

ST 15-03

Tax Type: Sales Tax

Tax Issue: Exemption From Tax (Charitable Or Other Exempt Types)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE)	XXXX
OF THE STATE OF ILLINOIS)	Sales Tax Exemption
)	
v.)	
)	
)	
ABC PROGRAM,)	
)	Kelly K. Yi
Taxpayer)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Robin Gill, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Ms. Laurie Samuels on behalf of ABC PROGRAM.

Synopsis:

On January 17, 2014, the Department of Revenue of the State of Illinois (“Department”) issued a “Denial of Sales Tax Exemption” to ABC PROGRAM (“ABC Program” or “Taxpayer”) denying its 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 retailers’ occupation tax as set forth in 35 ILCS 105/1 *et seq.* Taxpayer protested the Department’s decision and requested an administrative hearing. In lieu of a hearing, the parties subsequently submitted a “Joint Stipulation of Facts and Waiver of Oral Hearing,” (“Stipulation”) along with Department Exhibit 1, inclusive of the exemption application, the denial by the Department, Taxpayer’s request for hearing, and other various documents offered by Taxpayer. Stipulation and Dept. Ex. 1. Following the submission of all evidence and a review of the record, it is

recommended that this matter be resolved in favor of the Department. The following Findings of Fact and Conclusions of Law are made in support of this recommendation.

Findings of Fact:

1. The Department's case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Department's denial of exemption dated January 17, 2014. Dept. Ex. 1, p. 2.
2. Taxpayer was incorporated on December 17, 2012 as a not-for-profit organization. Dept. Ex. 1, p. 21.
3. Taxpayer's mission is "[t]o align talented youth with meaningful opportunities to strengthen their competencies and afford them the social capital needed to make their mark on the world." Taxpayer aims to achieve this goal by engaging the youth to: 1) demonstrate faith to believe they are greater than their circumstances; 2) focus on education as a means to break society barriers; 3) increase the quality of life by providing meaningful opportunities; and 4) be active participants in the communities through service. Dept. Ex. 1, p. 11.
4. Taxpayer offers a summer program for youth ages 10 through 17, grades fifth through eleventh at the time of participation. Dept. Ex. 1, pp. 3, 5.
5. Taxpayer serves both rural and urban communities. It selects students from elementary through high school levels to experience a three-week summer opportunity, which exposes them to a variety of activities ranging from literacy to classical piano. Through a selection process, it places participants in their areas of interests and aims to expand their vision. Dept. Ex. 1, p. 9.
6. Taxpayer's program is limited to 24 students. Dept. Ex. 1, p. 9.

7. Activities offered at the summer camp are: athletics, culinary art, film industry, historic vehicle restoration, music industry, musical instruments, cosmetology, and miscellaneous activities/professions. Dept. Ex. 1, p. 12.
8. Each activity is supported by industry experts and volunteers. In addition to the activities offered, each participant receives age appropriate financial literacy skills and a reading component in the form of journaling. Dept. Ex. 1, p. 12.
9. Mathematics is incorporated in the activities, such as basketball and music, which encompass numerical sequences. Participants selecting culinary arts learn basic principles of farming. Dept. Ex. 1, p. 12.
10. Taxpayer's selection process requires an application, a 500 word essay, three letters of recommendation, in which at least two must be from a teacher, counselor, or principal, the most current academic grade report, and standardized test scores. Dept. Ex. 1, p. 5.
11. The application requires parents and guardians to answer short questions and provide financial information for all parents/guardians. Only one applicant per family is allowed to submit an application. Dept. Ex. 1, p. 8.
12. Once the applications have been received, Taxpayer's team reviews them for quality and selects the top 50% during the first round. During the second round, the top 50% of applications are further reviewed and the top applicants are contacted to schedule a telephone interview. Dept. Ex. 1, p. 4.
13. Taxpayer's selection process is highly competitive, as only about one in five applicants are selected, following an initial telephone interview and a final in person interview. Dept. Ex. 1, pp. 5, 8.

14. During the third and last week of the program, the participant and one parent/guardian are taken on an all expense paid trip to Walt Disney World in Orlando, Florida. Dept. Ex. 1, p. 5.
15. Taxpayer is exempt from federal income taxes as an entity described in Section 501(c)(3) of the Internal Revenue Code since June 12, 2013. Dept. Ex. 1, p. 32.
16. Taxpayer's bylaws state that it is organized exclusively for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code. Dept. Ex. 1, p. 20.
17. Taxpayer's bylaws further state that no part of Taxpayer's net earnings may inure to the benefit of or distributable to any director, officer, employee, or agent of the organization. Dept. Ex. 1, p. 24.
18. Taxpayer's directors or officers are not compensated except reimbursement for reasonable expenses incurred in the performance of duties on behalf of the organization. Dept. Ex. 1, p. 12.
19. Taxpayer does not issue shares of stocks. Dept. Ex. 1, p. 12.
20. Taxpayer has a policy that its fees may be waived or reduced in accordance with each recipient's ability to pay; its staff has the discretion to make such waivers or deductions, when appropriate. Dept. Ex. 1, p. 33.
21. Taxpayer's 2013 financial statements show that it had \$XXXX of revenues over expenses of \$XXXX. All of its revenues came from donations. Expenses consist of \$XXXX in charitable donations, \$XXXX for banking, \$XXXX for professional development, \$XXXX

for marketing, \$XXXX in general expenses, and \$XXXX in investments. Dept. Ex. 1, pp. 13-15.

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)).

Taxpayer has requested an exemption identification number pursuant to these provisions, which the Department has denied on the basis that it did not demonstrate that it operates exclusively for charitable purposes. Dept. Ex. 1, p. 2. The Department’s denial of an applicant’s claim for an exemption identification number is presumed to be correct. 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). “The burden is a very heavy one.” Provena Covenant Medical Center v. Department of Revenue, 236 Ill.2d 368, 388 (2010).

An examination of the record establishes that Taxpayer has not demonstrated, by the presentation of exhibits, evidence sufficient to warrant an exemption from sales tax as an association organized exclusively for charitable, educational, or religious purposes.¹ Accordingly, under the reasoning given below, the determination by the Department denying Taxpayer a sales tax exemption number should be affirmed. In support thereof, I make the following conclusions:

As to the issue of “educational purposes” exemption, 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 authorized 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 ‘education purposes’ as meaning for ‘school...purposes,’ as the phrases ‘school...purposes’ has been interpreted or maybe interpreted by the Supreme Court.” 86 Ill. Admin. Code § 130.2005(1)(1). The Illinois Supreme Court has concluded that an institution is not organized for “school purposes” unless the institution: (1) offers an established, commonly accepted program of academic instruction, which compares favorably with courses of

¹ It is unclear from the record whether Taxpayer, in addition to charitable and religious exemptions, is claiming the “educational purposes” exemption, but as it alludes to an educational component in its brief, I address this issue as well. See Taxpayer’s brief.

study offered in tax-supported schools; and (2) substantially lessens what would otherwise have been a government obligation. A school, within the meaning of the constitutional provision, is a place where systemic instruction in useful branches is given by methods common to schools and institutions of learning. See Coyne Electrical School v. Paschen, 12 Ill.2d 387, 392-293 (1957); 86 Ill. Admin. Code 130.2005(1)(2).

Taxpayer did not offer its summer program course catalog into evidence. It did not offer a written description of its curriculum into evidence. While Taxpayer did offer into evidence a copy of the application for the summer program, explaining the selection process and the list of “activities offered,” there is no evidence in the record that Taxpayer offers courses in traditional disciplines such as reading, writing, mathematics, history or literature. Some contents of its website submitted into evidence state that it incorporates journaling and mathematics into disciplines they offer such as financial literacy and basketball and music, but I cannot conclude from this that Taxpayer offers primarily traditional disciplines taught in elementary to high school levels, especially given the short length of the activities, limited to two weeks excluding a free weeklong trip to Disney World. Without a course catalog, descriptions of the curriculum and a program calendar, I cannot conclude that Taxpayer offers systemic instruction within the meaning of the constitutional provision of “school” to the level deemed organized and operated primarily for educational purposes. Furthermore, the record does not support a finding that Taxpayer’s summer program substantially lessens what would otherwise have been a government obligation. Taxpayer has not referred me to any Illinois statutes or regulations that would require the State to offer the classes offered at its summer program such as culinary art, film industry, historic vehicle restoration, and cosmetology. These are disciplines of study traditionally regarded as in the category of personal enrichment or vocational pursuits. There is

no government burden to offer such classes. I conclude that Taxpayer has failed to prove by clear and convincing evidence that it is entitled to a sales tax exemption as an institution organized and operated exclusively for educational purposes.

Taxpayer's next argument is that it qualifies for a sales tax exemption as an institution organized and operated exclusively for religious purpose under 35 ILCS 120/2-5(11). In a property tax exemption case, where same criteria are applied as in sales tax exemption cases, the court noted that "for purposes of this section, a religious use means public worship, Sunday schools, and religious instruction." Three Angels Broadcasting Network, Inc., v. Department of Revenue, 381 Ill.App.3d 678, 694 (2008). While this is not inclusive of everything that might be regarded as a religious use, it is illustrative of the nature of a religious use in the context of property tax exemptions. *Id.* at 695. In the present case, no evidence was presented that public worship, Sunday schools or religious instruction, or anything of that nature takes place at Taxpayer's summer program. While Taxpayer's program is rooted in religious convictions and principles to encourage the students to have "unwavering **faith** to overcome any obstacles," and "reach their God given potential," no evidence was presented that it includes a curriculum of religious instructions. (emphasis in the original) *See* Dept. Ex. 1, p. 11. Rather, Taxpayer offers a summer program only to academically talented students for development of personal enrichment and vocational pursuits in a fun environment that includes a free one week trip to Disney World. I agree with the Department that Taxpayer has failed to show that its program is primarily religious that could qualify for a sales tax exemption under 3-5(4) of the Use Tax Act, 35 ILCS 105/3-5(4).

With respect to the issue of whether Taxpayer is a charitable organization, the Illinois Supreme Court, in Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 149 (1968) ("Korzen"),

outlined several factors to be considered in determining whether an entity is an institution of public charity: (1) the benefits derived are for an indefinite number of person [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; and (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 at 157. These factors are balanced with an overall focus on whether and how the organization serves the public interest and lessen the State's burden. DuPage County Board of Review v. Joint Comm'n on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461 (2nd Dist. 1995).

In order to be exempt from taxes under the UTA and the ROTA, an institution must be organized and operated "exclusively" for charitable purposes. 35 ILCS 105/3-5(4) and 35 ILCS 120/2-5(11). 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). In determining whether an institution is exempt from taxation, the test is whether its primary purpose is charitable. People v. Young Men's Christian Ass'n of Chicago, 365 Ill. 118 (1936). It is well settled in Illinois that incidental acts 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 Department contends that Taxpayer's primary purpose is not for charitable purposes, but is a competitive youth summer program in which applicants are selected. It argues that Taxpayer's activities, while beneficial to a few students who are selected to the program, are focused on serving a few students who are selected through a competitive application process. It further contends that Taxpayer's camps and selection process do not amount to the distribution of charity to all who need and apply for it. Department's brief, pp. 1-5.

Taxpayer, in turn, argues that its program provides benefits for an indefinite number of persons, persuading them to an educational or religious conviction, for their general welfare or in some way reducing the burdens on the government. It contends that its summer program is opened to an indefinite number of persons, in that all students within a specific age and grade range can apply for it, but as with any organization there is a finite amount of funds, and it is currently only able to support approximately 24 students. Taxpayer argues that its program is akin to universities where the application is opened to indefinite number of persons but only the students meeting the rigors of the admission requirements are selected for admission. Taxpayer's brief, pp. 2-3.

I disagree. Because Taxpayer imposes a multiple level of selection process to the applicants vying for a position in the summer program, I cannot conclude that it is organized exclusively for charitable purposes. As reflected in Korzen, the law is clear in that the benefits derived, not the opportunity to apply for benefits, must be for an indefinite number of persons. While Taxpayer's summer program is open to all students in a specific age and grade range, the result is that the vast majority of the students are merely given an opportunity to apply for the benefits Taxpayer provides. I disagree with Taxpayer's point that the benefits derived are the *opportunity to apply* for the summer program, not the actual participation in the program. The

record clearly reveals that the benefits derived are only for a limited number of academically talented students. Taxpayer contends that it is merely a funding issue in that as its funding increases, so will its capacity to sponsor more students in the summer program. This assertion is not supported by Taxpayer's financial statements which show that it has donated to charity \$XXXX of \$XXXX total expenses in 2013, of which includes \$XXXX investment in an unspecified source. Moreover, if it is indeed a funding issue, Taxpayer could admit the same number of students, 24 students, on a first come first serve basis but it does not. Taxpayer argues that by offering the program to students of lower economic status, it ultimately reduces a burden on the government by breaking the cycles of incarceration and dependence on the government assistance program that is linked to lack of education and poverty. In support of the argument, Taxpayer avers that it *anticipates* that a sizeable percentage of the applicants will derive from those of lower economic status. I cannot make findings based on a conjecture. No evidence was presented as to the economic status of the overall applicant pool and the specific applicants who were admitted to the summer program. Taxpayer admittedly selects the best applicants, judged generally by sterling academic records, teachers' recommendations, and two interviews. As such, it would not be outside of a logical inference that the selected students are already academically accomplished and motivated to succeed, irrespective of their economic status, and with or without Taxpayer's summer program. It should be noted that Taxpayer merely avers that it anticipates a sizeable percentage of applicants will come from the lower social economic status; it does not aver that it anticipates that a sizeable percentage of applicants of the lower economic status will be selected into its summer program. This counters Taxpayer's contention that it helps reduce a government burden by granting admission to the students who are at a high risk of becoming the wards of State in penal institutions and/or dependent on welfare programs.

As to Taxpayer's argument that it provides scholarships to the selected students, Taxpayer's President and CEO, John Doe, wrote to the Department that "[g]iven that students perform well academically our partners will assist them in attending top tier high schools and universities which limit the number of participants we can financially support." Dept. Ex. 1, p. 9. Without supporting documentary evidence, this is merely a conjecture. No evidence was presented to establish that Taxpayer's unnamed partners have committed funds to further these students' education, and Taxpayer's financial statements do not, as well, support this assertion. Even if Applicant's partners had committed these funds, no clear and convincing evidence was presented that such scholarship was a part of Taxpayer's program or administered through Taxpayer. I disagree with Taxpayer that the financial assistance, contingent upon academic excellence, reduces State's burden of providing federal student loans. It may ease some burden on the federal government, but the State of Illinois and its taxpayers receive no apparent relief from any conditional economic burden by Taxpayer or its partners. Moreover, since federal student loans are need based, if these students do well academically and receive scholarships from Taxpayer's partners or other sources, they would not have been in the pool of students needing federal student loans in the first place. I conclude that Taxpayer has failed to meet, by clear and convincing evidence, that it meets the first Korzen characteristic of a charitable organization.

The parties agree that Taxpayer has met the second and third characteristics of Korzen, in that Taxpayer has no capital, capital stock, or shareholders, and earns no profit or dividends, but rather derives its funds mainly from private and public charity and hold them in trust for the purposes express in its charter. Department's Legal Argument, pp. 2-3. Therefore, next issue is the first-prong of the fourth Korzen characteristic that the charity is dispensed to all who need and apply for it. Taxpayer admits that the admission to the summer program is not offered to

every applicant but contends that it is similar to universities which dispense available funds to those who need, apply and are selected for their program. As discussed earlier, Taxpayer does not qualify for a sales tax exemption under the “educational purposes” exemption. Unlike the universities that meet the Illinois Supreme Court’s definition of an institution organized for “school purposes,” Taxpayer here does not. Taxpayer’s summer program is akin to any competition where winners are awarded a prize; here, the prize is the participation in the program including a weeklong all expense paid trip to likes of Disney World in Florida. I concluded that Taxpayer’s summer program which is dispensed only to a small group of high achieving students does not meet the first-prong of the fourth characteristic of Korzen that charity be dispensed to all who need and apply for it.

The second-prong of the fourth Korzen characteristic requires that there be no gain or profit in a private sense to any person connected with a charitable organization. Korzen at 137. No person connected to a charitable organization is permitted gain or profit in connection with the organization. School of Domestic Arts & Sciences v. Carr, 322 Ill. 562, (1926). While Taxpayer’s expense report does not include salaries of any kind but does include a substantial amount, constituting more than 1/3 of total 2013 expenses, charged as “Professional Development.” Dept. Ex. 1, p. 13. No evidence was presented to explain the exact nature and reasonableness of such expenses as compared to other similarly situated organizations. Based on the evidence submitted, I cannot conclude that such expense did not provide any gain or profit in a private sense to any person connected with Taxpayer. I find that Taxpayer has failed to prove by clear and convincing evidence that it meets the second-prong of the fourth characteristic of Korzen.

The fifth and final Korzen characteristic dictates that a charitable organization place no obstacles of any character in the way of those who need and would avail themselves of the charitable benefits it dispenses. The record in this case clearly reveals that Applicant places a multiple obstacles in the way of those students vying for a coveted placement in the summer program. Taxpayer readily admits that only about 20% of the applicants are selected to its program each year. It is highly competitive, comprised of a multi-level selection process, judged by academic excellence, teachers' recommendations, and two interviews. Taxpayer argues that the selection process is not an obstacle but a good practice to prepare the applicants for competition and success in the society. It argues that it would be a disservice to the donors and other deserving students to devote resources to those students who would not "best avail themselves of the charitable benefits." It may be so, but that is not the settled law in Illinois in the tax exemption cases. A charitable organization is not created for donors' benefits; it is created for the benefits of those in need. The law does not say that a charitable institution may dispense only to those who "best" avail themselves of the benefits it dispenses. The law requires that no obstacles of any character be placed in the way of those who need and would avail themselves of the charitable benefits it dispenses. As well intentioned as its purpose, I conclude that Taxpayer exists, not for a charitable purpose, in the legal sense, but because of Taxpayer's pursuit of supporting a select group of students who are already academically accomplished at the exclusion of all other students who need, probably more so than other 'deserving students,' and apply for the summer program. Taxpayer's program is essentially a competition where students compete for awards, in this case, participation in the summer program including a free trip to Disney World and a purported, conditional future scholarship. I conclude that Taxpayer has failed to meet, by clear and convincing evidence, that it meets the fifth Korzen characteristic

that no person is denied the benefit of Taxpayer's summer program despite the lack of qualifications.

In balancing Taxpayer's characteristics of a charitable organization with an overall focus on whether and how the organization serves the public interest and lessens the State's burden, as noted in Joint Commission, I conclude that Taxpayer is neither a religious, educational, nor charitable organization, not in the legal sense. Taxpayer offers a competitive summer program only to the most gifted students in a specific age and grade range at the exclusion of all other students who vie for a placement in the program. It is no different from any competition in which a prize is awarded, in this case, an admission to Taxpayer's summer program with actual and conditional benefits. While Taxpayer's program benefits the few students selected, there is no ease of government burden. Taxpayer's contention that it relieves the burdens of providing federal student loans does not ease the burdens of Illinois taxpayers nor does it override the substantial lack of characteristics of a charitable organization. The fourth and fifth Korzen characteristics that a charitable organization dispense charity to all who need and apply for it and place no obstacles in their way, are "more than guidelines." They are "essential criteria" and "go 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). Although Taxpayer has no stocks or shareholders and derives its funds mainly from private charity, without it meeting the "essential criteria" above, I conclude that Taxpayer is not an institution of public charity.

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 property 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). Great caution must be exercised in determining whether property is exempt in order to insure that “sound principles” are preserved, unwarranted exemptions from taxation are avoided and that only the limited class of properties meant to be exempt actually receives the exempt status that the Legislature intended to confer. Otherwise, any increases in lost revenue costs attributable to unwarranted application of the charitable exemption will cause damage to public treasuries and the overall tax base. In this case, 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 (2nd Dist. 1991). Taxpayer has failed to prove by clear and convincing evidence that it is an exclusively charitable organization, as required for exemption under Illinois statutes, and that it falls within the limited class of institutions meant to be exempt for charitable purposes.

Recommendation:

For the above stated reasons, I recommend that the Department’s determination denying the Taxpayer a sales tax exemption number be affirmed.

March 10, 2015

Kelly K. Yi
Administrative Law Judge