

**ST 06-5**

**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**

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

**v.**

**ABC FEDERATION,**

**Applicant**

**Docket No: 05 ST 0000**

**Sales Tax Exemption**

**Kenneth J. Galvin  
Administrative Law Judge**

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**RECOMMENDATION FOR DISPOSITION**

**APPEARANCES:** Mr. Adam E. Bossov, Law Offices of Adam E Bossov, on behalf of ABC Federation; Mr. Shepard Smith, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

**SYNOPSIS:** On April 11, 2005 the Illinois Department of Revenue (hereinafter the "Department") denied ABC Federation's (hereinafter "ABC" or "applicant") 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 April 18, 2005, ABC protested the Department's decision and requested a hearing, which was held on February 23, 2006, with Randy Doe, chief strategy officer and former executive director of ABC, testifying. The sole issue to be determined at the hearing was whether ABC 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 April 11, 2005. Tr. pp. 7-8; Dept. Ex. No. 1.
- 2.ABC was incorporated in May of 1985 for the purpose of promotion and improvement of conditions for bicycling as a means of transportation and recreation. The goals of ABC include a safer bicycling environment, the efficient use of the transportation system through increased bicycle use, the reduction of air pollution and the conservation of energy, and the improvement of facilities for bicycling. ABC determines the needs of bicyclists, educates the public and promotes facility improvements. Tr. pp. 13-15; Dept. Ex. No. 2.
- 3.ABC’s Bylaws state that its mission is to improve the bicycling environment and the quality of life in the region. ABC does this by promoting bicycle safety, education and facilities, and by encouraging the use of the bicycle as an energy-efficient, economical, and nonpolluting form of transportation and as a healthful and enjoyable form of recreation. Tr. pp. 13-16, 19, 24-25; Dept. Ex. No. 2; Applicant’s Ex. No. 3.
- 4.ABC is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. Tr. pp. 16-17; Applicant’s Ex. No. 3.

5. Individuals, institutions and organizations with interests consistent with the purpose and objectives of ABC are eligible for membership. Membership shall be declared upon payment of dues. Non-payment of dues shall result in automatic termination of membership. Members get discounts on ABC events and some businesses offer discounts to ABC members. Officers and directors of ABC are elected by its membership. There are currently over 5,000 members. Tr. pp. 25-27, 70; Dept. Ex. No. 2.
6. ABC sponsors a program called “Shop By Bike” in the City of Anywhere and suburbs, which encourages people to use their bicycles to run errands to local retail establishments. ABC teaches people how to carry packages on their bicycles and lock their bikes. Tr. pp. 29-30, 37, 67-69.
7. ABC sponsors a program called “Safe Routes to Schools” which teaches children how to ride bicycles to school safely. Eight ABC employees work at the Department of Transportation on this program. The City pays ABC for these employees who are supervised by the City. Tr. pp. 28-29, 34, 37-39, 42-43.
8. ABC wrote a bicycle safety brochure for the City of Anywhere with the City using funding from the Federal Safety Program to pay ABC. The City of Anywhere hired ABC to recommend sites for bike racks throughout the City. Tr. pp. 32-33, 35.
9. ABC does consulting work with various government agencies, including the Village of Anywhere and the Council of Mayors. ABC completed a three-year assignment for the City of Anywhere setting the agenda for bicycle improvements in the City. Tr. pp. 33-34.

10. ABC produced a bicycle awareness program for taxi and bus driver training. ABC advocated for bicycle racks on busses, and for taking bicycles on C.T.A. and Metra trains. ABC produced materials to remind students to bring their bicycles to campus when they attend Anywhere universities. Tr. pp. 49-52.
11. ABC sponsors a “Healthy Streets Campaign” for the purpose of making physically active transportation safe, convenient and fun and achieving a balanced transportation environment that more wisely allocates resources and space to encourage walking, bicycling and public transit. Tr. pp. 53-56; App. Ex. No. 6.
12. ABC’s Form 990, “Return of Organization Exempt From Income Tax” for year ended August 31, 2004 shows total revenue of \$1,593,150. Of this amount, 86% or \$1,369,376, is from “program service revenue including government fees and contracts,” 4% is from “direct public support” and 9% is from “membership dues and assessments.” Tr. pp. 46-47; Dept. Ex. No. 2.
13. The \$1,369,376 in “program service revenue including government fees and contracts” includes the following: \$538,158 from “Bike the Drive Receipts;” \$66,397 from “Boulevard Lakefront Tour Receipts;” \$23,006 from “Biketown Bash,” a black-tie annual fundraiser; and \$637,477 in contract revenue from the City of Anywhere Department of Transportation. Tr. pp. 46-47, 49, 65-66; Dept. Ex. No. 2.
14. ABC has two major fundraisers each year: “Bike the Drive” and “The Boulevard Lakefront Tour.” For “Bike the Drive,” Drive is shut down

on a Sunday morning to vehicle traffic and open only to bicycles. The fee is \$35. This fundraiser had 18,000 riders last year. The “Boulevard Lakefront Tour” is scheduled in September and has approximately 2,000 riders. It is a tour of the boulevards of Anywhere although the streets remain open to automobile traffic. Riders pay a fee and there is a discount for children. Tr. pp. 31, 46-48, 61-65.

### **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 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 has requested an exemption identification number pursuant to these provisions, which the Department has twice denied on the basis that ABC 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 (4<sup>th</sup> 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 that the entity: (1) has no capital, capital stock or shareholders; (2) earns no profit or dividends, but rather derives its funds mainly from private and public charity, and holds them in trust for the objects and purposes expressed in the charter; (3) dispenses charity to all who need and apply for it; (4) does not provide gain or profit in a private sense to any person connected with it; and (5) 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.

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 (1<sup>st</sup> 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).

In determining whether an organization is charitable in its purpose, it is proper to consider provisions of its charter. Rotary International v. Paschen, 14 Ill. 2d 387 (1987). ABC’s Articles of Incorporation state that it was organized for the purpose of promotion and improvement of conditions for bicycling as a means of transportation and recreation. The goals of ABC are a safer bicycling environment, the efficient use of the transportation system through increased bicycle use, the reduction of air pollution and the conservation of energy, and the improvement of facilities for bicycling. The organization determines the needs of bicyclists, educates the public and promotes facility improvements. Tr. pp. 13-15; Dept. Ex. No. 2. ABC’s Bylaws state that its mission is to improve the bicycling environment and the quality of life in the region. ABC does this by promoting bicycle safety, education and facilities, and by encouraging the use of the bicycle as an energy-efficient, economical, and non-polluting form of transportation and as a healthful and enjoyable form of recreation. Tr. pp. 13-16, 19, 24-25; Dept. Ex. No. 2; Applicant’s Ex. No. 3.

It is impossible to conclude from these provisions that ABC is operated “exclusively” for charitable purposes, as is required for a sales tax exemption. Dispensing charity is not the primary purpose of ABC. There is nothing inherently charitable in promoting and improving conditions for bicycling as a means of transportation and enjoyable recreation, promoting a safer bicycling environment, improvement of bicycle facilities, promoting facility improvements and encouraging the use of bicycling for transportation. These purposes and activities are of interest to ABC’s membership which

consists of bicycle riders and may also be of interest to nonmembers who are bicycle riders. Similarly, ABC sponsored programs, including “Shop By Bike” and “The Healthy Streets Campaign,” are of interest to and benefit the membership of ABC and may also be of interest to nonmembers who are bicycle riders. While ABC’s purposes are commendable, they are not charitable under the law. “There is nothing in its objects which requires plaintiff to devote its funds or income to purposes deemed charitable in law.” Rotary International v. Paschen, 14 Ill. 2d 480, 488 (1958).

Fraternal and social organizations 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). As will be discussed below, I am unable to conclude that ABC engages in any charitable work. ABC’s activities primarily serve to benefit its membership of bicycle riders. 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).

Any possible benefits from ABC flowing to nonmembers, such as the reduction of air pollution, conservation of energy and improving the quality of life in the region, are commendable but not quantifiable and are not endeavors ever recognized by Illinois courts as “charitable.” Furthermore, these “benefits” are obviously incidental and secondary to ABC’s main purpose of improving conditions for bicycling. During his closing argument, counsel for the applicant stated that: “I don’t know how [ABC] would

provide charity like the hospitals and other nursing homes or things that I represent, because they're not providing services directly to people." Tr. p. 83. As his statement indicates, there is no immediate benefit to nonmembers from ABC's activities. ABC is not "providing services directly to people." Any beneficial effect on the nonmember public is indirect and incidental and is not the primary or substantial purpose or effect necessary to warrant the granting of a charitable tax exemption. Gas Research Institute v. Dep't. of Revenue, 154 Ill. App. 3d 430 (1<sup>st</sup> Dist. 1987).

The fact that ABC is a membership organization is evidence that it exists to serve a limited class of persons. According to ABC's Bylaws, individuals, institutions and organizations with "interests consistent with the purpose and objectives of ABC" are eligible for membership. "Membership shall be declared upon payment of dues." Non-payment of dues shall result in automatic termination of membership. Members get discounts on ABC events and some businesses offer discounts to ABC members. Officers and directors of ABC are elected by its membership. There are currently over 5,000 members.<sup>1</sup> Tr. pp. 25-27, 70; Dept. Ex. No. 2.

Membership in ABC is declared upon the payment of dues and nonpayment of dues results in termination of membership. There is no provision in the Bylaws and no testimony at the hearing regarding the waiver of dues for those wishing to become a member but unable to pay. There was no testimony at the evidentiary hearing that dues had ever been waived for any member. If promotion and improvement of conditions for bicycling were a charitable purpose, there is no evidence that ABC dispenses this "charity" to all who need and apply for it, one of the guidelines of Korzen. Because

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<sup>1</sup> ABC's Form 990 shows "\$137,584 in "membership dues and assessments." There was no testimony at the evidentiary hearing as to individual dues. Mr. Doe stated at one point that "[S]omebody who joins at \$200 gets the same benefits as a person who joins at \$25." Tr. p. 26.

there is no provision for waiver of membership dues, I am unable to conclude that ABC does not place obstacles in the way of those who would avail themselves of its “charity.”

The only Korzen factor which ABC appears to meet is that the organization has no capital, capital stock or shareholders. Tr. pp. 23-24. ABC’s Form 990, “Return of Organization Exempt from Income Tax” for year-end ending August 31, 2004 shows that only 4% of its funding is derived from “direct public support,” which I presume is public and private charitable donations. Of ABC’s total revenue of \$1,593,150, 86% is from “program service revenue including government fees and contracts,” and 9% is from “membership dues and assessments.” Tr. pp. 46-47; Dept. Ex. No. 2. Based on the Form 990, I am unable to conclude that ABC derives its funds mainly from public and private charity, another guideline from Korzen.

It is acknowledged that the Korzen guidelines are not to be applied mechanically or technically. DuPage County Board of Review v. Joint Commission on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461, 468-69 (2d Dist. 1995). Rather, they are to be balanced with an overall focus on whether, and to what extent, the applicant primarily serves non-exempt interests such as those of its own dues paying members (Rogers Park Post No. 108 v. Brenza, 8 Ill. 2d 286 (1956)) or operates primarily in the public interest and lessens the State’s burden. DuPage County Board of Review v. Joint Commission on Accreditation of Healthcare Organizations, *supra*.

I am unable to conclude from ABC’s Form 990 that the organization lessens the State’s burden. ABC’s Form 990 shows that it earned \$637,477 in contract revenue from the City of Anywhere Department of Transportation and \$17,029 in other contract revenue. If there is a “burden” on the City to promote bicycle safety and encourage bicycle riding, the City is paying ABC for this burden. Five “Project Notices” between

ABC and the City of Anywhere were admitted into evidence. Dept. Ex. No. 2. Under the terms of these Notices from the “Department of Transportation, Contracts and Specification Section,” the City identified the programs needed, all related to bicycling, and the payment it would make for the services rendered. The City of Anywhere is apparently compelled to provide the services that it contracted for with ABC. The funding for the programs was paid for by a governmental agency, pursuant to an arm’s length business transaction, with the City of Anywhere assuming substantial financial responsibility for it. The payments under the contracts are not acts of voluntary donation by the City and the evidence does not manifest, in any way, a lessening of the burdens of government. Although there was testimony at the hearing that contract work performed by ABC often goes beyond the “scope of the contract,” and is uncompensated, no documentary evidence was offered to support this. Tr. pp. 33-34.

The \$1,369,376 in “program service revenue including government fees and contracts” also includes \$538,158 from “Bike the Drive Receipts,” \$66,397 from “Boulevard Lakefront Tour Receipts” and \$23,006 from “Biketown Bash,” a black-tie annual fundraiser. Tr. pp. 46-47, 49, 65-66; Dept. Ex. No. 2. It costs \$35 to participate in “Bike the Drive.” “And kids are cheaper.” “...We also give away some registration.” Tr. p. 62. The dollar amount “given away” was never quantified and no documentary evidence was admitted to support this. There were 18,000 participants in “Bike The Drive” last year. I presume then that this fundraiser is open to nonmembers who pay a fee although there was no testimony on this point. I believe it is safe to assume that bicycle riders on the Drive, whether members of ABC or not, are not biking for any charitable purpose. They are there because of their mutual interest in bicycling and the uniqueness of this once-a-year opportunity. The revenue from ABC’s fundraising may be used for

the objects and purposes expressed in ABC's charter, but, as discussed previously, these purposes are not charitable. In effect, the fundraising generates income to pay for ABC's activities which are of interest to and benefit bicycle riders.

ABC's Form 990 also shows \$1,563,543 in "Total expenses" for the year. There was no testimony at the hearing as to salaries paid to employees and I am unable to conclude that ABC does not provide gain or profit in a private sense to persons connected with it. I am unable to identify even \$1 of the "Total expenses" that was spent for charitable purposes. This is consistent with counsel for the applicant's statement in his closing argument that ABC is not providing services directly to people. Tr. p. 83. In Rogers Park Post No. 108 v. Brenza, 8 Ill. 2d 286 (1956), the Illinois Supreme Court found it significant that that the record contained no evidence of "any expenditure for charitable purposes."

In his testimony, Mr. Doe described the expenses involved in sponsoring "Bike-The Drive." These include buying food for volunteers, paying police for permits, "Port-o-Potties," advertising, buying "signs on Drive for the weeks beforehand that warn drivers that it's going to be closed," and bananas and granola bars and "Gatorade" given to participants. Tr. pp. 57, 62.

Given the nature of ABC's expenditures, it is difficult to justify granting the organization an exemption number. The lack of any identifiable expenditure for charity indicates that an exemption identification number might well be used to reduce ABC's expenses of fundraising 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

April 11, 2006

Kenneth J. Galvin