

## Does Your Client Qualify for a Charitable Property Tax Exemption?

By [Karyn R. Vanderwarren](#)

Whether you're counsel to a charity or a board member, you can help the organization determine whether it qualifies for a charitable property tax exemption and, if not, how it might make itself eligible.

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**Charitable organizations are once again considering capital campaigns as they recover from losses on endowment funds and decreased funding in recent years. Charity boards, which count attorneys among their membership, will make important decisions about capital investments. Attorneys can provide a valuable service to charitable organizations, either as board members or as retained counsel, by educating charity boards about the importance of the property tax exemption in their decision-making. Familiarity with the law's requirements can also prevent boards from making decisions that could jeopardize an already-granted exemption.**

Purchasing property may be more financially beneficial to charitable organizations than leasing, especially when the real estate tax exemption is factored in. Not only does property ownership provide an additional asset to leverage, it usually results in tax savings as well. Property leased by charitable organizations from non-profit landlords does not qualify for an exemption, and most leases require the tenant to pay its proportionate share of real estate taxes. Therefore, charities that lease may be paying more than necessary.<sup>1</sup>

### **The Illinois exemption**

The Illinois revenue Code provides that property owned by a public charity "is exempt when actually and exclusively used for charitable or beneficent purposes, and not leased or otherwise used with a view to profit."<sup>2</sup> To qualify for the exemption, the charity must demonstrate that the property is owned by a charitable organization and that it is exclusively used for charitable purposes.<sup>3</sup> The onus of proving that the charity qualifies for the exemption is placed on the charity, which must prove its eligibility by clear and convincing evidence.<sup>4</sup> In Illinois, courts have authority to determine whether an organization is a charity; therefore, charitable status granted by another governmental body, such as the Internal revenue Service, is not determinative.<sup>5</sup> The courts will resolve any questions about eligibility for the exemption in favor of taxation.<sup>6</sup>

Upon first glance, the language of the Code seems to bar many of the activities charities frequently permit on their property, such as allowing other organizations (including business organizations) to use their property and charging rents or fees for its use. The courts, however, have interpreted the Code to permit other uses of the property as long they are incidental to the primary charitable use.

### **Charitable ownership**

A charity must "own" the property to qualify for the exemption. Illinois courts have construed ownership to give charities some flexibility in how they own property.

For example, charities can qualify for the exemption even when they are not the sole owners or owners in fee simple title. The supreme court held that property in which a police museum owned a 50 percent undivided interest was permitted a partial exemption even though another police association owning the other undivided 50 percent was not exempt.<sup>7</sup> A charity may also be able to claim a partial exemption for the portion of the property devoted to charitable purposes.<sup>8</sup>

Charitable organizations may also take advantage of the protections of placing real property in so-called holding companies without risking the exemption. For example, the court held that a charity was the equitable owner of property where it was owned by a foundation connected to the charity.<sup>9</sup> The test in that situation is whether the organization is the equitable owner of the property, whether the holding company is holding the property for profit, and whether the organization is using the property for charitable purposes.<sup>10</sup>

As noted above, charities that lease property do not qualify for an exemption because they do not pass the ownership test, even if the property is used solely for charitable purposes. There is, however, an exception for sale/leaseback transactions, which allow a charity to benefit from the financing advantages of a lease while still qualifying for the exemption.<sup>11</sup> The courts have found that a charity is an "owner" for purposes of the Code where it sells the property to a non-profit landlord and then leases back the same property.<sup>12</sup>

The lease in a sale/leaseback transaction must provide the charity with an unconditional purchase option and may not give the landlord discretion in exercising that option.<sup>13</sup> The option need not be available to the charity during the entire lease term or even in the early years of the lease. In one case, a lease in a sale/leaseback transaction was deemed charity ownership, although the earliest date the purchase option would be available to the charity was the fifteenth anniversary of the lease.<sup>14</sup>

### **Exclusive use**

Courts have interpreted the statutory requirement that property be "exclusively used" for charitable purposes to mean that the primary purpose of the property must be charitable.<sup>15</sup> Incidental or secondary purposes unrelated to the charitable purpose will not bar a finding that the property is exempt.

For example, the courts have found that the charitable character of a property primarily used to operate an agricultural society was not defeated by occasionally holding fund-raising functions on the property.<sup>16</sup> Similarly, a community center occasionally used for business purposes may be permitted an exemption if the business uses are only incidental.<sup>17</sup> In another case, softball fields owned by a foundation were determined to be exempt from property taxes even though 20 to 30 of the 500 games held on the property were sponsored by a private corporation.<sup>18</sup>

Charity-owned property that is used primarily to raise funds for charity operations, even if there is an incidental charitable benefit, may also qualify for an exemption.<sup>19</sup> Previously, the Code did not provide an exemption for property used to produce income by selling donated goods and, therefore, courts did not allow an exemption for such property.<sup>20</sup> The state legislature has since amended the statute to provide an exemption for organizations that use property for the resale of donated goods where the income is used to support the charitable activities of the property owner.<sup>21</sup>

An exemption under this section of the Code requires exclusive use in the traditional sense of the word. No provision is made for incidental use and the Code specifically permits only the "owner, and no other person"

to use the property for the resale of donated goods.<sup>22</sup>

The bottom line: a charity (except one selling donated goods) that may benefit financially or otherwise from another organization's occasional use of its property need not fear losing its exemption if that use is incidental to the property's use for charitable purposes.

Charity boards and their attorneys should analyze the types of activities that do or will occur on charity-owned property to determine whether they might disqualify the organization from an exemption. An organization that was denied an exemption in the past but has changed the uses of its property should reevaluate its position.

### Charitable purpose

In determining whether property is used for charitable purposes, the courts weigh the facts of the case against the factors set forth in *Methodist Old Peoples Home v Korzen*.<sup>23</sup> The *Korzen* factors are guidelines rather than strict requirements, and a charity's failure to meet all of them will not necessarily prove fatal.<sup>24</sup>

[Charitable exemption checklist](#)

Factors that support a finding of charitable purpose include the following: (1) the organization benefits the general welfare of an indefinite number of people or reduces the burdens of government; (2) the organization has no capital stock or shareholders who earn profits or dividends, and those connected with the organization do not gain or profit from that connection; (3) operating funds are derived primarily from private or public donations, which are spent on charitable purposes; (4) benefits are dispensed to those who need and request them; and (5) obstacles are not placed in the way of those seeking benefits.<sup>25</sup>

An attorney representing a charitable organization should carefully review existing organizational documents to ensure that the charter and bylaws indicate a charitable purpose. If they do not, he or she should revise the documents appropriately. Courts have made the absence of such a statement a factor in denying an exemption,<sup>26</sup> though inclusion of a charitable-purpose statement alone is not enough to support a finding of charitable purpose.

**Members-only services.** Perhaps the most important factor in the *Korzen* test is whether the charity benefits an indefinite number of people or reduces the burden on government to provide services. An organization that openly offers all of its charitable services to the general public will generally be able to meet this test. However, whether an indefinite number of people are benefited requires further inquiry when the organization offers some services to the general public while reserving others to members.

In *Arts Club of Chicago v Department of Revenue*,<sup>27</sup> the club appealed a department of revenue finding that its property was not exempt from real estate taxes. The property contained two galleries that were open to the public most hours of the day Monday through Saturday.<sup>28</sup> The club also operated a dining room during lunch hours available only to members and their guests.<sup>29</sup> The club posted a sign in its entrance saying that the art exhibitions were open to the public.<sup>30</sup> Over a two and one-half year period, only about 4,300 of the approximately 73,000 visitors who came to the arts club were walk-ins. The remainder were members and their guests who came to use the dining room and people who attended public events or private parties.<sup>31</sup>

Even though the dining room was off-limits to the general public and members accessed the club more frequently than the general public,<sup>32</sup> the court reasoned that the club, by opening its collection to the general public for a number of hours, benefited an indefinite number of people and found that the dining room operation was an incidental use of the property.<sup>33</sup>

*DuPage Art League v Department of Revenue* also involved an arts organization, but in that case the court upheld the department's denial of exemption.<sup>34</sup> As in *Arts Club*, collections were open to the general public; however, only paying members could exhibit their work and all of the works displayed were required to be priced for sale.<sup>35</sup> Although the DuPage Art League provided free educational programs to the general public, they were only offered six days each year.<sup>36</sup> In upholding the department of revenue determination, the court found that the organization's members were the main benefactors and the benefit to the general public was incidental.<sup>37</sup>

Because this factor is critical to obtaining an exemption, it is important to determine whether the organization offers exclusive benefits to members or others. If so, determine the nature, extent, and frequency of the exclusive benefits and compare the exclusive benefits to those offered to the public at large. To be successful, you must prove that exclusive benefits are merely incidental and the property is used primarily to benefit the general public.

**Sources of funding.** Charities that get most of their funding from public or private donations are favored for exemption under the *Korzen* test. Many organizations receive much of their income from endowment funds. Occasionally, an organization may realize a significant gain due to appreciation of a donated asset. Where these income sources are derived from public or private donations, courts are likely to classify them as public or private donations and thus not preclude a determination that the property is exempt.<sup>38</sup>

Note that the source-of-funds factor weighs less heavily when the organization has established charitable use. Organizations that receive their income from dues, fees, or other sources should not consider themselves ineligible for exemption if they use the property primarily for charitable purposes and the other factors weigh in favor of exemption.

**What constitutes an obstacle to benefits?** Another issue in exemption appeals is whether policies maintained by a charitable organization create an obstacle to those seeking benefits. In *Korzen*, the charity was denied exempt status in part because it required prospective residents to be in good health and free of any communicable diseases to obtain proffered benefits. The court found that the good-health requirement was at odds with the charity's stated purposes - to provide "accommodations and care for the sick and homeless aged"<sup>39</sup> - and impeded those wishing to receive the benefits.<sup>40</sup>

In addition, the home's funding came entirely from fees charged to residents, who were charged higher premiums for more desirable rooms.<sup>41</sup> The organization's charter suggested that fee reductions would be available, but in practice no fees were ever reduced.<sup>42</sup> This, in the court's opinion, placed an obstacle to those seeking the home's benefits.

Conversely, in *Arts Club*, the court found that although the club charged for events it waived fees for members of the public who could not pay.<sup>43</sup> Reading these cases in tandem, it seems clear that charging a fee does not constitute an obstacle if the organization also provides a mechanism for fee waivers or reductions.

The fee waiver must be truly available. In cases where an organization's documents provided for fee waivers but the waiver option was not made public, courts have found the fee to be an obstacle.<sup>44</sup> The determination is fact intensive. A community center in a small town successfully argued that the fee waiver policy was adequately publicized through word of mouth and that advertising would have wasted the organization's funds.<sup>45</sup>

The best practice for a fee-based organization is to publicize the availability of fee waivers. This can be as simple as stating "open to the public," as in *Arts Club*. Where applicable, charities should include a statement in their registration notices that fee waivers or reductions are available. Organizations can institute procedures to verify financial need if they fear abuse.

### **Making the most of scarce resources**

If the organization owns property, determine whether it is already classified as tax exempt. If not, find out whether the organization has sought exemption and, if so, what factors contributed to the denial and whether they can be addressed. For example, perhaps a non-charitable use of the property can be eliminated. (See the sidebar on page 42 for a checklist of questions to help determine whether your organization is a good candidate for exemption.)

Charity boards that review exemption eligibility as part of the capital acquisitions analysis are better equipped to make decisions that maximize resources. They thus can devote more resources to serving those in need. ?

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1. *Coles-Cumberland Prof Develop Corp v Dept of Revenue*, 284 Ill App 3d, 351, 672 NE2d 391 (4th D 1996), holding that property leased by not-for-profit organization was not subject to charitable exemption, and improvements constructed on property by lessee were not exempt from taxation.
2. 35 ILCS 200/15-65(a). This article focuses on ? ? (a) and (b).
3. *Midwest Physician Group, Ltd v Dept of Revenue*, 304 Ill App 3d 939, 953, 711 NE2d 381, 390 (1st D 1999).
4. *Lena Community Trust Fund, Inc v Dept of Revenue*, 322 Ill App 3d 884, 888, 750 NE2d 1261, 1265 (2d D 2001).
5. *Clark v Marian Park, Inc*, 80 Ill App 3d 1010, 1012, 400 NE2d 661, 663 (2d D 1980).
6. *Midwest Physician Group* at 953, 711 NE2d at 390.
7. *Chicago Patrolmen's Association v Dept of Revenue*, 171 Ill 2d 263, 281, 664 NE2d 52, 61 (1996).

8. *Evangelical Hospitals Corp v Dept of Revenue*, 223 Ill App 3d 225, 584 NE2d 1004 (2d D 1991).
9. *Community Mental Health Council, Inc v Dept of Revenue*, 186 Ill App 3d 73, 80, 541 NE2d 1330, 1335 (1st D 1989).
10. Id.
11. See *Henderson County Retirement Center, Inc v Dept of Revenue*, 237 Ill App 3d 522, 604 NE2d 1003 (3d D 1992); but see *Cole Hospital, Inc v Champaign County Bd of Review*, 113 Ill App 3d 96, 446 NE2d 562 (4th D 1983), where the court found that because the landlord retained the right to decide whether to sell the property and when, the organization was not an owner for purposes of the Property Tax Code.
12. *Henderson* at 527, 604 NE2d at 1005.
13. Id.
14. Id.
15. *Methodist Old Peoples Home v Korzen*, 39 Ill 2d 149, 157, 233 NE2d 537, 542 (1968).
16. See *In re Guilford Hope Grange No. 6*, 52 Ill App 3d 718, 367 NE2d 1021 (2d D 1977).
17. See *Lena Community Trust Fund* (cited in note 4).
18. See *Decatur Sports Foundation v Dept of Revenue*, 177 Ill App 3d 696, 532 NE2d 576 (4th D 1988).
19. See 35 ILCS 200/15-65(b).
20. See *Salvation Army v Dept of Revenue*, 170 Ill App 3d 336, 524 NE2d 628 (2d D 1988), where the court found that property on which the Salvation Army operated a thrift store was not exempt from property taxes.
21. 35 ILCS 200/15-65(b).
22. Id.
23. *Korzen* (cited in note 15).
24. Id at 156-57, 233 NE2d at 541-42 (*Korzen* factors not strict rules).
25. Id at 157, 233 NE2d at 542.
26. See *DuPage Art League v Dept of Revenue*, 177 Ill App 3d 895, 901, 532 NE2d 1116, 1119 (2d D 1988).
27. 334 Ill App 3d 235, 777 NE2d 700 (1st D 2002).
28. Id at 244, 777 NE2d at 707.
29. Id.
30. Id at 238, 777 NE2d at 703.
31. Id at 239, 777 NE2d at 703.
32. Id.

33. Id at 250, 777 NE2d at 712.
  34. *DuPage Art League* (cited in note 26).
  35. Id at 897, 532 NE2d at 1117.
  36. Id.
  37. Id at 901, 532 NE2d at 1119.
  38. *Arts Club* at 245, 777 NE2d at 708.
  39. *Korzen* at 152, 233 NE2d at 539.
  40. Id.
  41. Id.
  42. Id at 155, 233 NE2d at 540.
  43. *Arts Club* at 246, 777 NE2d at 709.
  44. *DuPage Art League* at 901, 532 NE2d at 1119.
  45. *Lena Community Trust Fund* at 889, 750 NE2d at 1266.
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### Charitable exemption checklist

The following questions provide a starting point for determining how likely your charity is to qualify for the property-tax exemption.

- Does the charity hold legal title to the property?
- If not, is the charity arguably the equitable owner of the property (e.g., is the property owned by a foundation connected to the charity)?
- Will the property be used exclusively by the charity?
- If not, who besides the charity uses or will use it and for what purpose? If other uses are incidental or secondary, they won't bar a finding that the property is tax exempt.
- Will the property be used to resell donated goods? That's typically

OK if the proceeds support the charitable activities.

- Does the charity benefit an indefinite number of people or reduce the burdens of government? If so, that supports finding a charitable purpose (and thus granting an exemption).
  - Does the organization issue capital stock, or are there shareholders or others connected with the organization who gain from that connection? If so, that weighs against finding a charitable purpose.
  - What are the organization's funding sources? If it's mostly donations, that supports finding a charitable purpose.
  - Are benefits dispensed to those who need and request them? If so, that supports finding a charitable purpose.
  - Do any of the organization's policies or practices place obstacles in the way of those seeking its benefits? If so, that weighs against finding a charitable purpose.
  - Do the organization documents state its charitable purpose? They should.
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