

**ST 12-07**

**Tax Type: Sales Tax**

**Issue: Exemption From Tax (Charitable or Other Exempt Types)**

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

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<b>THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS,</b>	}	<b>Docket No: XXXX</b>
<b>v.</b>	}	<b>Sales Tax Exemption</b>
<b>M &amp; N EDUCATION SYSTEM, APPLICANT</b>	}	<b>Kenneth J. Galvin Administrative Law Judge</b>

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**RECOMMENDATION FOR DISPOSITION**

**APPEARANCES:** Ms. Mary White, ABC Legal Firm, PC, on behalf of M & N Education System; Mr. John Alshuler, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

**SYNOPSIS:** On February 4, 2011, the Illinois Department of Revenue (hereinafter the “Department”) denied M & N Education System’s (hereinafter “M & N”) 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 March 16, 2011, M & N protested the Department’s decision and requested a hearing, which was held on February 7, 2012, with Ms. Jane Doe, Associate Vice-President and Counsel for M & N, testifying. The sole issue to be determined at the hearing was whether M & N qualified for an exemption identification number as “a corporation, society, association, foundation or institution organized and operated

exclusively for educational ... 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 *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Department’s second denial of exemption dated February 4, 2011. Tr. p. 8; Dept. Ex. No. 1.
2. M & N is exempt from income tax under section 501(c)(3) of the Internal Revenue Code. According to its Articles of Incorporation, M & N shall be operated for the benefit of, to perform the functions of, and/or to carry out the purposes of educational institutions and related organizations that fund or advance education ... so long as [these] publicly funded organizations are exempt from federal income tax under Section 501(a) of the Code. Tr. pp. 12-14, 24-25; App. Ex. F and I.
3. M & N was incorporated on February 23, 2009. M & N operates under Bylaws adopted by its Board of Trustees on August 18, 2009. Tr. pp. 16-17, 21-22; App. Ex. C.
4. M & N provides services to six educational institutions, classified as “schools” by the Internal Revenue Code. App. Ex. F.
5. The six educational institutions are The Anywhere School of Professional Psychology (with five campuses, including one in Anywhere), Over There Graduate Institute, Over There and Concrete Colleges of Law, Under There

College, Under There Children's School and Pluto Park Preparatory Academy, located in Anywhere. Tr. pp. 22-24; App. Ex. F.

6. The six educational institutions have a student body and employ full and part time faculty. All of the schools are accredited or hold state-approval. Tr. pp. 26-31; App. Ex. F.
7. The Anywhere School of Professional Psychology has approximately 4,100 students, 192 faculty members and holds State accreditation in each of the States it operates in. It is exempt from sales tax in Illinois, "organized and operated exclusively for educational purposes," and exempt from income tax under Section (501)(c)(3) of the Internal Revenue Code. Tr. pp. 27-28, 33-34; App. Ex. F and L.
8. The Pluto Park Preparatory Academy is a contract school with the Anywhere Public Schools. It has 15 teachers and 203 students in kindergarten through 4<sup>th</sup> grade. It is exempt from sales tax in Illinois, "organized and operated exclusively for educational purposes," and exempt from income tax under Section 501(c)(3) of the Internal Revenue Code. Tr. pp. 28-29, 32-33, 35; App. Ex. D and K.
9. M & N has a "Services Agreement" with Anywhere School of Professional Psychology which states that M & N "shall perform, or cause to be performed" the following services: 1) Human Resources activities; 2) Legal, Regulatory and Compliance activities; 3) Finance and Accounting activities; 4) Information Technology activities; 5) Financial Aid activities; 6) Recruitment and Admissions activities; 7) Marketing activities; 8) Institutional Research

activities; 9) Online activities; 10) Academic Support; and 11) International Services. Tr. pp. 37-56; App. Ex. H.

**CONCLUSIONS OF LAW:**

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

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 free from imposition of the 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.” 35 ILCS 105/3-5(4). Section 2-5(11) of the Retailers’ Occupation Tax Act (“ROTA”) contains a similar provision. 35 ILCS 120/2-5(11).

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 clearly and conclusively proving that it is entitled to the exemption. Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455 (2<sup>nd</sup> Dist 1995). To prove its case, a taxpayer must present more than testimony denying the Department’s determination. The taxpayer must present sufficient documentary evidence to support its claim. Sprague v. Johnson, 195 Ill. App. 3d 798 (4<sup>th</sup> Dist. 1990). It is well established

that there is a presumption against exemption and that therefore, “exemptions are to be strictly construed” with any doubts concerning the applicability of the exemption “resolved in favor of taxation.” Van’s Material Co. Inc. v. Department of Revenue, 131 Ill. 2d 196 (1989). In the instant case, there is insufficient documentary evidence in the record for me to conclude that M & N is entitled to a sales tax exemption number.

Pursuant to its authority under Section 12 of ROTA (35 ILCS 120/12), the Department of Revenue promulgated 86 Ill. Admin. Code § 130.2005. This regulation acknowledges that there is no specific exemption in the Illinois Constitution for “educational purposes” as to any kind of tax, but Section 6, Article IX of the Constitution authorizes the General Assembly to grant a property tax exemption for property that is used for “school purposes.” “Consequently the Department will construe the Retailers’ Occupation Tax exemption for ‘educational purposes’ as meaning for ‘school purposes,’ as the phrase ‘school purposes’ has been interpreted or may be interpreted by the Supreme Court.” 86 Ill. Admin. Code § 130.2005 (1)(1).

86 Ill. Admin. Code § 130.2005 also acknowledges that for property tax purposes, the Supreme Court has held that an association, which is not, itself, a school in the ordinary sense, but which provides a substantial service in improving the educational standards of schools, is within the ‘school purposes’ exemption, so that the Department will consider such an organization to be organized and operated exclusively for ‘educational purposes’ for Retailers’ Occupation Tax purposes. 86 Ill. Admin. Code § 130.2005 (1)(6).

Whether an institution has been organized and is operating for an exempt purpose is to be determined from its charter and bylaws and actual facts relating to its method of operation. DuPage County Bd. of Review v. Joint Com’n on Accreditation of Healthcare

Organizations, 274 Ill. App. 3d 461 (2<sup>nd</sup> Dist. 1995). M & N is exempt from taxes under section 501(c)(3) of the Internal Revenue Code. According to its Articles of Incorporation, M & N shall be operated for the benefit of, to perform the functions of, and/or to carry out the purposes of educational institutions and related organizations that fund or advance education ... so long as [these] publicly funded organizations are exempt from federal income tax under Section 501(a) of the Code. Tr. pp. 12-14, 24-25; App. Ex. F and I. M & N was incorporated on February 23, 2009 and it operates under Bylaws adopted by its Board of Trustees on August 18, 2009. Tr. pp. 16-17, 21-22; App. Ex. C.

M & N seeks to qualify for an exemption identification number as a “corporation, society, association, foundation or institution organized and operated exclusively for educational purposes.” The issue before this tribunal is whether M & N is organized and operated exclusively for educational purposes. “Exclusively” as used in the statute refers to the primary purpose of the organization, not any secondary or incidental purpose. Evangelical Hospital Association v. Novak, 125 Ill. App. 3d 439 (2<sup>nd</sup> Dist. 1984). An organization may have many activities but the question of whether it is entitled to a sales tax exemption must be determined from its primary activity. I am unable to determine from the record of this case that M & N’s primary activity is educational or that it is providing a “substantial service” in improving the educational standards of its client schools.

M & N did not offer into evidence any financial information, including an Income Statement or Form 990, “Return of Organization Exempt from Income Tax.” I am unable to determine the source of M & N’s revenue or income and I am unable to determine specifically what services M & N performs for its client schools and what services it is billing its client schools for. M & N caused to be admitted into evidence the “Services

Agreement” between M & N and The Anywhere School of Professional Psychology, which lists services that M & N may perform for The Anywhere School. Pages 6 through 31 were omitted from the exhibit. App. Ex. H.<sup>1</sup> M & N caused to be admitted into evidence pages from its website. The first page of the website states that an “Annual Report” is included. No Annual Report was submitted with the Exhibit. App. Ex. G. M & N caused to be admitted into evidence a document entitled “Year In Review 2009-2010.” The last page contains financial information on four of M & N’s client schools, but there is no financial information in the document on M & N. App. Ex. J.

When Ms. Jane Doe was asked how M & N is compensated for providing services to its client schools, she replied: “There is a fixed fee – M & N receives payments from things that are directly billed. So all of those services, there is a flat fee that both the institution and the system actually negotiated that we will pay you this amount for those services, things like that.” Tr. pp. 56-57. However, without financial evidence in the record, it is unclear what services M & N is billing for.

According to 86 Ill. Admin. Code § 130.2005, M & N may be entitled to a sales tax exemption if its primary activity is to improve the educational standards of schools. I cannot tell from the record what M & N’s “primary activity” is. If the majority of the services that M & N provides and bills its client schools are “Accounting and Finance activities,” I would be unable to conclude that this is a “substantial service” that improves the educational standards of schools. An accounting firm that provided these same services for a school would not be able to bootstrap its way into the sales tax exemption

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<sup>1</sup> According to TCS, an excerpt of the document was provided “because the remainder of the document is confidential and TCS cannot produce the entirety of the document without the entry of an appropriate protective order.” App. Pre-Hearing Submission, p. 2. TCS did not request a protective order from this tribunal.

enjoyed by the school, as M & N is requesting. It was imperative in this case for M & N to put in the record exactly what services they are providing to each of the six schools.

“Appendix A” to the “Service Agreement” between The Anywhere School of Professional Psychology and M & N states that M & N “shall perform, or cause to be performed” the following services. App. Ex. H. But again, the record is incomplete as to what services M & N “did perform” for The Anywhere School. The phrase “cause to be performed” implies that M & N could subcontract the services out to a third party, even while M & N enjoys the exemption from sales tax that it is requesting from this tribunal for performing these services.

The specific “services” listed in “Appendix A” are grouped into 11 categories. These categories are Human Resources activities, Legal, Regulatory and Compliance activities, Finance and Accounting activities, Information and Technology activities, Financial Aid activities, Recruitment and Admissions activities, Marketing activities, Institutional Research activities, Academic Support and International Services. The “Services Agreements” for M & N’s other five client schools were not offered into evidence. The record is incomplete as to whether M & N provides the same services for these five client schools as contained in the Services Agreement between M & N and The Anywhere School. Under There College was founded in 1950 and joined M & N in 2010. Over There Graduate Institute was founded in 2000 and joined M & N in 2009. App. Ex. J. Because these schools were in existence for a considerable period of time before they joined M & N, I assume that their accreditation and approvals, which might be considered a “substantial service” in improving the educational standards of schools, were in place before these schools hired M & N. But the record is incomplete as to whether M & N performed accreditation and approval issues for these or for any schools.

Some of the service categories delineated in “Appendix A” are not specifically related to education and cannot be considered, by any stretch of the imagination, educational activities or activities that improve the educational standards of schools. Under “Human Resources activities,” M & N designs and administers benefits and compensation plans, maintains human resource information systems and administers retirement benefits. Many for-profit, consulting firms provide, for a fee, these same services.<sup>2</sup> If these consulting firms provided “human resource activities” for schools, the firm would not be able to bootstrap its way into the sales tax exemption enjoyed by the school, as M & N is requesting.

In Association of American Medical Colleges v. Lorenz, 17 Ill. 2d 125 (1959), the Illinois Supreme Court considered the issue of whether real estate owned by the Association of American Medical Colleges, a not-for-profit corporation, and used by the corporation to improve U.S. medical education, was exempt from taxation as property “used for public school, college, seminary, university, or other public educational purposes.” The Association of American Medical Schools published a journal and directory showing admission requirements and other information about medical schools, compiled student information designed to assist medical schools in developing programs of instruction, sponsored admission tests and teaching institutes, evaluated students’ intellectual and personality characteristics and their relationship to scholastic and professional performance, maintained a library of motion picture films for use by medical schools, performed placement functions and appraised the curricula of medical schools. The Court noted that “plaintiff’s services, in improving educational standards meet the

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<sup>2</sup> See, for example, the website for AON/Hewitt Associates.

statutory test [for property exemption].” *Id.* at 129. M & N cited and relied on Association in their closing arguments.

Association is easily distinguishable from the case at issue here. The first and most important distinction is that the record in the instant case does not show what services M & N is providing to its client schools. Without knowing what services are provided, I cannot conclude that M & N “meets the statutory test” in improving educational standards. Second, in Association, a group of colleges formed a separate organization to perform certain administrative functions. The Association of American Medical Colleges’ members “include medical schools throughout the country, each of which contributes, annually, a substantial sum of money.” *Id.* at 126. “Through its inspection and liaison committee, the Association joins in the accrediting of all medical schools in the United States.” *Id.* at 127. In the instant case, M & N does not have contributing members. A group of colleges did not “form” M & N. M & N is an “outgrowth” of The Anywhere School, “an educational enterprise.” Tr. pp. 22-23. M & N is not performing services for “all” schools in the United States. M & N is performing unknown services for six schools that pay M & N a “fixed fee.” Tr. p. 57.

M & N also cites and relies on Big Ten Conference v. Department of Revenue, 312 Ill. App. 3d 88 (1<sup>st</sup> Dist. 2000). In Big Ten, the Court found that the “administration of intercollegiate athletic programs is a legitimate educational activity.” There is no evidence in the record of the instant case that M & N administers the intercollegiate athletic programs of its schools. The Court noted in Big Ten that “Big Ten reduces administrative costs for its members.” *Id.* at 92. M & N makes the same argument about their services. According to the testimony, M & N generates cost savings for its client schools so that “we can use those funds for scholarships for the students.” “We can

use those funds so we don't have to increase tuition in those areas." When M & N gets a "bulk purchase price," it results in "one, it could be lower tuition or, two, one of the biggest areas is the students are not hit with a whole lot of fees because we can absorb those fees." Tr. p. 59.

This testimony cannot be verified by any documentary evidence admitted at the hearing. As discussed previously, there is no financial information for M & N in the record. There is no evidence in the record of scholarships provided by M & N or the lowering of student fees at the six client schools. Big Ten reduced administrative costs for its members but I cannot reach this same conclusion for M & N. The record does not show what costs were incurred by the six client schools before they hired M & N. The record does not show what services M & N performed for its client schools. The record doesn't show what the six schools paid M & N for whatever services were performed. In this matter, M & N has the burden of clearly and conclusively proving that it is entitled to the exemption it is seeking. Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455 (2<sup>nd</sup> Dist 1995). The evidence of record falls far short of proving, clearly and convincingly, that M & N is organized and operated exclusively for educational purposes.

Tax exemptions are inherently injurious to public funds because they impose lost revenue costs on taxing bodies and the overall tax base. In order to minimize the harmful effects of such lost revenue costs, and thereby preserve the Constitutional and statutory limitations that protect the tax base, statutes conferring tax exemptions are to be strictly construed in favor of taxation. People ex rel. Nordland v. Home for the Aged, 40 Ill. 2d 91 (1968). In addition, great caution must be exercised in determining whether an institution is organized and operated exclusively for educational purposes. Otherwise, any

increases in lost revenue costs attributable to unwarranted application of the use tax exemption will cause damage to public treasuries and the overall tax base. In this case, M & N has failed to prove first, that it is organized and operated exclusively for educational purposes and, second, that it falls within the limited class of organizations that the Legislature meant to be exempt from use tax purchases of tangible personal property.

For the above stated reasons, I recommend that the Department's determination denying the applicant, M & N Education System, a sales tax identification number be affirmed.

Kenneth J. Galvin  
Administrative Law Judge

May 17, 2012