

ST 11-14
Tax Type: Sales Tax
Tax Issue: Tangible Personal Property
Whether Certain Purchases Were Exempt

DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS
OFFICE OF ADMINISTRATIVE HEARINGS

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ABC Institute)	
)	
Now known as XYZ Institute,)	
)	
Taxpayer)	
)	Docket No. XXXXXX
v.)	
)	
DEPARTMENT OF REVENUE OF)	
THE STATE OF ILLINOIS)	

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FINAL ADMINISTRATIVE DECISION

SYNOPSIS

The ABC Institute, now known as the XYZ Institute (“Taxpayer”), is an Illinois not-for-profit corporation that is recognized by the Illinois Department of Revenue (“Department”) as a not-for-profit service enterprise operating exclusively for charitable purposes. Since at least 1997, the Department has issued Taxpayer an exemption identification number (an “E number”) evidencing its tax exempt status. Taxpayer provides comprehensive visual rehabilitation programs to patients with low vision and trains doctors of optometry in the highly specialized field of low vision care. Rehabilitation programs include professional examinations, counseling, and training in adaptive skills and tools to assist patients in maximizing their vision and functioning independently at home, school, work and within the community. Following an audit, the Department issued twelve Notices of Tax Liability (“NTLs”) for Retailers’ Occupation Tax (“ROT”) to the Taxpayer for periods from January 1, 2001 through March 31, 2008. Taxpayer

protested all twelve NTLs. Following a hearing held pursuant to Taxpayer's timely protest, the Department's Administrative Law Judge ("ALJ"), Julie-April Montgomery, submitted a recommendation, including Stipulated Facts and conclusions of law to me, as Director, for consideration and final determination.

SUMMARY OF ISSUES AND FINDINGS

The issues in controversy here are twofold. The primary issue is whether Taxpayer's sales of tangible personal property to patients are subject to tax under the Retailers' Occupation Tax Act ("the Act"), or are nontaxable under provisions in Section 1 of the Act that allow tax-free sales to be made by an exempt entity to its members or patients "to be used primarily for the purposes of" the exempt entity. Taxpayer's sales at issue in this case include prescription items, such as glasses, magnifiers, telescopes and portable and non-portable electronic magnifying glasses, and also non-prescription items, such as large character telephones, kitchen timers, wall clocks and calendars. The second issue involves a determination of whether these provisions confer an exemption from tax, or function as an exclusion from tax that removes these sales, *ab initio*, from the reach of the ROT. If characterized as an exemption, Taxpayer bears the burden of proof in establishing entitlement to the exemption. However, if characterized as an exclusion, the law requires that the statute be strictly construed, with all doubts construed strongly against the Department and in favor of Taxpayer.

Upon due consideration, I disagree with the recommendation of the ALJ to exclude these items from tax. Specifically, I find that the provisions of Section 1 constitute an exemption from tax, and that consequently, Taxpayer bears the burden of demonstrating that it is entitled to the exemption. I further find that Taxpayer's sales to patients are made primarily for the purpose of

patients, and do not constitute sales of tangible personal property to be used primarily for its own purposes. As such, the sales do not fall within the narrow ambit of sales exempted from the Act.

In reaching a conclusion that rejects ALJ Montgomery's recommendation, I am very well aware of my responsibilities to Taxpayer as well as to the State of Illinois. My decision is based solely upon the record in this matter and my legal analysis based upon this record. I have apprised myself of those pertinent provisions of Illinois statutes, regulations and case law related to the issues in controversy. I also find that the record is sufficient to permit the appropriate review and issuance of a final administrative decision that differs from the ALJ's, in accordance with the provisions of 86 Ill. Adm. Code 200.130. See also *Highland Park Convalescent Home v. Health Facilities Planning Commission*, 217 Ill.App.3d 1088, 578 N.E.2d 92 (2d Dist. 1991).

FACTS ADOPTED AND INCORPORATED BY REFERENCE

In lieu of a hearing, the parties submitted Stipulated Facts and filed briefs. I have accepted, and hereby incorporate as if fully set forth in this decision, all 22 of the "Stipulated Facts" set forth in pages 2 through 4 of the ALJ's opinion.

APPLICABLE LAW

The Act imposes a tax upon persons engaged in the business of selling tangible personal property at retail. See, 35 ILCS 120/2. Section 1 of the Act defines a "sale at retail." It states, in part, that

[a] person whose activities are organized and conducted primarily as a not-for-profit service enterprise, and who engages in selling tangible personal property at retail (whether to the public or merely to members and their guests) is engaged in the business of selling tangible personal property at retail with respect to such transactions, excepting only a person organized and operated exclusively for charitable, religious or educational purposes either (1) to the extent of sales by such person to its members, students, patients or inmates of tangible personal property to be used primarily for the purposes of such person or (2) to the

extent of sales by such person of tangible personal property which is not sold or offered for sale by persons organized for profit. The selling of school books and school supplies by schools at retail to students is not “primarily for the purposes of” the school which does such selling. The provisions of this paragraph shall not apply to nor subject to taxation occasional dinners, socials or similar activities of a person organized and operated exclusively for charitable, religious or educational purposes, whether or not such activities are open to the public.

The Department’s administrative regulations at 86 Ill. Adm. Code 130.2005 implement these provisions. Section 130.2005 (a)(1)(“Scope of the Exemption”) states, in part, that “[t]here are still some very limited exemptions from the Retailers’ Occupation Tax for sales by exclusively charitable, religious and educational organizations and institutions.” Three kinds of exempt selling may be made, including sales to members; noncompetitive sales; and occasional dinners and similar activities. This case involves only the provisions governing sales made to members. Section 130.2005 (a)(2)(A-C) describes these sales:

2) Sales to Members, etc.

- A) The first exception is that the sales by such an organization are not taxable if they are made to the organization’s members, or to its students in the case of a school or to its patients in the case of a nonprofit hospital which qualifies as a charitable institution, primarily for the purposes of the selling organization.
- B) Examples of sales that come under this exemption are sales of uniforms, insignia and Scouting equipment by Scout organizations to their members; sales of Bibles by a church to its members, and sales of choir robes by a church to the members of the church’s choirs. The selling organization would incur Retailers’ Occupation Tax liability if it should engage in selling any of the foregoing items at retail to the public.
- C) The selling of school books and school supplies by schools at retail to students shall not be deemed to be “primarily for the purpose of” the school which does such selling. Consequently, schools incur Retailers’ Occupation Tax liability when they engage in selling school books or school supplies at retail to their students or to others.

Section 130.2005(b)(1) and 130.2005(m) set out specific rules for hospitals. Section 130.2005(m) lists factors used by the Department to determine if a hospital is considered “exclusively charitable.” This latter subsection notes that “[t]he principles stated in this

subsection with respect to hospitals apply also to sanitararia and clinics.” Section 130.2005(b)(1) explains the circumstances under which hospitals qualify for the exemption for sales to members.

This subsection states:

1) Hospital Sales

- A) Nonprofit hospitals which qualify as exclusively charitable institutions are not taxable when selling food or medicine to their patients in connection with the furnishing of hospital service to them, nor on the operation of restaurant facilities which are conducted primarily for the benefit of the hospital’s employees, and which are not open to the public. However, sales made in a hospital cafeteria which is open to the public will be taxable sales.
- B) In the case of hospitals which qualify as charitable institutions, such hospitals are not taxable when selling drugs to anyone because this is for the relief of the sick (which is the hospital’s primary purpose) and so is “primarily for the purpose of” such hospitals, thus qualifying such transactions for tax exemption. However, a hospital or hospital auxiliary incurs Retailers’ Occupation Tax liability when selling candy, chewing gum, tobacco products, razor blades and the like at retail even when such items are sold only to patients because (unlike food and medicine) these items are not necessary to the furnishing of hospital service, and they are competitive.
- C) The same distinctions apply to nonprofit sanitararia and nonprofit nursing homes when they qualify as exclusively charitable institutions.

Section 130.2005 (b)(4) governs “Special Problems Concerning Sales by Schools”. Subsections

(A) and (C) of this Section provide examples of selling activities by schools:

(A) Dining facilities

A school does not incur Retailers’ Occupation Tax liability on its operation of a cafeteria or other dining facility which is conducted on the school’s premises, and which confines its selling to the student and employees of the school. In any instance in which the dining facility is opened up for the use of other persons, all sales that are made at such facility while that condition continues to prevail are taxable.

* * * * *

(C) School Books and School Supplies

- (i) A school incurs Retailers’ Occupation Tax liability when selling school books and school supplies to its student or others, for use.

- (ii) Schools are not taxable on their sales of school annuals because these are noncompetitive items.

ANALYSIS OF FACTS

Taxpayer has been issued an E number by the Department in recognition of its exempt charitable status, and is therefore exempt from Use Tax on purchases made in furtherance of its organizational purposes. See, 35 ILCS 120/2-5 (11). In addition, Section 1 of the Act allows entities with E numbers to engage in retail selling without incurring tax in three limited situations. In determining whether Taxpayer's sales fall within these limited situations, two issues are presented. The first issue is whether the provisions of Section 1 of the Act constitute an exemption or an exclusion from tax. Resolution of this issue clarifies the responsibilities of each party with regard to the burden of proof. The remaining issue is whether Taxpayer's sales fall within the scope of the statutory provisions.

Burden of Proof

In determining whether the provisions of Section 1 confer an exclusion or exemption, I must take into consideration not only the plain language of the Act itself, but also relevant case law. The Act provides for exemptions and exclusions in a number of different ways. The Act is imposed upon "persons engaged in the business of making sales at retail of tangible personal property." See, 35 ILCS 120/2. For a sale to be taxable under the Act, certain requirements must be met: the sale must be made by an entity engaged in the occupation of making sales at retail; the sale must be a sale at retail; and there must be a sale of tangible personal property. The Act often excludes persons from tax by deeming them to lack one or more of these basic requirements. This method of excluding persons from the reach of the tax is utilized in Section 1

of the Act. For example, Section 1 of the Act provides that persons who make isolated or occasional sales of tangible personal property, or persons who have received grants under Section VII of the Older Americans Act of 1965 and serve meals to participants in the federal Nutrition Program for the Elderly, are deemed not to be engaged in the business of selling tangible personal property at retail with respect to such transactions. Sales of specific types of tangible personal property are also excluded in this manner. For instance, Section 1 states that the purchase, employment and transfer of tangible personal property as newsprint and ink for the primary purpose of conveying news is not a purchase, use or sale of tangible personal property. In contrast, exemptions are generally expressed as exceptions to a general rule of taxability. Such is the case with the provisions at issue here, which specify that not-for-profit organizations engaged in making sales at retail to members or the public are, in fact, engaged in the business of making sales at retail, with three exceptions.

Examination of the manner in which the courts have construed the nature of the exceptions for not-for-profits, as well as the various amendments made by the legislature to Section 1 through the years, are instructive. In 1942, the supreme court construed a “sale at retail” to exclude sales by not-for-profit organizations. See, *Svithiod Singing Club v. McKibbin*, 381 Ill. 194 (1942). In 1961, however, Section 1 of the Act was amended by SB 564 to expressly include sales by not-for-profit organizations, with three limited exceptions. Since that time, several courts have unequivocally construed the provisions of Section 1 as an exemption, not an exclusion. In 1963, the supreme court invalidated a regulation promulgated by the Department that provided an “exemption” allowing schools to make tax-free sales of school books and school supplies to students. See, *Follett’s Illinois Book and Supply Store, Inc. v. Theodore J. Isaacs*, 27 Ill.2d 600 (1963). The court, in discussing the statutory provisions

underlying the regulation, clearly considered the exception for sales to members, students and patients, to be an exemption when it stated that:

“[s]tatutes exempting property from taxation must be strictly construed and cannot be extended by judicial interpretation. *In determining whether property is included within the scope of a tax exemption* all facts are to be construed and all debatable questions resolved in favor of taxation. *Every presumption is against the intention of the State to exempt property from taxation. Rotary International v. Paschen*, 14 Ill.2d 480, 486, and cases there cited. (emphasis added).” *Follett’s*, 27 Ill.2d at 606.

The Second District Appellate Court characterized these same statutory provisions as an exemption over 17 years later in *Farm Progress Show Concessions v. Department of Revenue*, 83 Ill.App.3d 228 (1980). That case involved determination of whether sales of food by a tax exempt church at a Farm Progress Show fell within the exception for “occasional dinners” found in Section 1 of the Act. The court referred to the statutory exception throughout the opinion as an “exemption” and concluded that “[t]he activities are therefore *within the statutory exemption*.” See, *Farm Progress Show*, 83 Ill. App.3d at 232 (emphasis added).

It is also important to note that the Department’s regulation characterizes the exception for sales by not-for-profit organizations as an exemption. The characterization of these provisions as an exemption has been in effect for nearly 50 years. In both *Follett’s* and *Farm Progress Show*, courts had the opportunity to invalidate the Department’s characterization of these exceptions as “exemptions.” Despite this opportunity, they did not do so, and instead, affirmed the Department’s characterization of these provisions as exemptions.

For these reasons, I find that the provisions in Section 1 constitute an exemption from tax. As such, in determining whether the Taxpayer’s selling activities fall within the scope of the exemption, all facts are to be construed and all debatable questions resolved in favor of taxation.

See, *United Air Lines, Inc. v. Johnson*, 84 Ill.2d 446 (1981); *Rotary International v. Paschen*, 14 Ill.2d 480 (1958).

Taxpayer's selling activities fall outside the limited types of selling scope of the exemption

The second part of my analysis examines whether the Taxpayer has met its burden of proving that its sales fall within the limited statutory exemption for “sales to members, students, patients or inmates of tangible personal property to be used primarily for the purposes of such person.” I find, for the reasons set forth below, that the Taxpayer has not proven its entitlement to the exemption.

In resolving whether Taxpayer's sales fall within the narrow ambit of sales exempted under the Act, I must consider the Stipulated Facts in the context of the Department's regulations interpreting the scope of the exemption. Several subsections of Section 130.2005 are relevant in this inquiry, each of which will be examined. Section 130.2005 (a)(2)(A – C) sets forth guidance regarding the three types of sales that all exempt entities can make without incurring tax. The regulation, like Section 1 of the Act, stresses that the general rule is to tax sales by exempt entities, with only limited exemptions. Sales to members that constitute “property to be used primarily for the purposes of” the selling organization are explained by means of example. Such sales include sales of uniforms, insignia and Scouting equipment by Scout organizations to their members; sales of choir robes by a church to choir members, and sales of Bibles by a church to its members. These items can reasonably be construed to be sold “primarily for the purpose of” the seller because they promote organizational unity and identity (Scout insignia), or are necessary for participation an entity's core activities (Bibles for bible study; robes for choir

performance). In each of these situations, the property, although also used by a member, is used primarily for the purpose of strengthening the entity's relationship with its members.

This is not the case with the items sold by Taxpayer. Sales of large character telephones, kitchen timers, wall clocks and calendars are used primarily for purposes of the patients, not the Taxpayer. These items do not promote Taxpayer's identity or strengthen its relationship with patients. Rather, these items, as well as prescription devices sold by Taxpayer, such as glasses, magnifiers, telescopes and portable and non-portable electronic magnifying devices, are used primarily by patients outside of the clinic to improve their visual impairments and enable them to function independently at home, work and in the community. I can find no evidence in the Stipulated Facts showing that Taxpayer uses any of the items sold to purchasers during its course of rehabilitative services. Even assuming such use does occur, I am not persuaded that these items are used "primarily for the purposes of" Taxpayer. Instead, the primary use of these items insures to the benefit of the patient by facilitating maximum independence at home, work and in the community.

Section 130.2005 (b)(1)(A-C) provides special rules for nonprofit hospitals, nursing homes and sanitarium. I find that these rules apply equally to clinics, such as the one operated by Taxpayer. I make this determination because Section 130.2005 (m), which lists indicia typical of exempt nonprofit hospitals and sanitarium, specifies that these principles "apply also to ... clinics." There is no reasonable basis to conclude that sales made by clinics are not equally eligible for the exemption from tax in Section 1 of the Act. These rules state that the sale of food and medicine to patients in connection with the furnishing of hospital service, is exempt. The rules posit that such sales are exempt because they are made primarily for the purpose of the hospital, i.e., to provide relief for the sick. In contrast, the regulations specify that a hospital incurs tax

when it sells candy, chewing gum, tobacco products, razor blades and the like at retail, even to patients, because, unlike food and drugs, these items “are not necessary to the furnishing of hospital service, and are competitive.” See, Section 130.2005 (b)(1)(B). Thus, the regulations instruct that exemption from tax is authorized only when the item sold is necessary in furthering the purpose of the exempt organization. The same logic applies to sales made in hospital cafeterias that are not open to the public, which the regulation cites as nontaxable. Such sales are exempt because the provision of food in an on-site cafeteria assists employees in carrying out the hospital’s function of caring for the sick.

Additional regulatory guidance is found in Section 130.2205 (b)(4) (“Special Problems Concerning Sales by Schools”). This subsection explains the taxability of various types of selling by schools to students. It explains that sales made in a school cafeteria open only to students and employees, like sales made in a hospital cafeteria not open to the public, are considered nontaxable. Clearly, these sales are an inseparable part of the school’s purpose of providing meals to resident students (and staff that work to fulfill the schools’ educational purposes). These sales thus constitute sales made “primarily for purposes of” the school. In contrast, however, subsection (b)(4)(C)(i) provides that schools incur tax liability when selling books and school supplies to students. Clearly, such selling is not considered to be made “for the purposes of” the school. See also *Follet’s Illinois Book and Supply Store, Inc. v. Theodore J. Isaacs*, 27 Ill.2d 600 (1963)(invalidating Department’s regulation providing an exemption for sales of books by schools to students).

Taxpayer asserts that its sales of telephones, clocks, magnifiers and other items are made primarily for its own purposes in fulfilling its charitable mission. It argues that its sale of these items in connection with the rendering of service to patients is therefore nontaxable, just as a

hospital is nontaxable when it transfers food and medicine to patients in the course of treatment, or dispenses drugs. The record in this case indicates that Taxpayer's mission is to "render visual rehabilitation services to patients who suffer from physical/medical impairments, i.e., low vision" (Stipulated Fact No. 17). Its patients "receive counseling and training in adaptive skills and tools to help them function independently using the abilities they have" (Stipulated Fact No. 21). In the course of rendering services to patients, Taxpayer sells tangible personal property to patients (Stipulated Fact No. 24). All its sales (of both prescriptive and non-prescriptive devices) "are offered to fulfill ABC Institute's exclusively charitable mission of providing the visually impaired with the tools and training necessary to maximize their vision and function independently at home, at school, at work, and within the community at large." As indicated in Stipulated Fact No. 26, "[t]he non-prescriptive items sold by ABC Institute are available for purchase from other retailers, either online or in stores."

Taxpayer's charitable mission is indeed a laudable one. It dispenses visual rehabilitation services to all who need and apply for them (Stipulated Fact No. 13). It provides a residency program to train doctors of optometry in the specialized field of low vision in collaboration with the ABC College of Optometry (Stipulated Fact No. 22). The Department has recognized the charitable nature of Taxpayer's mission by issuance of an E number to Taxpayer. This E number allows Taxpayer to make tax-free purchases of tangible personal property that are used in furtherance of its charitable mission. It can, for instance, make tax-free purchases of assistive devices and other tools it uses to train patients as part of its rehabilitation services. I cannot conclude, however, that Taxpayer's sales can be made tax-free under the limited exemption for sales to members and patients "to be used primarily for purposes of" the selling entity. Taxpayer's sales are not akin to sales by hospitals to patients. Nothing in the Stipulated

Facts indicates that Taxpayer's sales of kitchen timers, wall clocks, calendars, glasses, and magnifiers, are necessary to the furnishing of charitable services by the clinic. Taxpayer's services consist primarily of physical examinations, counseling, and training in adaptive skills and tools, all of which are possible without sales of adaptive devices. In contrast, sales of food and medicine to patients by hospitals is an inseparable element of its charitable purpose of providing care to the sick. Taxpayer's assertion that its sales are like sales of food and drugs by hospitals, is diminished by the fact patients are free to purchase the items sold by Taxpayer from other retailers. Stipulated Fact No. 26 provides that "the non-prescriptive items sold by ABC Institute are available for purchase from other retailers." While the Taxpayer's ability to offer adaptive devices for sale to patients is no doubt an important part of its charitable mission, it is not so inseparable a part of that mission to cause its sales to be deemed "primarily for its own purposes."

I find Taxpayer's sales to be akin, instead, to the sale of books to students by a school. Such sales clearly assist in fulfilling a school's educational purposes. However, Department regulations, as well as established case law (see, *Follett's*, herein), do not consider these sales to be sufficiently necessary to a school's educational purposes to warrant tax exemption. In other words, they do not constitute sales made "primarily for purposes of" the school. Likewise, while the sales made by Taxpayer may assist it in fulfilling its goal of helping patients achieve maximum independence, the sales primarily benefit the patients who use the clocks, glasses, magnifiers and other devices outside the clinic.

Summary and conclusion

For the foregoing reasons, I am unable to conclude that Taxpayer's sales of prescription and non-prescription assistive devices to its patients qualify for the exemption in Section 1 of the Act for sales by charitable entities to members and patients of tangible personal property "to be used primarily for the purposes of" the selling entity. This exemption was narrowly crafted by the legislature. Review of the legislative history, case law and Department regulations demonstrates that this exemption was intended to bestow a benefit upon charitable entities whose sales of property to members is an inseparable and necessary part of their purpose. The record in this case does not permit me to conclude that Taxpayer's sales fall within this limited exemption. As such, Taxpayer must be considered a retailer subject to tax under the Act. I therefore conclude that the Department was correct in issuing the twelve NTLs to Taxpayer based upon its sales of tangible personal property to patients.

Brian Hamer, Director

Illinois Department of Revenue