly of things for different companies. The items go back to the customer for distribution. (Dept. Ex. #1, p. 4; Tr. pp. 41-43)

19. The taxpayer's expenses for the year 2016, excluding depreciation, were \$X,XXX,XXX.XX, which resulted in a net operating loss of \$XXX,XXX. (Taxpayer Ex. B)
20. For 2015, the Contribution amount (*i.e.*, the discounted cost of COOK's services) was \$XXX,XXX.XX, and the taxpayer's total revenue was \$XXX,XXX.XX. This contribution was approximately 25% of the total revenue. (Dept. Ex. #1, p. 7)
21. The taxpayer's expenses for the year 2015, excluding depreciation, were \$X,XXX,XXX.XX, which resulted in a net operating loss of \$XXX,XXX.XX. (Dept. Ex. #1, p. 7)
22. With respect to income, the taxpayer hopes to generate enough cash to invest in its equipment and people. If there is excess income, it would go to the employees. (Tr. pp. 38-39)
23. ABC only performs services; it does not sell products at retail. (Dept. Ex. #1, p. 4; Tr. p. 44)
24. The City of ANYTOWN provided a \$XXX,XXX grant toward the cost of converting an unused warehouse as a location where ABC could operate. (Dept. Ex. #1, p. 4; Tr. p. 26)
25. The taxpayer has no capital, capital stock, or shareholders. (Dept. Ex. #1, pp. 18-19; Tr. p. 27)

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 for personal property sold to these organizations. 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; (4) whether the organization does not provide gain or profit in a private sense to any person

connected with it; (5) whether the organization 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 (6) whether the organization is actually and factually operated primarily for charitable purposes. 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)).¹ 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. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990); 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.*

¹ Because these factors are also used to analyze charitable exemptions from property taxes, cases involving property taxes will also be cited. See Wyndemere, *supra*.

The Department argues that the taxpayer is not organized and operated for charitable purposes and does not meet the standards set forth in Methodist Old Peoples Home, *supra*. The Department contends that the primary function of the organization is to provide jobs for a targeted group of people, and there is no charity involved. The taxpayer provides work for its employees, and it pays them salaries. The Department also argues that the taxpayer provides services for which it receives income, and the majority of its income is not derived from public or private charity. The Department claims that the taxpayer does not benefit an indefinite number of people or dispense charity to all who need and apply for it. The Department also claims that the taxpayer places obstacles in the way of those seeking charity, and, therefore, the taxpayer does not qualify for the exemption.

In response, the taxpayer argues that it is a non-profit agency with charitable purposes, and there is no other way for these purposes to be fulfilled in the community. There is no government funding for this organization, and the clients are not charged fees. The taxpayer also states that it offers benefits to anyone in the community who needs these particular services, and there are no barriers to employment with the taxpayer.

During the hearing, the taxpayer explained that if a disabled person cannot work in the competitive job market, they generally work in a shelter program where they receive a portion of the minimum wage depending on how productive they are. If they are 50% productive, then they receive 50% of the prevailing wage for that job. According to the taxpayer, in an affirmative industry, even though a disabled person may be 80% productive, they still receive at least minimum wage. As a result, that

organization may lose money. (Tr. p. 49) The taxpayer believes that this is the charitable aspect of its organization. In the taxpayer's view, the unique feature of an affirmative industry is its charitable nature.

The taxpayer's evidence does not show clearly and convincingly that the taxpayer is organized primarily for charitable purposes. According to the bylaws, the taxpayer is organized for the purpose of operating a business that hires people with and without disabilities. The purpose statement does not mention the word "charity" and does not indicate any type of charity that it provides. In Provena Covenant Medical Center v. Department of Revenue, 384 Ill. App. 3d 734, 746 (4th Dist. 2008), *aff'd*, 236 Ill. 2d 368 (2010), the court reaffirmed that charity is a "gift." *Id.* at 750. Nothing in the taxpayer's purpose statement indicates that the taxpayer provides any type of gift in the form of free goods or services.

In addition, the evidence does not support a finding that the taxpayer is operated primarily for charitable purposes. One of the taxpayer's board members referred to ABC as "a business in the community." (Tr. pp. 14-15) He stated that employment is the key focus at ABC, and the goal "is to run it as much like a business as any other business in the community." (Tr. pp. 15-17) Although there are some business aspects to operating a charity, generally operating like a business is the antithesis of operating as a charity.

The taxpayer's actual activities indicate that the taxpayer operates like a business. Even though the taxpayer is organized as a non-profit with no capital, capital stock or shareholders, the majority of its income is not derived mainly from public and private charity, which is one of the factors to consider under Methodist Old Peoples Home, *supra*. Most of the taxpayer's income is from the fees that it charges for its services, and

there is no indication that it charges anything less than the market rate for its services. During the first year of operation in 2015, the contribution amount from COOK was approximately 25% of its income. This amount decreased significantly to approximately 6.5% of its income in 2016.² The taxpayer's activities generated a substantially higher amount of income during its second year of operation.

Another factor to consider under Methodist Old Peoples Home, *supra*, is whether the organization provides gain or profit in a private sense to any person connected with it. The taxpayer indicated that it hopes to generate enough income to invest in its equipment and people, and any excess income is expected to be given to its employees. (Tr. p. 39) This goal is indicative of a business and not a charitable organization.

It is difficult to determine whether charity is dispensed to all who need and apply for it because the "charity" that the taxpayer claims to provide is not clearly specified. The taxpayer indicated that it considers charity to be, for example, the difference between an employee who is 100% productive and an employee who is 80% productive. The taxpayer did not provide any information concerning how many people are working below 100% productivity. Although this might be difficult to substantiate, it is also difficult to consider this organization to be charitable without any substantiation of charitable activity. The record does not indicate that the taxpayer provides any type of charity in the form of free goods or services.

Furthermore, if the charity is considered to be paying full salary to an employee who is less than 100% productive, then this charity is incidental to the taxpayer's primary purpose of providing jobs and operating a business. The exemption is determined based

² The taxpayer did not provide a copy of the contract that it has with COOK, and it is unclear how the "contribution" amount is determined.

on the primary operations of the taxpayer and not on any secondary or incidental activity. See Yale Club of Chicago, *supra*. In addition, charity is not merely helpfulness, but generosity; “[t]o be charitable, an institution must give liberally.” Provena, at 750. The record simply does not support a finding that the taxpayer gives a liberal amount of charity or that it meets the factor under Methodist Old People Home, *supra*, that the organization is actually and factually operated primarily for charitable purposes

The taxpayer has also not clearly established that it does not place obstacles in the way of those who are seeking employment with the taxpayer. Although the taxpayer targets hiring people who have barriers to employment, the taxpayer’s representative said that it recruits all of its employees in the same manner because they are all trying to find jobs. (Tr. pp. 30, 33) The taxpayer did not provide documents to show how it advertises the open positions in order to target people who have barriers to employment. The taxpayer also did not provide any evidence of its actual hiring process. (Tr. pp. 31-32) The taxpayer did not give information concerning how many people it employs, how many of them are disadvantaged workers, or the wages of those workers.

From the evidence presented, it appears that the taxpayer operates in a manner similar to that of any other business in the community. The taxpayer explained that there are very few similar organizations in the country, and it requires a unique set of circumstances in a community in order to facilitate this type of organization. (Tr. pp. 46-47) Providing employment to disadvantaged members of the community is certainly an important service and promotes the well-being of society. The taxpayer’s operations are laudable, but laudable acts do not necessarily constitute charity. See Coyne Electrical School v. Paschen, 12 Ill. 2d 387, 399 (1957); 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).

As previously stated, exemption provisions are strictly construed; all doubts and debatable questions must be resolved in favor of taxation. Wyndemere, *supra*. The taxpayer must establish clearly and convincingly that it is entitled to the exemption. See Wyndemere, *supra*; Rogy's New Generation, Inc., *supra*. The evidence raises doubts concerning the extent of the taxpayer's charitable acts. Because the evidence falls short of showing clearly and convincingly that the taxpayer meets most of the guidelines in Methodist Old Peoples Home, *supra*, and 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: November 20, 2017