

ST 12-06

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**

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

v.

ABC FOUNDATION,

APPLICANT

Docket No: XXXX

Sales Tax Exemption

**Kenneth J. Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

APPEARANCES: John Doe, Black, Black & White, LLC, on behalf of ABC FOUNDATION; Mr. John Alshuler, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

SYNOPSIS: On December 11, 2007, the Illinois Department of Revenue (hereinafter the “Department”) denied ABC FOUNDATION’s (hereinafter “ABC Foundation”) second request that the Department issue it an exemption identification number so that it could purchase tangible personal property at retail free from the imposition of use tax, as set forth in 35 **ILCS** 105/1 *et seq.* On November 18, 2010, ABC Foundation protested the Department’s decision and requested a hearing, which was held on January 24, 2012, with Ms. Mary White, Vice-President of ABC Foundation, testifying. The sole issue to be determined at the hearing was whether ABC Foundation qualified 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).

Following a careful review of the evidence and testimony presented at the hearing, I recommend that the Department's denial be affirmed.

FINDINGS OF FACT:

1. The Department's case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Department's second denial of exemption dated December 11, 2007. Tr. p. 6; Dept. Ex. No. 1.
2. The purpose of ABC Foundation, according to its Bylaws, is to contribute to Anywhere County "through charitable, educational and other philanthropic programs that will enhance the health, welfare and educational development of individuals and families in the promotion of the appreciation of the arts." Tr. pp. 8-9; App. Ex. No. 2.
3. ABC Foundation's Bylaws state that "[M]embership shall consist of members of the Bright ("BRIGHT") Chapter." BRIGHT is a chapter of Shining("SHINING") Sorority which was formed in 1908 at Philip College and was the first black Greek organization. ABC Foundation has 36 members. Tr. pp. 22-23; App. Ex. No. 2.
4. ABC Foundation was incorporated under the Illinois "General Not For Profit Corporation Act" in August, 2006. Tr. pp. 8-9; App. Ex. No. 1.
5. ABC Foundation is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. Tr. pp. 10-11; App. Ex. No. 3.
6. ABC Foundation puts on a debutant ball, "Debutant Ball," every two years and they are currently planning their 21st ball. Debutant Ball is open to junior and senior high school girls. Debutant Ball is held at a venue. The most reasonable venue in 2010 was the Holiday Inn which charged approximately \$23,000.

Girls sell tickets to Debutant Ball and the ticket prices are applied to the rental of the venue. ABC Foundation also incurs costs for a stage, flowers, and prizes for the first, second and third runner-up. Total costs to put on Debutant Ball in 2010 were \$38,602. ABC Foundation sells an ad-book for Debutant Ball which costs \$8,000 to \$13,000 to produce. ABC Foundation earns \$18,000 from Debutant Ball. Tr. pp. 13-17, 24; App. Ex. No. 4.

7. ABC Foundation's scholarship applications are sent to the high schools in the USA City and Anywhere County area and posted on ABC Foundation's website. Applicants must meet with ABC Foundation's representatives for a 15 minute interview. There were 20 applicants in 2010, and 7 scholarships were awarded. One scholarship was for \$2,000 and six were for \$1,000. Tr. pp. 17-20, 29; App. Ex. Nos. 5 and 8.
8. The budget for Debutant Ball, 2012, estimates revenue of \$52,000, expenditures of \$38,900 and "estimated profit" of \$13,100, of which \$10,000 will be used for scholarships, \$900 will be used for donations and contributions and \$2,200 will be used for "program activities which benefit the community." Tr. pp. 27-28; App. Ex. No. 7.

CONCLUSIONS OF LAW:

The Use Tax 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 of the Act provides a list of tangible personal property that is exempt from tax, and includes the following: "(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...[.]” “On or 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, 35 ILCS 120/1 *et seq.* contains a similar provision. (See 35 ILCS 120/2-5(11)).

ABC Foundation has requested an exemption identification number pursuant to these provisions, which the Department has twice denied on the basis that ABC Foundation did not demonstrate that it operates exclusively for charitable purposes. Dept. Ex. No. 1. The Department’s denial of an applicant’s claim for an exemption identification number is presumed to be correct, and the applicant has the burden of clearly and conclusively proving its entitlement to the exemption. See Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455, 459 (2d Dist. 1985). To prove its case, an applicant must present more than just testimony denying the Department’s determination. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990). Rather, the applicant must present sufficient documentary evidence to support its claim. *Id.*

It is well established in Illinois that there is a presumption against exemption and that therefore, “exemptions are to be strictly construed” with any doubts concerning the applicability of the exemptions “resolved in favor of taxation.” Van’s Material Co. Inc. v. Department of Revenue, 131 Ill. 2d 196 (1989). The applicant bears the burden of proving “by clear and convincing” evidence that the exemption applies. Evangelical Hospitals Corp. v. Department of Revenue, 223 Ill. App. 3d 225 (2d Dist. 1991).

Although it was in a case concerning a property tax exemption, the Illinois courts have used guidelines set forth in Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 149

(1968) in determining whether an entity qualifies as one organized and operated exclusively for charitable purposes. Wyndemere Retirement Community, *supra*. These guidelines are: (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; (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 charter; (4) the charity is dispensed to all who need and apply for it, and does not provide gain or profit in a private sense to any person connected with it; (5) 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. Korzen, *supra* at 156-57.

The purpose of ABC Foundation according to its Bylaws, is to contribute to Anywhere County “through charitable, educational and other philanthropic programs that will enhance the health, welfare and educational development of individuals and families in the promotion of the appreciation of the arts.” Tr. pp. 8-9; App. Ex. No. 2. ABC Foundation’s Bylaws state that “[M]embership shall consist of members of the Bright Chapter.” BRIGHT is a chapter of Shining Sorority. SHINING was formed in 1908 at Philip College and was the first black Greek organization. ABC Foundation has 36 members. Tr. pp. 22-23; App. Ex. No. 2. ABC Foundation was incorporated under the Illinois “General Not For Profit Corporation Act” in August, 2006 and is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. Tr. pp. 8-11; App. Ex. Nos. 1 and 3.

While it is apparent that ABC Foundation responds to the needs of the community, the evidence and testimony presented at the hearing were not sufficient for

me to conclude that ABC Foundation is a charitable institution in accordance with the guidelines set forth in Korzen.

In order to determine whether an organization meets the Korzen guidelines, reliable financial statements are required. ABC Foundation did not offer financial statements into evidence. Ms. Mary White testified that no member or officer of ABC Foundation is paid a salary. Tr. pp. 23-24. However, without financial statements in evidence, I am unable to conclude this as a finding of fact and I am unable to determine whether ABC Foundation provides gain or profit in a private sense to persons connected with it.

Ms. Mary White testified that ABC Foundation raises funds through its “Healthier You Walk-A-Thom,” in which it partners with other agencies to provide a health fair and a two mile walk. There is a minimum fee of \$5 to walk but walkers solicit sponsors who donate more. Donors can write on their form which charity they want their donation to go to. Ms. Mary White also testified that ABC Foundation has a “stay at home tea” where members put a teabag in an envelope and ask for a donation and these donations go toward scholarships. ABC Foundation also sponsors a “night bowl” at a bowling alley in Anywhere. Tr. pp. 12-14, 21-22. ABC Foundation solicits donations from church mailing lists, family, friends, acquaintances and employers. Tr. pp. 12-13. However, without financial statements in evidence, I am unable to determine whether ABC Foundation’s funds are derived from public and private charity.

Ms Mary White testified that ABC Foundation puts on a debutant ball, “Debutant Ball,” every two years and ABC Foundation is currently planning its 21st ball. Debutant Ball is open to junior and senior high school girls. Debutant Ball is held at a “venue.” The most reasonable venue in 2010 was the Holiday Inn which charged approximately

\$23,000. Girls sell tickets to Debutant Ball and the ticket prices go toward paying the venue. ABC Foundation also incurs costs for a stage, flowers, and prizes for the first, second and third runner-up. Total costs to put on Debutant Ball in 2010 were \$38,602. ABC Foundation sells an ad-book for the ball which costs \$8,000 to \$13,000 to produce. ABC Foundation earns \$18,000 from Debutant Ball. Tr. pp. 13-17, 24; App. Ex. No. 4. The budget for Debutant Ball, 2012, estimates revenue of \$52,000, expenditures of \$38,900 and “estimated profit” of \$13,100, of which \$10,000 will be used for scholarships, \$900 will be used for donations and contributions and \$2,200 will be used for “program activities which benefit the community.” Tr. pp. 27-28; App. Ex. No. 7.

According to the testimony, ABC Foundation’s scholarship applications are sent to the high schools in the USA City and Anywhere County area and posted on ABC Foundation’s website. Applicants must meet with ABC Foundation’s representatives for a 15 minute interview. There were 20 applicants in 2010, and 7 scholarships were awarded. One scholarship was for \$2,000 and six were for \$1,000. Tr. pp. 17-20, 29; App. Ex. Nos. 5 and 8. With 20 applicants and 7 scholarships awarded, I am unable to conclude that ABC Foundation benefits an indefinite number of persons or that it dispenses charity to all who need and apply for it.

There is no testimony or evidence in the record as to the standards utilized for determining eligibility for scholarships. There was no testimony as to whether scholarships are awarded based on grades or financial need. There was no testimony as to whether scholarships are awarded primarily or only to children whose parents are members of or affiliated with BRIGHT or SHINING. It is unclear from the record whether only those students having a membership connection to BRIGHT or SHINING benefit from the scholarship program. Ms. Mary White testified as to how “industrious”

one student was who was awarded a scholarship, but it is unclear from the record whether “industriousness” is the basis for the scholarships. This student received a \$2,000 scholarship, in comparison to six students who received \$1,000. According to the testimony, the “industrious” student has a summer camp where he teaches basketball and Bible school and he also collects computers and refurbishes them and gives them back to children who can’t afford them. Tr. p. 19. There was no testimony as to the basis for one student receiving \$2,000 when 6 students received only \$1,000.

Because ABC Foundation offered no evidence as to the standards used to award scholarships, it cannot clearly and convincingly be found that no barriers to such scholarships exist. Without any evidence in the record as to the basis for the awarding of the scholarships, I am unable to conclude that ABC Foundation does not place obstacles in the way of those who need and would avail themselves of the benefits it dispenses. The Korzen criteria that a charitable organization place no obstacles in the way of those needing its benefits is “more than a guideline.” It is an “essential criteria” and it “goes to the heart of what it means to be a charitable institution.” Provena Covenant Medical Center v. Department of Revenue, 384 Ill. App. 3d 734, 750 (4th Dist. 2008), aff’d, 236 Ill. 2d 368 (2010). The fact that the record does not allow me to conclude that this guideline is met weighs heavily against ABC Foundation.

According to ABC Foundation’s Bylaws, the organization has “one class of membership.” “Membership shall consist of members of the BRIGHT Chapter.” App. Ex. No. 2. The fact that ABC Foundation is a membership organization is evidence that it exists to serve a limited class of persons. Fraternal and social organizations generally do not qualify for exempt status because they operate primarily for the benefit of a limited class of persons who maintain membership therein. Department Regulation 2005(g)

notes that organizations whose activities primarily serve to benefit its members are not operated exclusively for charitable purposes even though such organizations may engage in some charitable work. 86 Ill. Adm. Code. § 130.2005(g).

I am unable to conclude from the very limited record in this case and the lack of evidence on how scholarships are actually awarded, whether ABC Foundation's charitable activities primarily serve to benefit its membership. If the primary benefit of an organization flows to its members and not the public, then an exemption will be denied. Board of Certified Safety Professionals of the Americas v. Johnson, 112 Ill. 2d 542, 547 (1986); Chicago Bar Association v. Department of Revenue, 177 Ill. App. 3d 896 (2d Dist. 1988).

Furthermore, Ms. Mary White testified that in 2010, ABC Foundation earned \$18,000 from Debutant Ball. Tr. p. 13. ABC Foundation used \$8,000 of this \$18,000 for scholarships in 2010. App. Ex. No. 4. But there is no documentary evidence in the record as to how the remaining \$10,000 was spent. I am unable to conclude from the record that ABC Foundation's funds are held in trust for charitable purposes.

ABC Foundation's membership restrictions and the inadequate record in this case cause me to question whether ABC Foundation's primary purpose is social rather than charitable. An "exclusively" charitable purpose need not be interpreted literally as the entity's sole purpose; it should be interpreted to mean the primary purpose, and not a merely incidental or secondary purpose or effect. Gas Research Institute v. Department of Revenue, 154 Ill. App. 3d 430 (1st Dist. 1987). Incidental acts of beneficence are legally insufficient to establish that the applicant is "exclusively" or primarily a charitable organization. Rogers Park Post No. 108 v. Brenza, 8 Ill. 2d 286 (1956). The limited

record in this case does not allow me to conclude that the awarding of scholarships is not “incidental” and secondary to the social activities which ABC Foundation sponsors.

Given the nature of ABC Foundation’s expenditures, it is difficult to justify granting the organization an exemption number. An exemption identification number might well be used to reduce ABC Foundation’s costs of putting on Debutant Ball but not directly used to further any charitable activities. Tax exemptions are inherently injurious to public funds because they impose lost revenue costs on taxing bodies and the overall tax base. Such detriments can only be warranted if lost resources are otherwise used to directly benefit the public through the support of truly charitable expenditures.

For the above stated reasons, I recommend that the Department’s second determination denying the applicant a sales tax identification number be affirmed

May 3, 2012

Kenneth J. Galvin
Administrative Law Judge