

ST 07-23

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**

ABC, INC.)	Docket No.	00-ST-0000
)	IBT No.	0000-0000
)		
v.)		
THE DEPARTMENT OF REVENUE)	John E. White,	
OF THE STATE OF ILLINOIS)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Jane Doe appeared *pro se* for ABC; John Alshuler, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose when ABC, Inc. (ABC or applicant) protested the Illinois Department of Revenue's (Department) denial of its application for an exemption identification number pursuant to § 1g of the Retailers' Occupation Tax Act (ROTA) and § 3-5(4) of Illinois's Use Tax Act (UTA). 35 ILCS 120/1g; 35 ILCS 105/3-5(4). The issue is whether ABC is organized and operated exclusively for charitable purposes.

The hearing was held at the Department's offices in Chicago. ABC presented a copy of a letter from the Internal Revenue Service, as well as the testimony of Jane Doe, ABC's chief financial officer. I have reviewed that evidence, and the Department's concessions of certain facts, and I am including in this recommendation findings of fact and conclusions of law. I recommend the Director finalize the denial as issued.

Findings of Fact:

1. In 2003, ABC received § 501(c)(3) status from the Internal Revenue Service (IRS). Applicant Ex. 1 (copy of August 24, 2004 IRS letter acknowledging ABC's § 501(c)(3) status).
2. ABC is an Illinois not-for-profit corporation, and has no capital stock or shareholders. Hearing Transcript (Tr.), p. 15 (Department's closing argument). For calendar year 2003, ABC's "audited financial statement[s], which [ABC] supplied to the Department, ... show[] that some 94.5 percent of [its] funding is obtained from state and federal grants; 87 percent from the Illinois Department of Human Services and 7.5 percent from the U.S. Department of Housing." Tr. p. 18.

Conclusions of Law:

This matter involves ABC's application for an active exemption identification number so that it might make purchases of tangible personal property at retail without paying use tax. Section 3-5 of the UTA provides, in pertinent part:

Exemptions. Use of the following tangible personal property is exempt from the tax imposed by this Act:

(4) 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, or by 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. ... 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.

Section 12 of the UTA incorporates several sections of the ROTA by reference.

35 ILCS 105/12. Section 7 of the ROTA is one of those sections, and it provides, in part:

It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the

contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be on upon the person who would be required to remit the tax to the Department if such transaction is taxable. ***

35 ILCS 120/7.

At hearing, the Department introduced a copy of its denial of ABC's application under the certificate of the Director. Department Ex. 1; Tr. p. 7. That exhibit, without more, constitutes prima facie proof that ABC is not entitled to the sought-after exemption. 35 ILCS 120/7-8. The Department's prima facie case is overcome, and the burden shifts to the Department to prove its case, only after a taxpayer presents evidence that is consistent, probable and closely identified with its books and records, to show that the Department's determinations were not correct. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157-58, 242 N.E.2d 205, 207 (1968). Additionally, "... when a taxpayer claims that he is exempt from a particular tax, ... the burden of proof is on the taxpayer." Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296, 421 N.E.2d 236, 238 (1st Dist. 1981) (citing Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305, 347 N.E.2d 729 (1976); Bodine Electric Co. v. Allphin, 81 Ill. 2d 502, 410 N.E.2d 828 (1980)).

When considering whether an entity is a corporation organized and operated exclusively for charitable purposes, Illinois courts and the Department follow the guidelines announced by the Illinois Supreme Court in Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 149, 233 N.E.2d 537 (1968). Eden Retirement Center, Inc. v. Department of Revenue, 213 Ill. 2d 273, 287, 821 N.E.2d 240, 248 (2004). While the Methodist Old Peoples Home case involved a property tax dispute, the guidelines are similarly applicable to a charitable exemption under Illinois' retailers' occupation and use tax acts. Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d

455, 459-60, 654 N.E.2d 608, 611-12 (2d Dist. 1995). As applied to this matter, those guidelines ask whether:

- (1) the benefits derived are for an indefinite number of persons for their general welfare or in some way reducing the burdens on government;
- (2) the organization has no capital, capital stock, or shareholders, and does not profit from the enterprise;
- (3) funds are derived mainly from private and public charity, and the funds are held in trust for the objects and purposes expressed in the organization's charter;
- (4) charity is dispensed to all who need and apply for it; and
- (5) obstacles are placed in the way of those seeking the benefits;

Eden Retirement Center, Inc., 213 Ill. 2d at 287, 821 N.E.2d at 248¹ (citing Methodist Old Peoples Home, 39 Ill. 2d at 156-57, 233 N.E.2d 537).

During closing argument, the Department asserted that ABC failed to show that it was organized and operated exclusively for charitable purposes. Tr. p. 20. ABC introduced only one document into evidence, a copy of the letter it received from the IRS notifying it that the IRS determined it was exempt from federal income tax. But Illinois law is clear that proof of tax exempt status for federal tax purposes does not require the same treatment under Illinois' tax laws. *See* People ex rel. County Collector v. Hopedale Medical Foundation, 46 Ill. 2d 450, 464, 264 N.E.2d 4, 11 (1970).

But for the IRS letter, ABC offered no books and records regarding its organization and operations. Ordinarily, without such records, an applicant is unable to satisfy any of the Methodist Old Peoples Home guidelines. *See* Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455, 460, 654 N.E.2d 608, 612

¹ The sixth guideline, which asks whether the primary use of the property is for charitable purposes, is not applicable here because this matter does not involve ABC's use of real property.

(2d Dist. 1995) (court must construe all facts and resolve all debatable questions in favor of taxation); American Welding Supply Co. v. Department of Revenue, 106 Ill. App. 3d 93, 100-02, 435 N.E.2d 761, 767-68 (5th Dist. 1982) (taxpayer's mere testimony that certain receipts were exempt did not rebut Department's prima facie correct determination that such receipts were taxable, whereas taxpayer established that other receipts were exempt when it introduced documentary evidence, i.e., resale certificates, required to document such exempt sales); Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296-97, 421 N.E.2d 236, 239 (1st Dist. 1981) (uncontroverted testimony that was not corroborated with documentary evidence was insufficient to show that taxpayer was entitled to claimed exemption).

Here, however, the Department conceded certain facts regarding ABC's operations that are relevant to some of the Methodist Old Peoples Home guidelines. Specifically, Department counsel, during closing argument, stated that ABC had no capital stock or shareholders. Tr. p. 15. He also stated that ABC's "audited financial statement[s], which [ABC] supplied to the Department for calendar year 2003, clearly show[] that some 94.5 percent of [ABC's] funding is obtained from state and federal grants; 87 percent from the Illinois Department of Human Services and 7.5 percent from the U.S. Department of Housing." Tr. p. 18. After making those factual concessions, the Department argued that ABC's receipt of most of its funds from government grants should not be considered evidence that it reduced a burden of government, when considering whether ABC's operations constituted charity. Tr. p. 19 ("The receipt of government money to implement a government mandated program lessens no burden on

government or no burden that government would otherwise have but for the activities if the Applicant.”).

When making this argument, the Department expressed its disagreement with a case, Community Mental Health Council, Inc. v. Department of Revenue, 186 Ill. App. 3d 73, 541 N.E.2d 1330 (1st Dist. 1989), in which the appellate court approvingly quoted the circuit court’s finding that the applicant was an exclusively charitable organization. Tr. p. 19; *see also* Community Mental Health Council, Inc., 186 Ill. App. 3d at 79, 541 N.E.2d at 1334. The Department calls the circuit court’s finding unsupported. Tr. p. 19. But it was amply supported simply by the fact that, in that case, the Department did not challenge the applicant’s status as an exclusively charitable organization. Community Mental Health Council, Inc., 186 Ill. App. 3d at 79, 541 N.E.2d at 1334 (“We first briefly note that the Department does not assert that the Council is not a charitable organization, nor can it.”); *id.* at 80, 541 N.E.2d at 1335 (“We have now reached the Department’s argument that notwithstanding the fact that the Council is a charitable organization, it was not using the property for charitable purposes”).

Perhaps what the Department means to do is to distinguish between a recipient of government grants and a government contractor. Illinois case law certainly suggests that the former type of activity, the receipt of government grants, constitutes evidence of public charitable funding. Albion Ruritan Club v. Department of Revenue, 209 Ill. App. 3d 914, 918, 568 N.E.2d 478, 481 (5th Dist. 1991) (“it has not been shown that Albion’s activities reduce the burdens of government because there is no evidence that the government was burdened with providing revenue for the projects to which Albion donated funds). On the other hand, the latter type of activity, that is, the receipt of

revenues from a governmental entity by a person that has contracted to perform work or to provide goods for it, does not evince charitable funding. *See* PLR 199924026, 1999 WL 399963 (IRS PLR) (June 18, 1999) (“The Service has held that payments made under legislatively provided social benefit programs for promotion of the general welfare are excludable from gross income. This general welfare doctrine applies only to governmental payments out of a welfare fund based upon the recipients' need, and not as compensation for services.”). Yet the Department here concedes that ABC is funded primarily through government grants. Tr. pp. 18-19.

Based on the Department’s concession of the facts referred to above, I find that there is no dispute that ABC satisfies part of the second and third Methodist Old Peoples Home guidelines. That is, there is no dispute that ABC has no capital, capital stock, or shareholders. Tr. p. 15. On the other hand, the second guideline also requires a showing that an entity was not operated for profit. Eden Retirement Center, Inc., 213 Ill. 2d at 287, 821 N.E.2d at 248. For purposes of Illinois tax exemptions, profit means the inurement of benefits to private individuals. DuPage Co. Bd. of Review v. Joint Comm. on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461, 470, 654 N.E.2d 240, 246 (2d Dist. 1995). As a simple matter of proof, the way a putative charitable organization shows that no one profits from its operations is to document how its funds are spent, and to document the features of its operations regarding its members if applicable. *Id.* at 470-71, 654 N.E.2d at 246 (court noting that the record in that case showed no such profit); DuPage Art League v. Department of Revenue, 177 Ill. App. 3d 895, 901, 532 N.E.2d 1116, 1119-20 (2d Dist. 1988) (court noting that applicant’s “members gain a distinct advantage not afforded to nonmembers by the opportunity to

sell, promote, and familiarize the community with their work.”). Here, ABC offered no documents showing how it spent its revenues. Thus, it has not satisfied the whole of the second Methodist Old Peoples Home guideline.

I make the same conclusion regarding the third Methodist Old Peoples Home guideline, which similarly focuses on two inquiries: first, whether the organization’s funds are derived mainly from private and public charity; and second, whether the funds are held in trust for the objects and purposes expressed in the organization’s charter. Eden Retirement Center, Inc., 213 Ill. 2d at 287, 821 N.E.2d at 248. Even with the Department’s acknowledgment that ABC derives most of its funds from government grants, ABC has not satisfied the third guideline because, again, it has failed to offer books and records which document how it spent its funds, and because it offered no organizational documents into evidence to show what its charitable purposes are. Morton Temple Ass’n, Inc. v. Department of Revenue, 158 Ill. App. 3d 794, 795, 511 N.E.2d 892, 893 (3rd Dist. 1987). (“[t]he first step in determining whether an organization is charitable is to consider the provisions of its charter.”)

The only evidence it did offer on this latter point was the testimony of Jane Doe (Doe), its CFO (Tr. p. 11), in response to the Department’s description of a charitable purpose. Doe testified that:

No. 1, we don’t persuade our clients to any type of educational training. Our main purpose of our organization is to help individuals feel better about themselves and to realize that the type of life that they are living[,] just because they are low income they don’t have to stay there. They come to us voluntarily. It’s not nothing that’s forced upon them. There is no brainwashing process, anything like that.

We have — we mentor them to build their self-esteem, to let them know that, hey, because you did this or

that, you are an ex-offender, you can do better. You can live in a different situation. You can have a job and you can hold that job. That's what we do.

Tr. p. 21.

Doe's testimonial expression of ABC's organizational purpose is, at best, vague, and that vagueness does not help ABC establish that its operations are exclusively charitable. Applicant did not offer any organizational documents into evidence, such as its articles of incorporation or bylaws, which would have at least articulated the purposes underlying its organization. Morton Temple Ass'n, Inc., 158 Ill. App. 3d at 795, 511 N.E.2d at 893. Nor did it offer into evidence any documents describing the programs undertaken in an attempt to meet such purposes.

It is ABC's burden to introduce evidence sufficient to show that it was organized and actually operated as an exclusively charitable organization. Chicago Patrolmen's Assoc. v. Department of Revenue, 171 Ill. 2d 263, 271, 664 N.E.2d 52, 56 (1996) ("The burden of proving the right to exemption rests upon the party seeking it."). Since ABC failed to introduce any financial books and records into evidence, it has not satisfied the second through fifth Methodist Old Peoples Home guidelines. Eden Retirement Center, Inc., 213 Ill. 2d at 287, 821 N.E.2d at 248. Since ABC failed to introduce any organizational documents into evidence, it has not satisfied the first Methodist Old Peoples Home guideline. *Id.*

Conclusion:

I recommend that the Director finalize the Department's tentative denial of ABC's application for an exemption identification number.

November 20, 2007
Date

John E. White, Administrative Law Judge