

ST 13-16

Tax Type: Sales Tax

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 BUSINESS,

TAXPAYER

No: XXXX

Sales Tax Exemption

Kenneth J. Galvin
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

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

SYNOPSIS: ABC Business (hereinafter “ABC Business”) sought an exemption from the imposition of tax under the Illinois Retailer’s Occupation Tax Act (35 ILCS 120/1 *et seq.*) and the Illinois Use Tax Act (35 ILCS 105/1 *et seq.*) as an entity organized and operated exclusively for charitable purposes. 35 ILCS 120/2-5; 105/3-5. The Department of Revenue denied ABC Business’s request twice, with ABC Business formally protesting and requesting a hearing following the issuance of the Second Denial of Sales Tax Exemption on February 23, 2012. Dept. Ex. No. 1.

An evidentiary hearing was held in this matter on May 3, 2013 with testimony from Ms. Jane Doe, Executive Director of ABC Business. The sole issue to be determined at the hearing was whether ABC Business 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 the Department’s second 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 23, 2012. Tr. pp. 5-6; Dept. Ex. No. 1.
2. ABC Business is exempt from income tax under Section 501(c)(3) of the Internal Revenue Code. ABC Business is registered under the Illinois “Charitable Trust and the Solicitation for Charity Acts.” App. Ex. No. 2.
3. ABC Business’s audited Financial Statements for December 31, 2012, under the section entitled “Nature of Organization,” state that ABC Business was incorporated on January 4, 2008 under the laws of Anystate and began operations on August 8, 2008. ABC Business uses running to help those experiencing homelessness change the way they see themselves so they can make real change in their lives that results in employment and independent living. ABC Business’s mission “is not to create runners within the homeless population, but to use running to create self-sufficiency in the lives of those experiencing homelessness.” ABC Business’s “success is measured by how many members achieve independence through employment and housing.” ABC Business has chapters in many cities. App. Ex. No. 1.
4. ABC Business’s Financial Statements for December 31, 2012 shows “Support and Revenue” of \$4.1 million, with 74% received from “corporate contributions,” “individual and foundation contributions,” “United Way,” “event revenue,” and

“contributed goods and services.” “Total salaries and related expenses” were \$2.6 million. The “Change in Net Assets” for 2012 was an increase of \$583 thousand. App. Ex. No. 1.

CONCLUSIONS OF LAW:

An examination of the record establishes that ABC Business 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 Business a sales tax exemption number should be affirmed. In support thereof, I make the following conclusions.

ABC Business seeks to qualify 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); 35 ILCS 120/2-5(11). In Methodist Old People’s Home v. Korzen, 39 Ill. 2d 149 (1968), the Illinois Supreme Court outlined several factors to be considered in assessing whether an organization is actually an institution of public charity: (1) 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; (2) the organization does not provide gain or profit in a private sense to any person connected with it; (3) the organization has no capital, capital stock or shareholders; (4) the charity is dispensed to all who need and apply for it; (5) the benefits derived are for an indefinite number of persons [for their general welfare or in some way reducing the burdens on government]; and (6) 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. The above factors are guidelines for assessing whether an institution is a charity, but are not definitive requirements. DuPage County Board of Review v.

Joint Comm'n on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461 (2d Dist. 1995).

According to ABC Business's audited Financial Statements for December 31, 2012, under the section entitled "Nature of Organization," ABC Business was incorporated on January 4, 2008 under the laws of Anystate and began operations on August 8, 2008. ABC Business uses running to help those experiencing homelessness change the way they see themselves so they can make real change in their lives that results in employment and independent living. ABC Business's mission "is not to create runners within the homeless population, but to use running to create self-sufficiency in the lives of those experiencing homelessness." ABC Business's "success is measured by how many members achieve independence through employment and housing." ABC Business has chapters in many cities. App. Ex. No. 1. ABC Business's Anycity chapter was launched in September of 2010. Tr. p. 12.

ABC Business caused to be admitted into evidence a "funded grant proposal" made to the Grand Foundation which states that ABC Business "promotes the self-sufficiency of homeless and underserved populations by engaging participants in running as a means to build confidence, strength and self-esteem." Through participation and hard work, members earn the opportunity to advance to the "Next Steps" phase of the program, as well as financial assistance. ABC Business partners with four homeless shelters "to create teams." "The team brings together 10-15 residential members living at each facility who are experiencing homelessness..." "We run alongside our teammates in the hopes that our support and friendship will enable them not just to complete a mile or finish a race, but also to set up and reach all kinds of goals, like going ABC Business to school, moving into an apartment, or finding a job." Tr. pp. 8-9; App. Ex. No.3.

The grant proposal states further that ABC Business's program takes 4 to 6 months to complete. Members run on Monday, Wednesday and Friday at 5:45 a.m. After 30 days of participation and maintaining 90% attendance, members can enter ABC Business's "Next Steps" phase where ABC Business matches their educational and employment needs with ABC Business's GED, re-education and job placement organization partners. Each member must also complete "a mandatory two-part literacy component provided through Streetwise in partnership with BIG Bank." Members are also required to attend two "Tools for Success" courses hosted by Intellectual. "Topics include resume writing, mock interviewing, time management and customer service modules." Tr. pp. 7-8, 10-12; App. Ex. No. 3. Ms. Jane Doe testified that in Anycity, ABC Business has served 205 members. "And we have a success rate of about 50% that actually move on and get jobs." Tr. p. 12.

In looking at the Korzen factors, I am able to conclude that ABC Business derives the majority of its funding from public and private charities. ABC Business's Financial Statement for December 31, 2012 shows "Support and Revenue" of \$4.1 million, with 74% received from "corporate contributions," "individual and foundation contributions," "United Way", "event revenue," and "contributed goods and services." App. Ex. No. 1.

The record in this case does not allow me to conclude that ABC Business holds its funds in trust for charitable purposes. In 2012, ABC Business had an increase of revenue over expenses of \$583,007. App. Ex. No. 1. ABC Business's grant proposal to Grand Foundation states that "it costs approximately \$1,500 to directly support one Member through our entire program from running gear to Next Steps classes..." App. Ex. No. 3. Ms. Jane Doe testified that the Illinois sales tax paid by ABC Business in 2011 and 2012, \$10,823, "could have helped five people move forward and find a job and a home." Tr. p. 16; App. Ex. No. 1. So it costs approximately

\$1,500 to \$2,160 (\$10,823 divided by 5) to support one member “to find a job and home.” ABC Business’s revenue over expenses for 2012, \$583,007, could have supported 388 new members at \$1,500 each or 270 new members at \$2,160 each. There is no explanation in the record as to why this excess of revenue over expenses was not used for charitable purposes in 2012.¹

I am also unable to conclude that ABC Business does not provide gain or profit in a private sense to any person connected with it. In 2012, ABC Business’s “total salaries and related expenses” were \$2.632 million, equal to 58% of ABC Business’s total revenue of \$4.517 million. App. Ex. No. 1. For every one dollar contributed to ABC Business in 2012, fifty eight cents covered salaries. There is no evidence in the record as to salaries paid to ABC Business’s employees.² ABC Business’s audited financial statements state that ABC Business “files Federal Form 990.” App. Ex. No. 1 (page 6). ABC Business’s Form 990, which usually shows highest paid employees, was not admitted into evidence.

“The employees of a charitable institution are not compelled to perform free services in order that the institution may be charitable.” Yates v. Board of Review, 312 Ill. 367 (1924). “The payment of reasonable salaries to necessary employees for services actually rendered does not convert a nonprofit enterprise into a business enterprise.” 86 Ill. Admin. Code §130.2005(h). In the instant case, no competent documentary evidence was presented by ABC Business to show that the dollar amount of the salaries paid to its employees was reasonable. Accordingly, I am unable to conclude from the record that ABC Business does not provide unreasonable gain and profit in a private sense to persons connected with it.

¹ I recognize that a charitable organization needs a “cushion” of net assets for unforeseen expenses. ABC Business had net assets of \$1,684,403 at the end of 2011 and \$2,267,410 at the end of 2012. App. Ex. No. 1.

² The transcript of this case is 17 pages with testimony from Ms. Jane Doe covering only 9 pages.

Three other factors to be considered in assessing whether ABC Business is a charitable organization are whether charity is dispensed to all who need and apply for it, whether ABC Business places obstacles in the way of those who would avail themselves of the charitable benefits it dispenses and whether ABC Business benefits an indefinite number of persons. The evidence and testimony presented at the hearing were not sufficient for me to conclude that ABC Business has met these guidelines.

Ms. Jane Doe was asked at the hearing how ABC Business knows that members “are physically able to run.” She replied that ABC Business is a “total self-selecting program.” “We have a bulletin board at the four shelters, and we have our program team members, staff members, go in and recruit, and they can just raise their hand and say they want to be a part of what we do.” Tr. pp. 9-10.

Whatever document was posted on the bulletin boards at the shelters was not admitted into evidence at the hearing. And it is unclear from the insufficient record of this case how a homeless person who is disabled or physically unable to run, would be able to join this organization and receive ABC Business’s benefits. The record indicates that ABC Business benefits a limited number of homeless people, namely those who are physically able to run. For those unable to run, their inability becomes an obstacle in the way of benefitting from ABC Business’s charity. There is no testimony or documentary evidence as to whether ABC Business accommodates homeless people who are unable to run. There is no testimony or documentary evidence as to whether a homeless person, unable to run, would know they can “self-select” themselves into ABC Business’s program after reading the bulletin board. There is no testimony or evidence that everyone who applied to become a member of ABC Business was accepted into the program. Without testimony or documentary evidence on these issues, I cannot conclude that

ABC Business dispenses charity to all who need and apply for it, that ABC Business benefits an indefinite number of homeless persons or that ABC Business has not set up obstacles in the way of benefitting from its charity.

The Korzen criteria that a charitable organization dispense charity to all who need and apply for it and place no obstacles in the way of those needing its benefits are more than guidelines. They are “essential criteria” which “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 these guidelines are met for those homeless people unable to run weighs heavily against ABC Business.

In exemption cases, the taxpayer 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). The Department’s second denial of ABC Business’s request for a sales tax exemption is presumed to be correct, and ABC Business had 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 (2nd Dist. 1995). To prove its case, a taxpayer must present more than its testimony. The taxpayer must present sufficient documentary evidence to support its exemption. Sprague v. Johnson, 195 Ill. App. 3d 798 (4th Dist. 1990). The evidence and testimony presented at the hearing indicate that ABC Business may perform some commendable services for the homeless who are physically able to run. However, the absence of documentary evidence in this case directly related to the Korzen factors discussed above, forces me to conclude that ABC Business has not proven, by clear and convincing evidence, that it is a charitable institution in accordance with the guidelines of

Methodist Old Peoples Home. For the above stated reasons, I recommend that the Department's determination denying ABC Business a sales tax identification number be affirmed

Kenneth J. Galvin
Administrative Law Judge

September 23, 2013