

ST 09-4

Tax Type: Sales Tax

Issue: Exemptions From Tax (Charitable or Other Exempt Type)

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

ABC PHYSICIANS & SURGEONS, INC.

Taxpayer

Docket # 07-ST-0000

Claim for Exemption Number

RECOMMENDATION FOR DISPOSITION

Appearances: Robin Gill, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Todd M. Turner of Sorling, Northrup, Hanna, Cullen & Cochran, Ltd. for ABC Physicians & Surgeons, Inc.

Synopsis:

ABC Physicians & Surgeons, Inc. (“taxpayer”) applied 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 taxes and use taxes. The Department denied the application, and the taxpayer timely protested the denial. An evidentiary hearing was held during which the issues presented were whether the taxpayer is organized and operated exclusively for educational or, in the alternative, 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 contends, *inter alia*, that it operates primarily for educational purposes because it is the “clinical arm” of the ABC University School of Medicine (“ABC” or “School of Medicine”). The Department did not file a brief or provide arguments in response to the taxpayer’s arguments. After reviewing the record, it is recommended that this matter be resolved in favor of the taxpayer.

FINDINGS OF FACT:

1. The taxpayer is an Illinois non-profit corporation that was organized in February 1997. (Taxpayer Ex. #5)
2. The taxpayer’s articles of incorporation state its purpose as follows:

The Corporation is organized exclusively for charitable, educational and scientific purposes and to foster and support the teaching, research and service missions of ABC University. The Corporation is established at the direction and approval of the Board of Trustees of [ABC] in furtherance of its responsibilities under 110 ILCS 520/8(11). Additional purposes of the Corporation include:

- To aid in the education and training of medical students, residents, fellows and physicians for the delivery of cost-effective, high-quality patient care and the conduct of medical and other scientific investigations.
- To support, aid and advance the study and investigation of human illnesses and the causes, preventions, relief and cure thereof.
- To integrate the independent professional activities of the clinical faculty of ABC School of Medicine through common planning and administration in a manner that is responsive to the changing health care market place while maintaining a commitment to high-quality medical education, provided that medical or surgical treatment, consultation or advice will be provided by Members of ABC P & S only if they are duly licensed or appropriately certified to perform such services as required by law.

- To provide, through duly licensed or appropriately certified members of the Corporation, a reasonable and proportionate share of charitable medical care to individuals in the community.¹ (Taxpayer Ex. #5)

3. The taxpayer's mission statement is the following:

It is our mission to be a leader in quality health care to all people of central and ABC in support of the mission of the ABC University School of Medicine.² (Taxpayer Ex. #11)

4. The taxpayer is a membership organization. Each member must be licensed or certified to provide professional medical care. (Taxpayer Ex. #6, p. 7)
5. Members must be faculty of the School of Medicine. Membership ceases if the person ceases to be a member of the School of Medicine faculty. (Taxpayer Ex. #6, pp. 6-8)
6. The bylaws state that membership requirements include the following:

All ABC School of Medicine faculty with a full-time equivalency of 51% or more who engage in clinical activity for which a professional fee is charged must be Members of ABC P&S. In addition, the Board of Directors may offer membership status to any ABC School of Medicine faculty member with less than 51% full-time equivalency who engages in clinical activity for which a professional fee is charged if 100% of their clinical practice is through ABC P&S. Such membership may be rescinded by the Board of Directors at any time.³ (Taxpayer Ex. #6, p. 7)

7. The taxpayer's members must not have an independent or outside medical practice. (Taxpayer Ex. #6, p. 7)

¹ The taxpayer's bylaws contain a purpose statement that is substantially similar to the one in the articles of incorporation. (Taxpayer Ex. #6)

² The mission of ABC School of Medicine is to assist the people of central and ABC in meeting their health care needs through education, patient care services and research. (Taxpayer Ex. #11)

³ The articles of incorporation and the Master Agreement between the taxpayer and ABC contain similar language indicating that "individuals with full-time clinical faculty appointments with the School of Medicine shall, when they become Members...have their faculty appointments reduced to less than 100%, but not less than 51% time." (Taxpayer Ex. #8, p. 7)

8. The taxpayer is the clinical practice of the School of Medicine. It has 215 members; 212 are full-time faculty members, and 3 are emeritus faculty (Taxpayer Ex. #14; Tr. p. 156)
9. The School of Medicine is a public medical school that was established in 1970 to focus on the health care needs of downstate Illinois. There are 72 students in each class. (Taxpayer Ex. #14)
10. During the last two years of medical school, students participate in clinical clerkships. These experiences allow students to become working members of the medical team that provides direct, hands-on care to specific patients. At the same time in the classroom, these students formally study the medical discipline they practice in the clinical setting. (Taxpayer Ex. #3)
11. Residency is the period of training following the M.D. degree and includes mostly clinical training. The residency lasts between 3 and 7 years, depending on the specialty. The School of Medicine offers residency training programs for physicians in 14 specialty areas. (Taxpayer Ex. #3, #14; Tr. pp. 19-20)
12. The taxpayer's members complete Student Performance Evaluations for the students' clinical performance. Areas that are evaluated include patient care, medical knowledge, practice-based learning and improvement, interpersonal and communication skills, professionalism, and systems-based practice. (Taxpayer Ex. #9; Tr. pp. 87-90)
13. Under the Master Agreement, which sets forth the terms of the relationship between the taxpayer and ABC (on behalf of the School of Medicine), the taxpayer agreed to cooperate with the Chancellor of ABC and the President of

ABC to allow the University to monitor the relationship between the University and the taxpayer. (Taxpayer Ex. #8, p. 3)

14. The School of Medicine employs the taxpayer's members as full-time faculty for their performance of duties relating to the school's teaching, research and service missions. The taxpayer provides separate and concurrent employment to its members for the performance of duties relating to patient care and service to the community. (Taxpayer Ex. #8, p. 2)
15. Members receive two paychecks, one from the school for the "academic salary," and the other from the taxpayer for the "clinical salary." The clinical paycheck is based on clinical productivity, which is measured by Medicare's work unit values. The taxpayer has seven clinical departments, and the department chairs set the academic salaries. (Taxpayer Ex. #11; Tr. pp. 37, 115-116)
16. ABC provides the taxpayer with facilities, furniture, equipment, utilities, janitorial services and other support as may be necessary and appropriate to operate and maintain the taxpayer's clinical activities. (Taxpayer Ex. #8, p. 4; Tr. p. 113)
17. ABC provides support to the taxpayer, including telephone system access, maintenance of facilities, campus mail system access, and administrative, legal and other support services. (Taxpayer Ex. #8, p. 5; Tr. p. 113)
18. ABC provides each of the taxpayer's members with individual professional liability coverage through ABC's Risk Management and Self-Insurance Program for claims arising out of professional services rendered to patients in the

member's capacity as a duly licensed provider employed by the taxpayer.
(Taxpayer Ex. #8, p. 5)

19. The taxpayer must obtain ABC's authorization for directly procuring any of the previously referenced goods and services. (Taxpayer Ex. #8, p. 5)
20. The taxpayer cannot lease or purchase real estate without written permission from ABC. The taxpayer cannot employ or terminate personnel other than its members and its chief executive officer without written permission from ABC. (Taxpayer Ex. #8, p. 5)
21. ABC, as an agent for the taxpayer, is responsible for billing, collection and receipt of all fees, compensation and other revenues generated by the services and activities of the taxpayer. ABC receives a portion of the income to cover its cost of providing support to the taxpayer. (Taxpayer Ex. #8, pp. 5-6; Tr. pp. 63, 101)
22. From the balance remaining of the funds collected (minus the amount paid to SUI to cover its cost of providing support), the taxpayer uses a portion of the money to fund the Academic Development Funds, which are used for medical, educational, research and academic development purposes of the School of Medicine. (Taxpayer Ex. #8, p. 6)
23. The balance remaining, after the deductions previously stated, is used to pay expenses in the following order: (1) the taxpayer's operating expenses; (2) the taxpayer's operating reserves; (3) members' compensation; and (4) funding other reserves as necessary and appropriate. (Taxpayer Ex. #8, p. 6)
24. The taxpayer's Board of Directors consists of 11 persons: one director is the Dean and Provost of the School of Medicine; three directors are academic chairs

of the clinical departments of the School of Medicine; four directors are members of the taxpayer; and three directors are independent members of the general public. (Taxpayer Ex. #6, p. 2)

25. According to the taxpayer's audited financial statements, the Statement of Revenues, Expenses, and Changes in Net Assets for the fiscal year ending June 30, 2006, shows the following:

Operating revenues	
Net patient service revenue	\$71,452,970
Other operating revenue	<u>979,884</u>
Total operating revenues	\$72,432,854
Operating expenses	
Salaries	24,264,831
Payroll taxes	1,142,421
General and administrative	466,190
Insurance	588,640
Professional services	672,754
Medical transcription	759,632
Software license fees	536,942
Clinical supplies	1,173,088
Equipment	64,596
Depreciation	167,412
Pharmaceutical	2,109,333
University overhead	30,591,351
Academic development	<u>7,595,883</u>
Total operating expenses	<u>70,133,073</u>
Operating income	2,299,781
Non-operating revenues (expenses)	
Interest income	355,321
Contributions/donations	<u>(13,963)</u>
Total nonoperating revenues (expenses)	341,358
Increase in net assets	\$2,641,139

(Taxpayer Ex. #10, p. 13)

26. Upon dissolution, the taxpayer's assets will be distributed to the School of Medicine or to a successor not-for-profit fund, foundation, or corporation.

(Taxpayer Ex. #5, p. 4)

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). Section 2c of the Act provides additional guidance regarding entities organized for educational purposes and provides in part as follows:

For purposes of this Act, a corporation, limited liability company, society, association, foundation or institution organized and operated exclusively for educational purposes shall include: all tax-supported public schools; private schools which offer systematic instruction in useful branches of learning by methods common to public schools and which compare favorably in their scope and intensity with the course of study presented in tax-supported schools; 35 ILCS 105/2c.

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. Du Page County Board of Review v. Joint Commission on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461, 466 (2nd Dist. 1995).

The Department's denial of the taxpayer's claim for an exemption identification number is presumed to be correct, and the taxpayer has the burden of proving by clear and convincing evidence that it is entitled to the exemption. See Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455, 459 (2nd Dist. 1995); Gas Research Institute v. Department of Revenue, 154 Ill. App. 3d 430, 436 (1st Dist. 1987). 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.*

Case law and the Department's regulations provide guidance for determining whether a taxpayer is "organized and operated exclusively for educational purposes." When the taxpayer is a corporation, the purpose for which it is "organized" is determined by reference to its Charter. 86 Ill. Admin. Code §130.2005(j)(1). Whether the taxpayer is "operated" exclusively for educational purposes is determined from the actual facts relating to its method of operation. See Du Page County Board of Review, *supra*. The term "exclusively" has been interpreted by the courts to mean "primarily." See Yale Club of Chicago v. Department of Revenue, 214 Ill. App. 3d 468, 473 (1st Dist. 1991). Finally, the phrase "educational purposes" is construed as meaning "school purposes" as that phrase has been interpreted by the Supreme Court. 86 Ill. Admin. Code

§130.2005(l); Rogy's New Generation, Inc. v. Department of Revenue, 318 Ill. App. 3d 765, 772 (1st Dist. 2000).

According to the Supreme Court, in order for an institution to operate for school purposes, its course of study must: (1) fit into the general scheme of education founded by the State and supported by public taxation, and (2) substantially lessen what would otherwise be a governmental function and obligation. Coyne Electrical School v. Paschen, 12 Ill. 2d 387, 392-93 (1957). Applying this two-part test, the appellate court found that an organization that operated a daycare center did not qualify for an educational purposes exemption from the retailers' occupation and use taxes. Rogy's New Generation, *supra*. The court stated that the fundamental flaw in the taxpayer's case was that the State of Illinois does not provide, nor mandate, education for children under the age of 5. *Id.* at 772.

In the present case, clinical training is mandated as part of the requirements for a medical education. The Medical Practice Act of 1987 (225 ILCS 60/1 *et seq.*) sets forth minimum education standards in order to receive a license to practice medicine. These include "at least 2 academic years of study in the basic medical sciences; and 2 academic years of study in the clinical sciences...." 225 ILCS 60/11(A)(2)(a). One of the regulations for the Department of Financial and Professional Regulation ("DFPR") reiterates this requirement and defines "academic year" as "a minimum period of 9 months that includes no less than 25 clock hours per week of basic sciences...and no less than 40 clock hours per week of clinical sciences...." 68 Ill. Admin. Code §1285.20(h).

The regulation for DFPR also states that the two academic years of study in the clinical sciences "shall include at least the following required core clerkship rotations:

(1) internal medicine; (2) obstetrics and gynecology; (3) pediatrics; (4) psychiatry; and (5) surgery.” 68 Ill. Admin. Code §1285.20(d). With respect to core clerkship rotations, the regulation includes the following:

The core clerkship rotations must have been taken and completed in clinical teaching facilities owned, operated or formally affiliated with the medical college that conferred the degree or under contract in teaching facilities owned, operated or formally affiliated with another medical college that is officially recognized by the jurisdiction in which the medical school that conferred the degree is located. 68 Ill. Admin. Code §1285.20(e).

“Clinical teaching facilities” include those that meet or exceed the requirements of Section 1285.40.⁴ 68 Ill. Admin. Code §1285.20(j). In addition, each clerkship must be at least 4 weeks long and “consist of hands-on experience with patients that is planned, managed and supervised by faculty of the medical school conferring the degree...” 68 Ill. Admin. Code §1285.20(i). The ABC University Management Act (110 ILCS 520/.01 *et seq.*) authorizes the Board of Trustees of ABC to conduct health care programs in furtherance of its teaching, research, and public service functions.⁵ 110 ILCS 520/8(10.5). It also authorizes the Board of Trustees to administer a clinical faculty plan for the School of Medicine.⁶ 110 ILCS 520/8(11).

It is clear from the statutes, regulations, and facts in the instant case that the clinical training for medical students provided by the taxpayer meets the requirements for the educational purposes exemption. The taxpayer’s clinical training fits into the general

⁴ Section 1285.40(d) indicates, *inter alia*, that clinical training programs that are accredited by the Accreditation Council for Graduate Medical Education meet the minimum criteria for clinical training programs and are, therefore, approved for clinical training. 68 Ill. Admin. Code §1285.40(d).

⁵ The health care programs include “patient and ancillary facilities, institutes, clinics or offices...to carry out such activities in the course of or in support of the Board’s academic, clinical, and public service responsibilities.” 110 ILCS 520/8(10.5).

⁶ The statute authorizes the Board to administer a plan “for the billing, collection and disbursement of charges for services performed in the course of or in support of the faculty’s academic responsibilities...” 110 ILCS 520/8(11).

scheme of medical education founded by the State and substantially lessens a governmental function or obligation. See Coyne, *supra*. Clinical training is an essential part of medical education in this State. Illinois law mandates a minimum of two academic years of study in clinical sciences in order to obtain a license to practice medicine. Clinical training consists of “hands-on experience with patients that is planned, managed and supervised by faculty of the medical school conferring the degree.” 68 Ill. Admin. Code §1285.20(i). This is the type of training that is provided by members of the taxpayer in connection with the ABC School of Medicine. The taxpayer is closely affiliated with ABC and provides clinical training as part of an established academic environment.

The taxpayer was organized for educational purposes and was established at the direction and approval of the Board of Trustees. The taxpayer’s members must be licensed to practice medicine and must not have an independent or outside medical practice. The members must be faculty of the School of Medicine with a full-time equivalency of at least 51%. The Chancellor of ABC and the President of ABC monitor the relationship between the University and the taxpayer, and ABC provides the taxpayer with various support services (including personnel, billing, and collection services) to operate its clinical activities. The taxpayer’s members complete performance evaluations of the students, and a portion of the taxpayer’s revenue funds the School of Medicine’s academic development. If the taxpayer dissolves, its assets go to the School of Medicine. The taxpayer is an integral part of the School of Medicine, and these facts support a finding that the educational purposes exemption for retailers’ occupation and use taxes has been met.

Recommendation:

For the foregoing reasons, it is recommended that the taxpayer's request for an exemption identification number be granted.

Linda Olivero
Administrative Law Judge

Enter: March 6, 2009