



Illinois
Facilities
Fund

Capacity- Building Digest

Property Tax Exemption

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Introduction

The nonprofit's role in society is much more than the presentation of the arts, the provision of services, the protection of the environment, or the promotion of better housing. Nonprofits are the vehicles through which all citizens connect with and express many of their beliefs about what American society should be. A strong nonprofit sector is as essential to maintaining our society's quality of life as is a good economy.

In the spring of 1998 the Illinois Facilities Fund and the Donors Forum of Chicago launched the first-ever financial study of Illinois nonprofit corporations that provide community support and services. The median annual revenue of the study's 500 respondents was \$690,000 in 1997.

Published in January 1999, *Illinois Nonprofits: Building Capacity for the Next Century* documented recent financial results, operating issues, key governance and management practices, data about facilities owned and leased, and attitudes about the future. The study provides a wide-angle snapshot of the many factors that make up the operations of a nonprofit corporation, as well as a close-up of the pressure points for change.

Any effort to measure a sector as diverse as that which comprises nonprofit corporations is a challenge. Performance groups and historical societies have built organizations that are different from those managing recreational facilities, caring for people who are elderly, or treating people who are mentally ill. And yet it is because their fundamental structure—governance by a voluntary board of directors—is a common bond of such strength, and the one which determines how problems are solved, that the IFF and Donors Forum are certain the study knowledge is valued across the sector.

The start-up equity of most nonprofits is the efforts, beliefs and financial contributions of volunteers. Financial growth over time cannot come from issuing stock, but from the long and slow process of building net assets through earnings and savings, and from raising charitable

contributions (a requirement of tax-exempt status). This exhausting progress is well documented in the study. While nonprofit corporations have always implemented other strategies to build net assets, in recent years more nonprofits are using direct business principles in their programs; many more have identified the need to be innovative in their financial planning in order to diversify their unrestricted income sources—particularly those with a reliance on government—and they are all asking for help in doing so.

Other key findings include:

- Nonprofits operate in a fragile financial cycle: financial margins are shrinking and deficits and cash flow problems plague them;
- Private fundraising is more critical than ever as clear bipartisan messages from government indicate a tighter funding future; and
- There are far too many unacceptable facilities, and the lack of capital grants is a barrier to improvement.

Overall, allocation and productivity of resources may well be the primary strategic issue for today's nonprofit board and executive. Many nonprofit corporations are efficient, resilient and adaptive, and many are well-positioned for the future. Nonprofit leaders bring tremendous skill, commitment, passion and creativity to their work.

One of the purposes of the study was to identify areas in which the IFF and the Donors Forum could play a larger role in assisting these leaders, through communication, information, and skill-building.

This *Digest* is the second in a series of issue-specific publications from the IFF which will provide stories, solutions, ideas, facts and figures as one way to assist nonprofits in their financial planning and other capacity building activities.



Overview

The Illinois Facilities Fund and the Community Economic Development Law Project have launched a project to examine the process by which nonprofit corporations obtain property tax exemption. Attention to this issue has increased due to several highly publicized cases in which municipal governments have played a role in denying an exemption so as not to lose much-needed general revenues. Both the IFF and CEDLP have experienced an increase in calls from nonprofits requesting information and assistance in this important area of operations.

In an informal survey of 40 nonprofit property owners conducted by the IFF and the CEDLP, 40 percent of respondents acknowledged encountering problems with the application process and obtaining an exemption to which they believe they are entitled. Among the common frustrations were unclear instructions, lack of definition of “charitable,” and no clear or single step-by-step chronology of the process.

Contrary to popular belief, neither nonprofit incorporation nor federal 501c (3) tax status makes an Illinois nonprofit corporation automatically eligible for property tax exemption. Under Illinois law, every property owner is responsible for paying taxes until it proves that it is entitled to an exemption. While Illinois law provides for the exemption from real estate taxes for properties owned by nonprofits and used for charitable purposes, obtaining this exemption is the sole responsibility of the owner. It has been the experience of the IFF and the CEDLP that many nonprofits purchase property without having a clear understanding of the law and the process for obtaining tax-exempt status for that property. Nonprofits that do not successfully argue that their mission is strictly charitable, religious or educational in purpose may be denied the exemption.

We’ve prepared this digest to help nonprofits better understand the application process and the interpretation of state law, in the hope of increasing the success rate of obtaining property tax exemption. This digest describes the steps of the process, but it does not take the place of legal counsel. In fact, because of the difficulties many nonprofits experience when seeking property tax exemption, nonprofits should obtain legal advice or representation for the application process.



Qualifying for Property Tax Exemption

Illinois law grants several types of property tax exemptions, including charter exemptions (Northwestern University is a prominent example), ownership exemptions (used by bodies of government), and ownership and use exemptions. This digest focuses on the ownership and use exemption, under which social service, health care, arts, economic development and educational nonprofit organizations file. The policy underlying this exemption from property tax is a recognition of the role nonprofits play in easing the burden of state and local government.

To be eligible for property tax exemption under the ownership and use exemption, a property must be owned by a nonprofit organization and its primary use must be for “charitable” purposes. Some charitable purposes are specifically identified in the state law, but no general definition of “charitable” is provided. Instead, the courts developed a six-point test to determine whether a property is exempt from taxation based on charitable use.

Aspire of Illinois, Palos Township

Facilities for persons with developmental disabilities are one of the few types of operations specifically named by law as having a charitable purpose, and the advantage of this clear statutory definition is evident in the experience of Aspire. Aspire, a 40-year-old organization that provides housing and services for persons with developmental disabilities, has encountered no difficulties over the years receiving tax exempt status for the more than 20 properties it owns and operates. From family homes that have been converted to group living spaces, to an 82-bed nursing facility, to a 40,000-square-foot work training site, to the agency’s resale shop - all Aspire’s properties have been granted full exemption.

Nonprofits owning property qualify for property tax exemption by demonstrating that they have a charitable purpose. Those organizations with a purpose not specifically named as charitable in the statute are reviewed using the six-point test:

- *The benefits derived are for an indefinite number of people.*
This means everyone is welcome or served, not just members or a preferred group. Fraternal and service organizations such as the Elks or the Lions Club fail to meet this criteria and therefore pay real estate taxes.
- *The applicant is a corporation that has no capital, capital stock or shareholders, and does not profit from the enterprise.*
In other words, it is a nonprofit 501(c)2, 501(c)3 or 501(c)4 corporation.
- *The funds are derived mainly from public and private charity, and the funds are held in trust for the objects and purposes expressed in the charter.*
For example, an organization such as a retirement home might not qualify, because the funding typically comes from the people the organization is benefiting. Some funds, however, can be generated by fees.
- *The charity is dispensed to all who need and apply for it.*
Organizations that discriminate in any way do not qualify.
- *No obstacles are placed in the way of people seeking the benefits.*
Fees, and how they are applied, are often used to measure the existence of obstacles. Applicants have to show that fees don’t prohibit access to their services or programs. For example, a fee-waiver policy outlined in the by-laws would help prove that the applicant does not impose barriers to its services.

Filing for Property Tax Exemption

- *The exclusive (primary) use of the property is for charitable purposes.*

Again, fraternal and membership organizations often fail on this point. While they may use the property for charitable purposes some of the time, this is usually not the primary use of the property.

The application for property tax exemption does not include a checklist of these six points; they are a guide developed by the courts and used by the application reviewers. By understanding these six points, applicants should be able to prepare a better application.

In addition, other information that can demonstrate that the nonprofit is performing a service that takes a burden off the State of Illinois is relevant because this is the public policy interest underlying all tax exemptions. Organizations that can demonstrate that they meet the above criteria should consider filing for property tax exemption. If a portion of a nonprofit's use of the property meets these criteria, the organization may be entitled to a partial exemption. The process to obtain a partial exemption is the same as that to obtain a full exemption.

Filing for property tax exemption can only be done by the owner of the property, so filing cannot occur until the nonprofit is the taxpayer of record. When a corporation buys property, it immediately becomes liable for property taxes. Therefore, it is a good idea to begin preparing for the application process early in the building acquisition process. It is essential to make financial planning decisions that will allow nonprofit property owners to meet the tax obligation during the period between purchase and obtaining an exemption. It is also important to retain tax bills and the cancelled checks indicating payment; they may be useful in the future.

Our survey of organizations seeking exemptions found that, from the time the application is submitted, the process of applying for real estate tax exemption takes an average of nine months. Therefore, applicants should budget for the payment of property taxes during the application process. If an application is being considered when property taxes become due, the taxes must be paid. Later, if the organization is granted a full exemption, it may apply for a refund of those property taxes. Likewise, if it is granted a partial exemption, it may apply for a partial refund. And if the applicant is denied exemption, its taxes will be paid and it won't be subject to any late payment penalties.

Applications by nonprofits seeking property tax exemption are reviewed initially by the local county and then by the Illinois Department of Revenue (the Department). The first step in filing for tax exemption is to complete an application from the county board of review. The Cook County Board of Review has four filing periods per year and applications are accepted only during those periods. Other counties have similar filing restrictions. Check with the local county board of review to find out when the filing periods are open.

The Application Process

Be comprehensive in preparing the application. The application process is a labor intensive endeavor and documentation and paperwork are extremely important. For example, any missing documents or incomplete information can delay the process, and possibly lead to a hearing or a denial of the application.

Cook County requires that two forms and 12 pieces of supporting documentation be completed and submitted with each application. A summary of those required items follows. Check with your local county board of review for specific instructions in other counties.

- ***Application form “Board of Review of Cook County [insert tax year] Real Estate Exemption Complaint”***

This is a one-page form provided by the county. The tax year for which the application is made must be entered on the title (top) line of the form. You must apply for an exemption for the current calendar year; this is not a prospective exemption. It is also imperative to fill in the statute under which the organization is seeking the exemption. Most applicants will be filing under statute 35 ILCS 200/15-65, but check with a lawyer or other expert to verify the correct statute for the property. Do not leave this or any other line blank.

- ***Illinois Department of Revenue Application for Property Tax Exemption (form PTAX-300 for charitable or educational organizations, or form PTAX-300-R for religious organizations).***

When completing this form, also available from the county, follow the specific instructions that are attached. As noted in line 15 of this form, applications involving property with an assessed value (not market value) of \$100,000 or more require that the applicant send a copy of the application to all other taxing units—including the municipality, school district and community college district—within which the property is located. This is the step that brings local units of government into the decision-making process.

The application begins with a brief, to-the-point statement detailing what charitable activity took place on the property during the tax year for which the exemption is sought. It should be written by someone who has first-hand knowledge of the activity. Be specific—for example, in addition to outlining the type of services or programs offered, and a description of the Illinois residents benefitting from the services, include information such as date, time and location of activities that take place in the building. The affidavit of use is the right place to highlight how the organization is taking a burden off the State of Illinois by providing its services. The signature on the affidavit of use must be notarized.

- ***Parsonage/Convent form***

This form is for religious organizations only.

- ***Title/Deed***

The title must be in the name of the organization, not an individual. The deed must be recorded with the county. You must submit a copy of the deed.

- ***Corporate Charter***

A copy of this document, on record with the secretary of state’s office, must be included with the application.

- ***By-Laws***

A copy of the organization’s by-laws must be submitted. The by-laws can help make the case for charitable purpose by outlining organizational policies that fulfill the six-point test.

- ***Tax Bills***

County tax bills from the tax year for which the application is being made must be submitted. Please note, this will determine the filing period during which you’ll be able to submit your application, because you can’t file until you have a tax bill.

- **Photographs**
Representative photos of the interior and exterior of the building must be submitted. Photos should be taken of each room. In the case of a building with many identical rooms that serve the same purpose, a photograph of, for example, a “typical one-bedroom unit” or a “typical classroom” should suffice. The photos should be attached to 8.5-by-11-inch sheets of paper, labeled and numbered to correspond to rooms on the floor plan (see “Floor Plan” below). Two original sets of photos are necessary—do not submit photocopies of photographs. Printed digital photos are allowed.
- **Plat of Survey**
Purchasers of property usually have a plat of survey made up as part of the purchase process. If not, a surveyor can be hired to create a plat of survey.
- **Floor Plan**
This can be computer-generated blueprints or a hand-drawn floor plan. Either way, be sure to clearly label all rooms on the floor plan.
- **Internal Revenue Service 501(c) 2 or 501(c) 3 Letter and Illinois Sales Tax Exempt Letter**
These documents are used to verify the organization’s nonprofit status.
- **Financial Statement**
Submit copies of the organization’s financial statement, or if the organization does not have such a statement, complete the form “Charitable Organization Financial Summary” supplied by the Cook County Board of Review.
- **Bulletins**
Submit copies of the organization’s brochures, newsletters, activities schedules and/or pamphlets. It is helpful if the address of the property is included in these materials. Remember that these items are building the case to prove your charitable purpose.

For example, by submitting brochures that state that the fees charged by the organization are based on ability to pay, the organization can help prove that it has a fee-waiver policy and makes the policy known to the public.

Applicants must submit two complete sets of these documents to the county board of review—the original set (with original signatures) and a copied set. Additional copies should be delivered to other taxing bodies, if appropriate. It is a good idea for the applicant organization to keep one full set of copies for its records as well. Eventually, the county will forward one full set of documents to the Department in Springfield, and the other will be kept on file locally.

Reviewers in the Cook County office say that packaging the application forms and supporting documents in fancy binders with indexes is neither necessary nor helpful, and they ask that applicants do not staple or three-hole punch the documents. They simply request that each set of paperwork, arranged in the exact order listed, be secured with a paper clip or binder clip.



The Review Process

1. Local Review

Once submitted to the Cook County Board of Review, which consists of a panel of three of the 12 county commissioners, the application and supporting documentation will be reviewed by the board's staff and then by the commissioners. The board of review will also assign a field inspector to visit the property and submit a written report.

The county commissioners serve as the local eyes and ears for the Department in the property tax exemption application process. They will evaluate the application and supporting documentation, and may request additional information. In Cook County the board may also conduct a hearing to gather more information. These hearings are informal, usually focus on a few simple questions and generally last less than 30 minutes. Again, check with your local county officials for procedural information.

After all the information is reviewed, the three commissioners will vote on whether or not to recommend tax exempt status to the Department. The application, with the recommendation of the board of review, will then be forwarded to Springfield for final determination. Do not expect to hear from the county at this point in the process. The county does not notify applicants of its recommendations.

2. Review and Ruling by the Illinois Department of Revenue

When received from any county by the Department, the application is assigned a docket number and the second phase of processing begins. As it considers the application, the Department may request additional information. This request will come in the form of a letter with check boxes for the specific information needed.

When the Department makes its final ruling, the applicant will be notified in writing. The Department's ruling will state that an exemption has been granted, denied, granted for a partial year or granted for partial exemption.

Appealing the Decision

If the application is denied, this determination of the Department is final unless the applicant files a formal appeal within 20 days of the ruling, requesting a hearing before an administrative law judge. Appeals can take an even longer time than the first ruling. The judges work on circuits, so it can take 12 to 18 months just to schedule a hearing.

At the hearing, which is more formal than that at the county level, the applicant may present information to support the claim of charitable use and have witnesses testify on the organization's behalf. The opinion is often handed down several months after the hearing. If an applicant is not satisfied with the ruling of the administrative law judge, the final step is to take the case to Circuit Court.

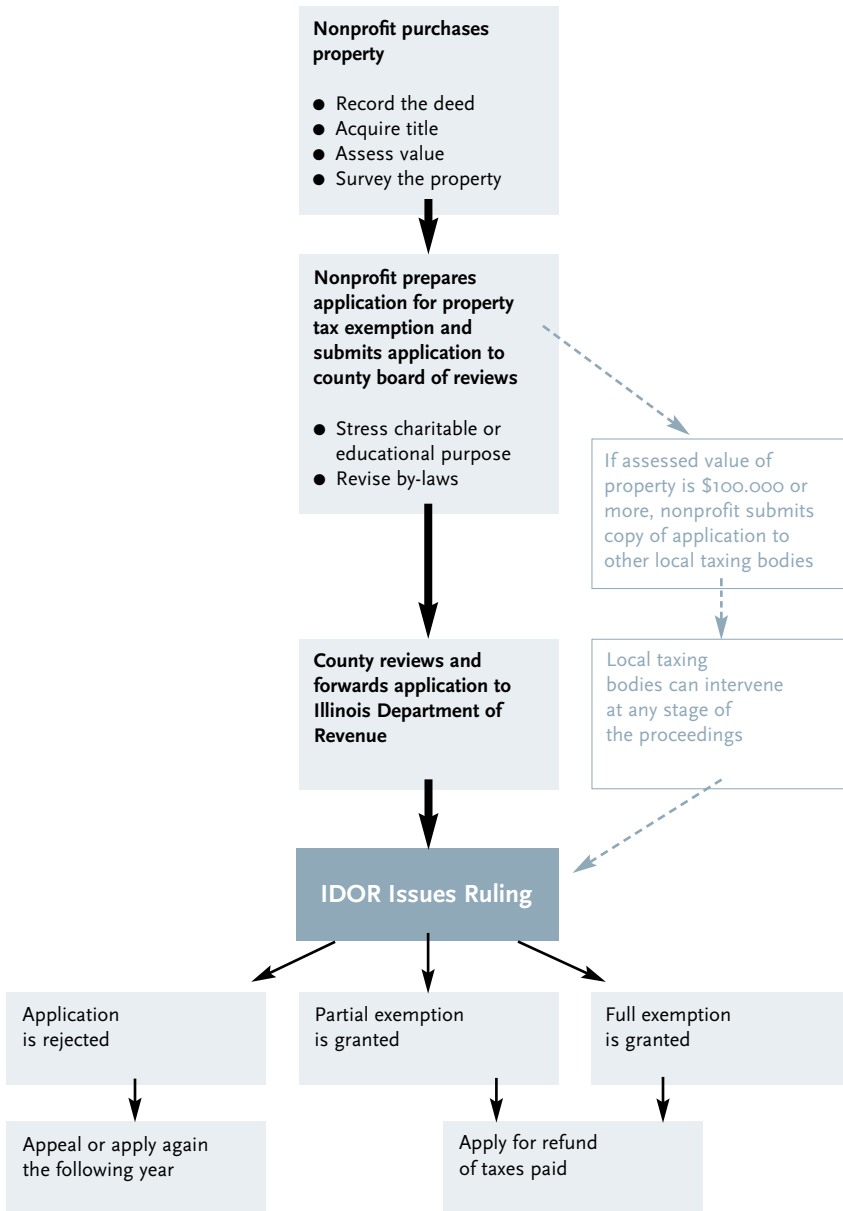
Remember, throughout the appeals process the organization is responsible for paying property taxes.

Family Guidance Centers, Chicago

In 1994, this nonprofit substance abuse treatment organization purchased a large building on Chicago Avenue to house its outpatient treatment programs. The organization assumed that the property would be tax exempt, but the application for exemption was denied and an administrative law judge determined that because Family Guidance Centers charges fees for its services, it is not a charitable organization. Family Guidance Centers, which receives 90 percent of its funding from the state, says that the fees do not present an obstacle to benefits because the organization charges clients on a sliding scale and fees are waived when necessary.

The case is being appealed. Meanwhile, the organization is paying close to \$100,000 per year in property taxes. "Had we understood the requirements, we would have made organizational changes to provide absolute clarity about our mission—and amended our by-laws to reflect those changes—before making the purchase," said Joe Lofy, vice president of Family Guidance Centers.

Steps in Applying for Property Tax Exemption



When an exemption is granted

After an organization is granted a full or partial property tax exemption, it will receive an annual affidavit letter to verify that the use and ownership of the property has not changed and the exempt status should remain. The notice must be signed and returned to the Department every year. If it is not returned, the property can be added back to the tax roles, and the organization must apply for exemption all over again. This happens even when a nonprofit acquires property from another nonprofit, if the notice is not returned.

After an organization has been granted exemption for the current tax year, it may file a “Certificate of Error” form to apply the exemption to the past three years as well, if the property was owned and used in the same manner during the entire time. To do this, it is necessary to provide proof of property tax payment for those years.

When an exemption is denied

Even when an organization is denied exemption, it may re-apply every year. However, it is wise to determine why a previous application was denied, and address those points before trying again. The county board of review staff can be helpful in advising applicants on why applications were denied.

A recent example

Some arts organizations face special challenges in proving their charitable purpose. For the Randolph Street Gallery (RSG), a nonprofit corporation that served as a public forum for the contemporary arts and arts education, the process of obtaining property tax exemption spanned more than six years. While many nonprofits would find it financially difficult to sustain such a long legal process, the win is worth noting because the court’s decision can provide guidance for other organizations, and arts organizations in particular, trying to prove that they serve a charitable purpose.

Summary

RSG purchased space to use for performances, exhibitions, lectures, artists workshops and other events. In addition, RSG hosted an internship program for art students; and created Team Arts Pursuits, a community arts education program for at-risk youths and adults. RSG charged fees for some programs, while others were free.

After twice being denied real-estate tax exemption, RSG began an appeals process which eventually went to the Illinois Appellate Court. The Department argued that RSG was not a charity because it charged substantial fees for the services it offered, and did not waive those fees for those who were unable to pay. Although RSG did have a fee-waiver policy in place, the Department said the policy was ineffective because RSG did not make it known to the public.

The courts disagreed, noting that RSG had a consistent pay-as-you-can fee-waiver policy and RSG's failure to advertise its policy did not equal an obstacle placed in the way of those seeking benefits. The Appellate Court ruled "Practically and symbolically integrating contemporary art and art education into the spectrum of community activities in a diverse and rebuilding neighborhood is charity." This decision could be beneficial to arts organizations seeking exemption in the future. Unfortunately, RSG closed its doors before the final ruling—for a variety of reasons.

The process of applying for property tax exemption can be complicated and time-consuming, and has clear financial implications. Understanding the criteria used to identify a charitable activity when you are developing your nonprofit's mission, description, and program can help set the stage for exemption from property taxes. It is up to you to make your case for exemption. Some things to keep in mind when embarking on the process are:

- A recommendation for exemption by the county is not a guarantee of exemption.
- Loss of property tax revenues can be unpopular locally and can be a factor that may outweigh any recognition of the role a nonprofit plays in the community.
- Eligibility and qualifications should be established before applying—perhaps even before acquiring property.
- Annual filing is required to retain a property tax exemption.

Next Steps

The Illinois Facilities Fund and the Community Economic Development Law Project continue to collect data on the success of nonprofits applying for property tax exemption in Illinois. Additional research is being conducted on the effectiveness of the process and the reasons for denials. The goal is to ensure that public policy decisions are made to allow the nonprofit sector to use this exemption as intended by state law.

Please contact IFF at eevans@iffund.org with any information about successes or problems your nonprofit corporation has experienced with the process, or if you wish to become involved in this project.

Resources

While this digest outlines the process of obtaining property tax exemption, it does not cover every set of circumstances a nonprofit may encounter. For additional information, contact:

Cook County Board of Reviews

County Building, Room 601
118 North Clark Street
Chicago, Illinois 60602
Phone: 312.603.5542

Illinois Department of Revenue

101 West Jefferson Street
Springfield, Illinois 62702
Phone: 217.785.2252.

For resources for legal advice, contact:

Community Economic Development Law Project

188 West Randolph, Suite 2130
Chicago, Illinois 60613
Phone: 312.427.6172

Chicago Volunteer Legal Service Foundation

100 North LaSalle Street, Suite 900
Chicago, Illinois 60602
Phone: 312.332.1624
Email: cvls@mcs.net

Northwestern University School of Law Small Business Opportunity Clinic

(for nonprofits that promote economic development and job creation only)

357 East Chicago Avenue
Chicago, Illinois 60611-3069
Phone: 312.503.0321
Email: small-business@nwu.edu
www.law.nwu.edu/small-business

Significant cases for reference:

Methodist Old Peoples Home v. Korzen
39 Ill.2d 149, 233 N.E.2d 537 (1968)

Randolph Street Gallery v. Zehnder,
et al., No. 1-00-0237
(Ill. App. Ct. 1st Dist. Aug. 9, 2000)

Defining Financial Health

The IFF and the Donors Forum of Chicago define financial health as a nonprofit's ability to maintain programs without interruption, to meet all financial commitments, and to end each year with positive net assets. In addition, a financially healthy nonprofit has a board of directors that assumes responsibility for the financial stability of the organization and has management that integrates financial and program planning.

Successful nonprofits operate with proactive strategies to define appropriate and balanced relationships with clients and constituents, with the government, with funders, and with the community, using dedication to mission as the driving force.

For a copy of *Illinois Nonprofits: Building Capacity for the Next Century*, or add a colleague to the mailing list for the *Capacity-Building Digests*, e-mail iffmail@iffund.org or call 312.629.0060.

Funding Acknowledgement

**Thanks to Sara Lee Foundation,
St. Paul Companies and
Fannie Mae Foundation for their
financial support of the
Capacity-Building Digest project.**



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