

ST 10-11

Tax Type: Sales Tax

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

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

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

No: 09 ST 0000

Sales Tax Exemption

v.

ABC4 HOUNDS,

Kenneth J. Galvin

Administrative Law Judge

TAXPAYER

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Mr. John Doe, *pro se*, on behalf of ABC; Mr. John Alshuler, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

SYNOPSIS: ABC (hereinafter “ABC”) sought an exemption from the imposition of tax under the Illinois Retailer’s Occupation Tax Act (35 **ILCS** 120/1 *et seq.*) (“ROTA”) and the Illinois Use Tax Act (35 **ILCS** 105/1 *et seq.*) (“UTA”) as an entity organized and operated exclusively for charitable purposes. 35 **ILCS** 120/2-5; 105/3-5. The Department of Revenue denied ABC’s request twice, with ABC formally protesting and requesting a hearing following the issuance of the Second Denial of Sales Tax Exemption on May 27, 2009. Dept. Ex. No. 1.

An evidentiary hearing was held in this matter on April 27, 2010 with Mr. John Does, President 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 120/2-5. Following a careful review of the evidence and testimony presented at the hearing, I recommend that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. ABC requested an exemption identification number from the Department on the basis that it was exempt from taxes imposed by the ROTA and UTA as an entity organized and operated exclusively for charitable purposes. The Department denied ABC’s second request on May 27, 2009. Tr. pp. 40-41; Dept. Ex. No. 1.
2. ABC is organized under the Illinois “General Not For Profit Corporation Act.” According to an Amendment to ABC’s Articles of Incorporation, ABC is “organized exclusively for the charitable purpose of preventing cruelty to animals.” Its “Mission” is to “[P]rovide every dog that passes through our shelter peace, care and comfort while they are here” and to “find them new loving homes and better lives than they had.” ABC is a “no-kill dog shelter.” Tr. pp. 9, 11-13; Taxpayer’s Ex. Nos. 1, 4 and 7.
3. As of June 5, 2005, ABC is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. Tr. pp. 9-10; Taxpayer’s Ex. No. 2.

4. ABC rescues dogs and adopts them out. Since October, 2007, ABC has rescued 53 dogs. The dogs come from “kill-shelters” or they may be abandoned strays. ABC also has a web-site and people inquire through the website whether ABC will take their dogs because they are unable to care for them, usually because of economic reasons. Tr. pp. 16-17.
5. The dogs that ABC receives are placed in a kennel that ABC has formed a relationship with, or with Jane Doe, who is Mr. John Doe’s daughter, or with John and Susie Doe. The dogs may be kept for as short as a couple of days or for a longer period of time. Tr. pp. 17-18, 27-28; Taxpayer’s Ex. No. 5.
6. ABC advertises its dogs on a national website called “ABCs.” Families wishing to adopt contact ABC and fill out an “Adoption Application Form,” with questions including why the family wants a dog, number of people in the household, other pets in the household and how they will care for the dog. Tr. pp. 18-20.
7. ABC’s “Adoption Application Form” states that “I understand that an Adoption Fee is necessary to help offset costs incurred to rescue/care for each dog.” “The fee includes spay/neuter, de-worming, shots, vet bills, rescue transport, food, etc.” “Fee does not include transport to you (that is extra and available), your vet costs, food, collar, leash costs, etc.” Adoptions will only be considered within a 200 mile radius of Chicago. Tr. pp. 13, 19-20, 23; Taxpayer’s Ex. No. 6.
8. ABC’s adoption fees range from \$100 to \$250, based on age and size of the dog. The Business Plan states that adult dogs “will cost” \$150, puppies four

months and younger “will cost” \$200. “Hard to find breeds, no matter the age of the dog, will cost \$250.” Tr. pp. 24-25; Taxpayer’s Ex. No. 5.

9. ABC’s unaudited “Profit & Loss” for July, 2009 through March, 2010 shows “Total Income” of \$63,915, of which 94% is from “Contributions Received,” and 5% is from “Adoption Fee.” ABC had \$66,526 in “Total Expenses” in the time period, resulting in a loss of \$2,611. Salaries during the period were \$15,400. Tr. pp. 10-11, 15; App. Ex. No. 3.

CONCLUSIONS OF LAW:

An examination of the record establishes that ABC has not demonstrated, by the presentation of testimony or through exhibits or argument, evidence sufficient to warrant an exemption from sales tax. Accordingly, under the reasoning given below, the determination by the Department denying ABC a sales tax exemption number should be affirmed. In support thereof, I make the following conclusions.

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 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 second denial of ABC's request for an exemption is presumed to be correct, and ABC had the burden of clearly and conclusively proving that it is entitled to the exemption. See Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455 (2nd 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 (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 (2nd 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 organization: 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) does not provide gain or profit in a private sense to any organization or person connected with it; 4) benefits an indefinite number of persons; and 5) dispenses charity to all who need and apply for it and 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. Methodist Old Peoples Home, *supra*.

ABC is organized under the Illinois “General Not For Profit Corporation Act.” According to an Amendment to ABC’s Articles of Incorporation, ABC is “organized exclusively for the charitable purpose of preventing cruelty to animals.” Its “Mission” is to “[P]rovide every dog that passes through our shelter peace, care and comfort while they are here” and to “find them new loving homes and better lives than they had.” ABC is a “no-kill dog shelter.” Tr. pp. 9, 11-13; Taxpayer’s Ex. Nos. 1, 4 and 7. ABC is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code as of June 6, 2005. Tr. pp. 9-10; Taxpayer’s Ex. No. 2. Mr. Doe testified that ABC has no capital, capital stock or shareholders. Tr. p. 26. I conclude that ABC possesses the characteristic of a charitable organization that the organization have no capital, capital stock or shareholders.

I am unable to conclude that ABC earns no profit or dividends and derives its funds from public and private charity. There are several discrepancies in the documentary evidence that ABC caused to be admitted at the hearing to support its claim for exemption. ABC’s unaudited “Profit and Loss” for July, 2009, through March, 2010, prepared by Mr. Doe, shows “Rent” expense of \$4,495. This is the third largest expense outlay on the “Profit and Loss.” Taxpayer’s Ex. No. 3. Mr. Doe testified that ABC did not have any property and that ABC did not have an office. “They will call my daughter

on her phone, or we do have a phone that is just another line in my house that we refer to in the website.” Tr. pp. 27-28. There was no explanation at the evidentiary hearing as to how ABC incurred “Rent” expense of \$4,495 during the period covered by the financial statements.

Mr. Doe testified that ABC gets dogs from kill-shelters, and picks up abandoned strays. On one occasion, Mr. Doe’s daughter rescued a stray dog in traffic. “And then there [are] others who just for one reason or another are unable to care for their dogs.” Tr. p. 16. Mr. Doe testified that “[W]e accept no remuneration for rescuing the dogs.” Tr. p. 17. However, Section 3.2 of ABC’s “Business Plan,” entitled “Adoption and Surrender Fees,” states that “[A]ll people surrendering dogs will be charged \$150 no matter the age or breed.” Taxpayer’s Ex. No. 5. No explanation was offered at the hearing for this statement in the Business Plan. It is unclear exactly who pays the \$150 to “surrender” their dog. If the \$150 charge for surrendering dogs is now being collected, it is unclear how it is accounted for in the financial statements.

Section 5.0 of ABC’s Business Plan is entitled “Sources of Income.” Among the “sources” listed are “shelter services, adoption fees, surrender fees, educational classes.” There was no testimony as to how income is derived, or will be derived, from “shelter services” or “educational classes.” Section 3.0 of the Business Plan, entitled “Products and Services,” states that “[W]e will offer numerous classes for the public for a nominal fee ...” Taxpayer’s Ex. No. 5. If classes are now being offered, it is unclear where the “nominal” fee for these classes is accounted for in the financial statements.

Several sets of ABC’s financial statements were admitted into evidence, but many of the financial statements are not signed. ABC’s 990-EZ for 2008 is unsigned. ABC’s “Illinois Charitable Organization Annual Report” for 2008 is unsigned. ABC’s 990-EZ

for 2007 is unsigned. I cannot conclude that these financial statements are authentic without a signature.

The unaudited “Profit & Loss,” prepared by Mr. Doe, for July, 2009, through March, 2010, shows “Contributions Received” of \$60,328. This represents 94% of “Total Income” of \$63,915. Whereas, it would appear from the unaudited “Profit & Loss” that ABC derives the majority of its funds from public and private charity, the record in this case raises doubts as to the accuracy of the financial statements. The record in this case is incomplete without an explanation for “rent” expense, and the accounting treatment for surrender fees and educational expenses. In Illinois, 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 doubts raised by the incomplete financial information must be held against ABC and resolved in favor of taxation. Accordingly, I am unable to conclude that ABC derives the majority of its funds from public and private charities.

I also am unable to conclude that ABC does not provide gain or profit in a private sense to persons connected with it. ABC’s Business Plan lists other sources of income including “retail sales: collars, leashes, food and water bowls, treats, treat jars, dog beds and dog toys.” “The store will be open to the public as well as make it convenient for those who adopt dogs to pick up supplies at a discounted rate.” “New adopters will receive a 20% discount on the day of the adoption and a 10% discount every visit thereafter.” “The retail store will be open to any pet owner in the community...” Taxpayer’s Ex. No. 5. There was no testimony at the hearing about the “retail store.” If the retail store is now open, it is unclear how the revenue from the retail store is accounted for in the financial statements.

More importantly, there are numerous internal control concerns inherent in having a not-for-profit entity operate a for-profit retail store. There was no testimony about these concerns at the hearing and they are not addressed in ABC's Business Plan. I must question how ABC will keep straight its inventory between the tax-free purchase of supplies used in its not-for-profit organization and the taxable purchase of the same supplies for sale in its retail store. There is a distinct potential for inurement by the owners of the retail store if the owners are not paying sales tax on purchases of supplies for the store. There is no testimony in the record on what internal control procedures have been adopted by ABC to ensure that tax exempt inventory is used only for tax exempt purposes. The lack of testimony on this issue again raises a serious concern as to whether the owners of ABC could privately profit from the purchasing of supplies for its retail store. These internal control concerns must be resolved against ABC's exemption request and in favor of taxation. Accordingly, I am unable to conclude that ABC does not provide gain or profit in a private sense to persons connected with it.

ABC advertises its dogs on a national website called "ABCs." Families wishing to adopt contact ABC and then fill out an "Adoption Application Form," with questions, including why the family wants a dog, number of people in the household, other pets in the household and how they will care for the dog. Tr. pp. 18-20. ABC's "Adoption Application Form" states that "I understand that an Adoption Fee is necessary to help offset costs incurred to rescue/care for each dog." "The fee includes spay/neuter, deworming, shots, vet bills, rescue transport, food, etc." "Fee does not include transport to you (that is extra and available), your vet costs, food, collar, leash costs, etc." Tr. pp. 13, 19-20, 23; Taxpayer's Ex. No. 6.

According to ABC's Business Plan, adoption fees range from \$100 to \$250, based on the age and size of the dog. The Business Plan states that adult dogs "will cost" \$150, puppies four months and younger "will cost" \$200. "Hard to find breeds, no matter the age of the dog, will cost \$250." Tr. pp. 24-25; Taxpayer's Ex. No. 5.

Mr. Doe testified that once an adopting family has been qualified, "we place no restrictions on who the adopting family could be." In that respect, Mr. Doe argues, ABC serves an indefinite number of people. Tr. p. 22. ABC does charge an adoption fee. Mr. Doe argues that if an individual is adopting a dog, they have to be able to demonstrate that they can care for the dog. Mr. Doe would "have some concern if somebody could not afford the adoption fee, would they be able to afford to take care of their dog." Tr. pp. 23-24.

There are several problems with Mr. Doe's arguments here. ABC charges adoption fees, and although the charging of fees does not automatically disqualify ABC as a charitable organization, ABC must furnish its services to those who are unable to pay. See Small v. Pangle, 60 Ill. 2d 510, 515-516 (1975). There is no evidence in the record that ABC has ever waived its adoption fees for anyone who was unable to pay.

Mr. Doe testified that he would have some concern that if a family could not afford the adoption fee, they may not be able to afford to take care of their dog. Tr. pp. 23-24. No evidence was presented to show that Mr. Doe's "concern" is valid. ABC's "Adoption Application Form" does not request information on the adopting family's income. Taxpayer's Ex. No. 2. The fact that an adopting family is able to pay ABC its adoption fee, without knowing the family's income, is not necessarily an indicator that the family can afford to care for the dog in the future.

In addition, ABC's adoption fee is not based on the income of the adopting family. There are no provisions in the Business Plan for a payment plan for families who want to adopt a dog, but are unable to pay the one-time "cost." Notwithstanding ABC's reasons for charging adoption fees, charity is a gift (Methodist Old Peoples Home, *supra*) and the record does not show an act of charity, a gift, by ABC in ever adopting out a dog to a family that is unable to pay the adoption fee.

ABC's Business Plan shows that the "cost" of the dog varies according to its value in the marketplace. Adult dogs "will cost" \$150, puppies four months and younger "will cost" \$200. "Hard to find breeds, no matter the age of the dog, will cost \$250." Tr. pp. 24-25; Taxpayer's Ex. No. 5. Because the "cost" of the dog increases according to its value in the marketplace, ABC makes more money from adopting out a more valuable dog, whereas ABC's cost of caring for this dog may be no more than the cost of caring for a less valuable one. Varying the cost of the dog based on its value in the marketplace does not suggest charitable activity. Small, *supra*.

ABC's Business Plan states that some shelters charge less for animals "but do not offer as much medically." "Other area shelters charge higher adoption fees with the same medical benefits and these shelters have a high adoption rate." Taxpayer's Ex. No. 5. These statements make it appear that ABC based its adoption fees on a study of what competitive shelters charge. There is no evidence in the record that these shelters are not-for-profit. The fact that ABC charges for its dogs according to the value that the dog has in the market place, after studying its competitor's pricing, gives ABC a retail and commercial atmosphere, reinforced by ABC's Business Plan and its provision that new adopters receive a 20% discount in the retail store on the day of the adoption. The Business Plan contains no provisions for charitable activity.

Without evidence of an act of charity by ABC, I am unable to conclude that charity was given to all who needed and applied for it. The adoption fees that ABC charges to all adoptees are obstacles in the way of those who need and would avail themselves of any charitable benefits that ABC could offer.

In exemption cases, 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, 231 (2d Dist.1991). The evidence in the instant case falls short of showing clearly and convincingly that ABC is a charitable organization. Because the evidence raises doubts as to whether ABC meets most of the criteria of Methodist Old Peoples Home, *supra*, the exemption must be denied.

For the above stated reasons, I recommend that the Department’s second denial of ABC’s request for a sales tax identification number be affirmed.

ENTER: July 12, 2010

Kenneth J. Galvin