

ST 09-7

Tax Type: Sales 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
OF THE STATE OF ILLINOIS**

v.

XYZ SERVICES, NFP

Taxpayer

Docket # 08-ST-0000

Claim for Exemption Number

RECOMMENDATION FOR DISPOSITION

Appearances: Robin Gill, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; John R. Daly, General Counsel, for XYZ Services, NFP

Synopsis:

XYZ Services, NFP (“taxpayer” or “XYZ”) applied to the Department of Revenue (“Department”) for an exemption identification number in order to purchase tangible personal property at retail free from the imposition of retailers’ occupation taxes and use taxes. The Department denied the application, and the taxpayer timely protested the denial. An evidentiary hearing was held during which the issue presented was whether the taxpayer is organized and operated exclusively for charitable purposes under section 3-5(4) of the Use Tax Act (35 ILCS 105/3-5(4)) and section 2-5(11) of the Retailers’ Occupation Tax Act (35 ILCS 120/2-5(11)). The taxpayer operates individual physician

practices that are located throughout Illinois. The taxpayer also operates a medical clinic, which is now known as the Anywhere, Illinois. The Department contends that the taxpayer does not operate its facilities exclusively for charitable purposes. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. XYZ is an Illinois not-for-profit corporation that was organized on August 30, 2006. (Taxpayer Ex. #1)
2. According to its articles of incorporation and bylaws, the purposes for which XYZ is organized are provided, in part, as follows:

The Corporation is organized and shall be operated as a not-for-profit corporation exclusively for charitable, educational and scientific purposes. More specifically, the Corporation will:

- (a) Acquire, own or lease, provide, make available, maintain, equip, conduct, manage and operate physician practices for the care and treatment of the medically sick, injured or afflicted on a not-for-profit basis;
- (b) Employ physicians;
- (c) Provide reduced cost or free medical treatment for the poor and indigent insofar as it is feasible;
- (d) Promote and further the general physical health of the community. (Taxpayer Ex. #1, p. 3; #2, p. 8)

3. The sole member of XYZ is ABC Services (“ABC” or “Corporate Member”), an Illinois not-for-profit corporation. (Taxpayer Ex. #1, p. 4; #2, p. 11)
4. The bylaws state that the Board of Trustees shall be elected and removed by the Corporate Member. The officers include the following: president, who is the chief executive officer of the Corporate Member; vice president, who is the vice

- president of the Corporate Member; and treasurer, who is the chief financial officer of the Corporate Member. (Taxpayer Ex. #2, pp. 12-13, 18-19)
5. The bylaws state that the accounts of XYZ “shall be audited and examined each year by a certified public accountant selected by the Finance, Audit and Budget Committee of the Corporate Member.” (Taxpayer Ex. #2, p. 22)
 6. The first physician to work for XYZ began in January 2007. On December 3, 2007, XYZ acquired the Rural Health Clinic, which was a for-profit entity that did not have a charity care policy. XYZ now operates the clinic as the MMM (“MMM”). Seven physicians were working for XYZ before it acquired the Clinic. (Taxpayer Ex. #4, p. 30; Tr. pp. 50, 53-54, 77)
 7. In September 2008, XYZ created its Healthcare Assistance Program, which is its charity care policy. The policy is to provide financial assistance to patients who apply and who meet the criteria for being either financially or medically indigent. (Taxpayer Ex. #5, p. 32; Tr. p. 27)
 8. The policy defines financially and medically indigent as follows:

Financially indigent refers to an uninsured or underinsured person who does not have the ability to pay for services rendered....XYZ may classify all patients whose income is less than or equal to 200% of the Federal Poverty Guidelines as financially indigent which results in 100% financial assistance. Partial financial assistance is provided on a sliding scale for those patients whose income is between 2 and 4 times (200% - 400%) of the Federal Poverty Guidelines....

Medically indigent refers to a patient whose remaining hospital bill(s), after application of financially indigent criteria, exceeds a specified percentage of the patient’s annual income and who is unable to pay the remaining balance of the bill(s)....To be considered for classification as a medically indigent patient the amount owed after application of the financially indigent adjustment must exceed ten percent (10%) of the patient’s annual

income and the patient must be unable to pay the remaining balance of their bill(s). (Taxpayer Ex. #5, p. 34)

9. The policy states that accounts will be considered for financial assistance after an exhaustive investigation of other funding sources indicates no coverage. All patients under the age of 19 are considered full bill until they have applied for KidCare of Illinois. “Refusal to pay premiums into the KidCare program will exclude patients for financial assistance consideration.” (Taxpayer Ex. #5, p. 33)
10. The policy also states that XYZ reserves the right to provide “judgmental health care assistance” and indicates as follows:

The following types of patient accounts will qualify for Judgmental Healthcare Assistance. A judgmental healthcare assistance form will be initiated and completed by [XYZ] explaining the circumstances of why this form was used in place of the regular form.

- Homeless – Patient intake should initiate the form on these types of accounts.
- Resident of shelter facilities – Patient intake should initiate the form on these types of accounts when it has been verified that there is no insurance available for reimbursement or any other means of payment.
- Rape victims or victims of violent crimes when no other source of reimbursement is available.
- Accounts of patients who are deceased, have no assets, no estate and no other party responsible for payment. A patient account representative will normally initiate this form.
- Accounts that have lawsuits initiated by XYZ once a citation has been conducted and it is shown to the court that there are no available assets for payment.

Accounts that should not be considered for judgmental healthcare assistance:

- People that are serving time in prison. This type of account should be written off to collection.

- Accounts on people that have given false information or refuse to give information. This type of account should be written off to collection.
- Accounts on people who are aliens and programs for payment have not been researched.
- Accounts where all avenues for payment have not been exhausted. (Taxpayer Ex. #5, p. 43)

11. Patients must complete an application for Healthcare Assistance that requests information concerning income and documentation to substantiate it. (Taxpayer Ex. #13; Tr. pp. 69-70)

12. The Healthcare Assistance policy also includes the following:

It is the policy of XYZ to reserve the right to limit or deny financial assistance at the sole discretion of XYZ....XYZ reserves the right to limit the services subject to XYZ healthcare assistance policy. Elective and/or services deemed not medically necessary may or may not be eligible for financial assistance consideration. (Taxpayer Ex. #5, p. 35)

13. A sign near the reception area and at the registration desk in the clinic states as follows:

Financial Assistance

A Healthcare Assistance Program is available to assist qualifying patients to aid in the financial resolution of their medical bills.

For details please speak to a receptionist.

(Taxpayer Ex. #8; Tr. p. 64)

14. A brochure provides as follows:

Get Help to Pay Your Medical Bills

[XYZ] has a Health Care Assistance Program that helps patients who cannot pay their medical bills. Patients who qualify for the program may have to pay only a part of, or in some cases none, of the medical bills they owe.

Qualifications are based on income level, government poverty guidelines and whether or not you qualify for other forms of government assistance.

You may find out more information on the program at XXXXX or by speaking with the receptionist in this office.

We care about you. If you believe you will not be able to pay your bill – ask for help now.

[XYZ] provides the same quality care to all people seeking medical services, regardless of their ability to pay.

(Taxpayer Ex. #9; Tr. p. 65)

15. The fiscal year for XYZ begins on April 1 and ends on March 31. (Taxpayer Ex. #2, p. 22)

16. XYZ provided an unaudited Statement of Operations for the period ending February 29, 2008, which shows the following revenue and expenses:

Revenue

Outpatient services	\$6,032,877
Charity care	<u>5,289</u>
Total gross patient service revenue	6,027,588
Deductions from patient service revenue	<u>2,858,444</u>
Net patient service revenue	3,169,144
Other operating revenue	<u>96,167</u>
Total operating revenue	3,265,311

Expenses

Salaries	3,297,506
Employee benefits	635,003
Physician fees	19,518
Professional fees	193,113
Purchased services	43,261
Patient chargeable supplies	62,492
Patient nonchargeable supplies	53,106
Drugs and pharmaceuticals	232,884
Office and other supplies	175,829
Leases/rent	79,347

Repairs and maintenance	39,023
Insurance	375,596
Misc other expense	(1,502,918)
Interest and amortization	129,545
Depreciation	104,168
Bad debt	<u>44,759</u>
Total operating expenses	3,982,232
Income (Loss) from operations	(716,921)
Nonoperating Gains (Losses):	
Unrestricted gifts and interest income	<u>4,106</u>
Total non-operating gains (losses)	4,106
Excess (deficiency) of Revenues over Expenses (Taxpayer Ex. #6)	(712,815)

17. XYZ has no capital, capital stock, or shareholders and is exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code pursuant to a determination made by the IRS on September 4, 2007. (Taxpayer Ex. #1, #3)

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(4) of the Act provides a list of tangible personal property that is exempt from the tax, and includes the following:

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 and 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 (“ROTA”) (35 ILCS 120/1 *et seq.*) contains a similar provision. See 35 ILCS 120/2-5(11).

In order to determine whether the taxpayer is organized and operated exclusively for charitable purposes, the following factors are considered: (1) whether the benefits derived are for an indefinite number of people, persuading them to an educational or religious conviction, for their general welfare or in some way reducing the burdens of government; (2) whether the organization has no capital, capital stock or shareholders, earns no profits or dividends, but rather derives its funds mainly from public and private charity and holds them in trust for the objects and purposes expressed in its charter; (3) whether the organization dispenses charity to all who need and apply for it, does not provide gain or profit in a private sense to any person connected with 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; and (4) whether the primary purpose of the organization, not any secondary or incidental purpose, is charitable. Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 139, 156-57 (1968); Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455, 459 (2nd Dist. 1995). These factors are balanced with an overall focus on whether and how the organization serves the public interest and lessens the State's burden. Du Page County Board of Review v. Joint Commission on Accreditation of Healthcare Organizations, 274 Ill. App. 3d 461, 466 (2nd Dist. 1995). Whether an institution has been organized and is operating exclusively for an exempt purpose is determined from its charter, bylaws and the actual facts relating to its method of operation. *Id.*

The taxpayer has the burden of proving by clear and convincing evidence that it is entitled to the exemption. Wyndemere, supra; Gas Research Institute v. Department of Revenue, 154 Ill. App. 3d 430, 436 (1st Dist. 1987). It is well-settled that tax exemption

provisions are strictly construed in favor of taxation. *Id.*; Heller v. Fergus Ford, Inc., 59 Ill. 2d 576, 579 (1975). All facts are construed and all doubts are resolved in favor of taxation. *Id.* To prove its case, a taxpayer must present more than its testimony denying the Department's determination. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990); Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296 (1st Dist. 1981). The taxpayer must present sufficient documentary evidence to support its claim. *Id.*

XYZ indicated it was formed because of a problem with access to care for citizens of Illinois; physicians were leaving the area due to the lack of employment opportunity. XYZ was created to attract and employ physicians. XYZ refers to its individual physician practices as its “community-based practices.” (Tr. pp. 79-80) The MMM has an urgent care center, and patients may also make appointments to see a specific physician. XYZ contends that it qualifies for an exemption because at all of its facilities, it takes care of people regardless of their ability to pay, and no one who has needed care has ever been turned away.¹

Despite its contentions, the evidence falls short of showing clearly and convincingly that XYZ meets most of the guidelines in Methodist Old Peoples Home, *supra*, for a charitable organization. First, XYZ does not derive its funds mainly from public and private charity. Although its bylaws require its accounts to be audited each year, XYZ provided an unaudited Statement of Operations. This unaudited statement shows that the majority of its income is from patient service revenue. XYZ also did not

¹ The sole member of XYZ operates 3 hospitals in Illinois. (Tr. p. 14) The testimony concerning the amount of charity care provided by the hospitals is not relevant to this case because XYZ is a separate corporate entity. (Tr. p. 16) Although XYZ claims it has a relationship with Southern Illinois School of Law Land of Lincoln Law Center where the staff comes in, interviews patients, and explains the charity care policy to the patients, the testimony indicates this takes place while the patient is in the hospital. (Tr. pp. 15-16) This testimony, therefore, would not apply to XYZ.

clarify some of the items on its Statement of Operations. XYZ explained that the “Deductions from patient service revenue” in the amount of \$2,858,444 were “writeoffs, things like that, bad debts” (tr. p. 60), but a bad debt expense is included at the bottom of its expenses in the amount of \$44,759. XYZ included “Misc other expense” under its expenses, but it did not provide an explanation of this “expense.” The amount is a negative \$1,502,918, which is a substantial amount of income; it is unclear why this was described as “miscellaneous” and why it was included under the expenses rather than income.

The fact that a taxpayer’s primary funding source is not public or private charity does not automatically require a conclusion that the organization is not charitable (Lutheran General Health Care System v. Department of Revenue, 231 Ill. App. 3d 652, 663-664 (1st Dist. 1992)); in the present case, however, the taxpayer has failed to meet other guidelines. Although XYZ has established a charity care policy, the evidence does not clearly and convincingly show that XYZ gives charity to an indefinite number of people or that XYZ dispenses charity to all who need and apply for it. The charity care policy, as stated in the bylaws and the Healthcare Assistance Program, places limits on the amount of charity that is given. The bylaws indicate that XYZ will provide charity care “insofar as it is feasible.” The chief financial officer explained this means that XYZ will balance its charity care with its fiduciary duty to protect the corporation. (Tr. p. 23) The Healthcare Assistance Program states that XYZ reserves the right “to limit or deny financial assistance at the sole discretion of XYZ....XYZ reserves the right to limit the services subject to XYZ healthcare assistance policy. Elective and/or services deemed not medically necessary may or may not be eligible for financial assistance

consideration.” (Taxpayer Ex. #5, p. 35) Providing free care only to the extent that XYZ speculates it has the financial ability to provide it and reserving the right to limit or deny the amount of charity care raise doubt that XYZ gives charity to an indefinite number of people or that it dispenses charity to all who need and apply for it. See Wyndemere Retirement Community, at 460 (charity provided in relation to financial circumstances is not provided to an indefinite number of people or dispensed to all who need it).

In addition, it is not clear why people who are serving time in prison are excluded from receiving financial assistance. Although it is understandable why a person who provides false information or who refuses to give information would not receive judgmental healthcare assistance, the policy states that people who are serving time in prison also do not receive help; this type of account is “written off to collection.” Sending the account to collection and disallowing financial assistance simply because a person is serving time in prison is not providing charity to all who may need it.

The evidence that was presented also does not clearly establish that XYZ does not place obstacles in the way of those seeking its charitable benefits. One obstacle, as already mentioned, is the limits that XYZ has in its charity care policy. In addition, failing to notify the public of a fee waiver policy is considered an obstacle in the way of those seeking charity. See Alivio Medical Center v. Department of Revenue, 299 Ill. App. 3d 647, 652 (1st Dist. 1998). Although XYZ presented some evidence that it notified the public of its financial assistance policy, the record is not clear concerning when and to what extent this was done. Before XYZ adopted its Healthcare Assistance Program in September 2008, it claims that it followed the charity care policy of its

Corporate Member.² (Tr. p. 44) XYZ indicated that the amount of charity care shown on its Statement of Operations is low because XYZ was slow in putting the charity care policy at the clinic into practice; XYZ had to implement the policy, train the staff, and post signs. (Tr. pp. 60-61, 77-78) XYZ also admitted that the outside billing agency for the community-based practices was not enforcing the charity care policy because it was easier for the agency to write the amount off as bad debt. (Tr. pp. 27, 61, 77) At the time of the hearing, XYZ claimed that the billing agency was going to be replaced, but the agency was still working for XYZ. (Tr. pp. 27, 62) XYZ could not remember exactly when it recognized that the billing agency was not following its charity care policy but claimed its concern was raised when it saw the low amount of charity care on its Statement of Operations. (Tr. p. 79)

Despite the fact that its billing agency was admittedly not following the charity care policy and XYZ cannot remember when it recognized this problem, XYZ claims that the bills that it sent to its patients contained a notice that charity care is available. (Tr. pp. 27, 42, 67) XYZ, however, did not offer samples of the bills into evidence. Even though XYZ provided samples of its brochure and a sign near the registration desk that concerned financial assistance, it is not clear from the record when XYZ began using these notices.³

Additional evidence fails to meet the clear and convincing standard for showing XYZ operates in a charitable manner. XYZ claims the contracts with its physicians

² A copy of the policy that XYZ followed prior to September 2008 was not provided.

³ XYZ provided samples of letters that it sent to some of its patients who had not applied for charitable assistance but who XYZ believed might qualify for charity care. (Taxpayer Ex. #10, #11) These letters notified the patients about the Healthcare Assistance Program and were sent less than a month prior to the hearing in this matter. Although XYZ claims it is difficult to get people to actually fill out the application for financial assistance, the letters do not offer help filling out the application as the testimony indicated. (Tr. p. 75)

contain a condition requiring them to provide charity care (tr. p. 54), but XYZ did not offer copies of the contracts into evidence. XYZ maintains that the salaries that it pays to its physicians are “fair market value” according to a Medical Group Management Association survey and a separate consultant (tr. pp. 51-52), but it did not provide the actual salaries, a copy of the survey, or other verification for how the salaries are determined.

As discussed previously, the evidence is also unclear concerning when XYZ actually applied its charity care policy. XYZ did not provide information concerning the patients who benefited from the charity care policy or those who were denied assistance. (Tr. pp. 46, 81-82) XYZ did not have information on how many accounts were sent to collection. (Tr. p. 43) Although XYZ gave an exhibit with a list of the amount of charity care provided during certain months in 2008 (Ex. #7), the person who prepared the exhibit did not testify and substantiation for the exhibit was not offered.

Exemption provisions must be strictly construed; all doubts and debatable questions are resolved in favor of taxation. Wyndemere, *supra*. Although XYZ may have taken steps towards establishing and implementing a charity care policy, the evidence presented fails to show that XYZ meets most of the criteria of Methodist Old Peoples Home, *supra*, for determining whether it is organized and operated for charitable purposes. Because the evidence falls short of showing clearly and convincingly that XYZ is organized and operated exclusively for charitable purposes, the exemption must be denied.

Recommendation:

For the foregoing reasons, it is recommended that the taxpayer's request for an exemption identification number be denied.

Linda Olivero
Administrative Law Judge

Enter: July 15, 2009