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## THE EXEMPTION OF CHARITABLE INSTITUTIONS FROM REAL PROPERTY TAXATION IN ILLINOIS

Since state governments are constantly confronted with financial crises, much attention focuses on sources of tax revenue. An area certain to receive close scrutiny is the real property tax exemption for charitable institutions. In 1954, an Ohio study by the Cuyahoga County Auditor (that county includes Cleveland) found that 17% of the entire county's real property was tax exempt, while in Cleveland the figure was 21%. The market value of this exempt property was estimated to be approximately two billion dollars. Charitable institutions represented more than 40% of the dollar value, while the remainder represented other tax exempt institutions.<sup>1</sup> With the proliferation of non-profit organizations seeking real property tax exemption as charities, it would seem most appropriate that the development of what is a charitable use and purpose should be reviewed.

The Illinois Constitution grants the power to exempt from taxation to the legislature.

The property of the state, counties, and other municipal corporations, both real and personal, and such other property as may be used exclusively for agricultural and horticultural societies, for school, religious, cemetery, and other charitable purposes, may be exempted from taxation; but such exemptions shall be only by general law.<sup>2</sup> (Emphasis added.)

The Constitution grants to the legislature permissive power to make specific exemptions. But the wording of the Constitution in effect restricts this permissive authority within classes already established by the document.

The legislature has by general law exempted charities from taxation and in doing so has broadened the meaning of "charity." The legislature has exempted:

All property of institutions of public charity, all property of beneficent and charitable organizations, whether incorporated in this or any other state of the United States, and all property of old people's homes, when such property is actually and exclusively used for such charitable or beneficent purposes, and not leased or otherwise used with a view to profit; and all free public libraries.<sup>3</sup>

It is readily apparent that neither the Constitution nor legislative enactment has provided a definition of "charity." Therefore, we must focus our attention on the judicial handling of the matter. While many states have rejected a common law definition of charity in preference to statutory defi-

<sup>1</sup> Bennett, Robert T., *Real Property Tax Exemption of Non-Profit Organizations*, 16 *Clev.-Mar. L. Rev.* 165 (1967).

<sup>2</sup> Ill. Const. art. IX, § 3 (1870).

<sup>3</sup> Ill. Rev. Stat., ch. 120, § 500.7 (1967).

inition, Illinois has not. The English Statute of Charitable Uses<sup>4</sup> is the foundation for Illinois law and its definition. From that point on the definition has developed through case law. The definition most notably and generally used by the Illinois courts is that given by Justice Gray in *Jackson v. Phillips*.<sup>5</sup>

A charity, in a legal sense, may be more fully defined as a gift, to be applied consistently with existing laws, for the benefit of an indefinite number of persons, either by bringing their hearts under the influence of education or religion, by relieving their bodies from disease, suffering or constraint, by assisting them to establish themselves for life, or by erecting or maintaining public buildings or works, or otherwise lessening the burdens of government. It is immaterial whether the purpose is called charitable in the gift itself, if it is so described as to show that it is charitable in its nature.<sup>6</sup>

In hearing cases in which an organization's ability to qualify for exemption is at issue, the courts have always followed the policy of strictly construing the exemption provisions in favor of taxation and against exemption.<sup>7</sup> In handling the exemption cases the courts have predominantly followed a two point test. The property in question must be owned by a charitable organization and must be used for a charitable purpose.<sup>8</sup>

The courts have been consistent on what they considered to be a charitable organization.

We have heretofore followed earlier decisions which said that the distinctive characteristics of a charitable organization are that it has no capital, capital stock, or shareholders, earns no profits, and pays no dividends, but derives its funds mainly from public and private charity and holds them in trust for the objects and purposes expressed in its charter.<sup>9</sup>

Most frequently, question has arisen regarding an organization making a profit. For example, where a religious organization ran a bookstore and derived a profit from it, the charitable status of the store was brought into question.<sup>10</sup> The court examined the purpose of running the bookstore. If the purpose was to effect religious education by distributing religious materials, and profits derived from these sales were used for the continuation or enlargement of that purpose, the exemption would be granted.<sup>11</sup> But

<sup>4</sup> 43 Eliz., C. 4 (1601).

<sup>5</sup> 14 Allen 556, 96 Mass. 556 (1867).

<sup>6</sup> *Crerar v. Williams*, 145 Ill. 625, 643, 4 N.E. 467, 470 (1893); *Skinner v. Northern Trust Co.*, 288 Ill. 229, 232, 123 N.E. 289, 290 (1919).

<sup>7</sup> *Follett's Illinois Book & Supply Store, Inc. v. Isaacs*, 27 Ill. 2d 600, 190 N.E.2d 324 (1963).

<sup>8</sup> *Rogers Park Post No. 108, American Legion v. Brenza*, 8 Ill. 2d 286, 134 N.E.2d 292 (1956); *Milward v. Paschen*, 16 Ill. 2d 302, 157 N.E.2d 1 (1959).

<sup>9</sup> *American College of Surgeons v. Korzen*, 36 Ill. 2d 340, 348, 224 N.E.2d 7, 11 (1967).

<sup>10</sup> *The Congregational Sunday School & Publishing Society v. Board of Review*, 290 Ill. 108, 125 N.E. 7 (1919).

<sup>11</sup> *Id.* at 113, 125 N.E. at 10.

if the purpose of running the bookstore is not to effect religious education, but simply to make a profit which might be used in another part of the organization for charitable purposes, the court would not grant the exemption.<sup>12</sup> The fine line rests in the determination of the purpose. Where profits are the motivation, the exemption is not granted. But where charity is the purpose and profits are incidental to it and used for fostering the primary purpose the exemption is granted.<sup>13</sup>

Another factor in determining if ownership of the land is by a charitable organization is the manner in which the organization receives its funds. While the courts favor gifts as a source of funds, they have been tolerant of organizations receiving their funds from membership dues.<sup>14</sup> Some charitable organizations raise the necessary funds for their charitable purposes by charging those able to pay for the services being rendered. By so doing the organization is able to provide services to those unable to pay.<sup>15</sup> In *The People v. Y.M.C.A.*,<sup>16</sup> the exemption of a YMCA hotel was challenged because it was making a profit from its paying customers. The court felt the profits were inconsequential and were not the goal of the organization, but rather a means of gaining funds from those who were able to pay in order that they could provide charity to those that were unable to pay. Likewise, in *Parks v. Northwestern Univ.*,<sup>17</sup> the exempt status of the university was challenged because part of its funds were derived from tuition. The court saw this as an entirely proper means of gaining funds in order to carry out a charitable purpose. With the exception of the areas of profits and source of funds, the courts have had little difficulty in determining if an organization was charitable. The court is quick to deny charitable status to an organization which has capital, capital stock, or shareholders.<sup>18</sup> Justice Cardozo's famous statement effectively touches this area.

What controls is not the receipt of income, but its purpose. Income added to the endowment helps to make it possible for the work to go on. It is only when income may be applied to the profit of the founders that business has a beginning and charity an end. The line of division is the same whether the gift is to education or to relief of the poor, the halt, and the blind. Charity ministers to the mind as well as to the body.<sup>19</sup>

The fact that the institution holding the property is judged to be charitable is insufficient to exempt it from real property taxation. The

<sup>12</sup> *Id.* at 117, 125 N.E. at 11.

<sup>13</sup> *The People v. Y.M.C.A.*, 365 Ill. 118, 6 N.E.2d 166 (1937).

<sup>14</sup> *Supra* note 9.

<sup>15</sup> *The Sisters of St. Francis v. The Board of Review*, 231 Ill. 317, 83 N.E. 272 (1907); *People ex rel. Cannon v. Southern Ill. Hospital*, 404 Ill. 66, 88 N.E.2d 20 (1949).

<sup>16</sup> *Supra* note 13.

<sup>17</sup> 218 Ill. 381, 75 N.E. 991 (1905).

<sup>18</sup> *American College of Surgeons v. Korzen*, 36 Ill. 2d 340, 224 N.E.2d 7 (1967).

<sup>19</sup> *Butterworth v. Keeler*, 219 N.Y. 446, 447, 114 N.E. 803, 804 (1916).

property must actually be used in carrying out the institution's charitable purposes.<sup>20</sup> Even though the land is owned by the charitable institution if it is not used for charitable purposes or is sitting idle it will not be exempt. The use of the land must be active and for charitable purpose.

Thus, in *The People v. Catholic Bishop*,<sup>21</sup> the Bishop appealed a judgment given the Lake County collector for delinquent taxes on 465 acres owned by the Bishop. The Bishop on appeal was able to show that 385 acres of the total was actually used for charitable purposes. But as to the other 80 acres he only could show an intent to use it for a charitable purpose (he planned to construct a golf course for seminarians). The court granted exemption for all but the 80 acres because they were actively used for a charitable purpose. Since the 80 acres was not in active use for a charitable purpose it was taxed.

The main issue surrounding the charitable use of property rests on the question of whether the use is primary or secondary. In *The School of Domestic Arts and Science v. Carr*,<sup>22</sup> the court was faced with this problem when a school which taught domestic arts, and qualified as a charitable institution, sought an exemption from taxation for its property, part of which was used as a restaurant. The meals which the students made in the course of their studies were sold in the restaurant and a profit was derived. The court granted the exemption, finding the purpose of running the restaurant charitable, with the profits being incidental to it. In regards to the primary versus secondary conflict, the court stated:

If the property is devoted primarily to the religious or charitable purposes which exempt from taxation an incidental use for another purpose will not destroy the exemption, but an incidental use for religious or charitable purposes of property whose primary use is for another purpose will not warrant exemption.<sup>23</sup>

Thus, we have seen that for property to be exempt from real estate taxation it is necessary that it be owned by a charitable institution and that the active use of the property be for a charitable purpose. Until very recently both of these requirements were not very stringently tested in determining qualification. The relationship between the charter of the organization, which stated its purpose, and the facts of the property's use were not required to be fully compatible. The ability to show some charitable purpose and some charitable use was all that was required. The Illinois Supreme Court in a recent case has shown strong signs of applying a more stringent standard to the present test.

<sup>20</sup> *Follett's Illinois Book & Supply Store, Inc. v. Isaacs*, 27 Ill. 2d 600, 190 N.E.2d 324 (1963).

<sup>21</sup> 311 Ill. 11, 142 N.E. 520 (1924).

<sup>22</sup> 322 Ill. 562, 153 N.E. 669 (1926).

<sup>23</sup> *Id.* at 568, 153 N.E. at 671.

In *Methodist Old Peoples Home v. Korzen*,<sup>24</sup> the plaintiff, an Illinois not-for-profit corporation, filed a complaint seeking a declaratory judgment that the Georgian Home, which it owned and operated in Evanston, was exempt from taxation. The Master in Chancery found that the Home did not qualify for exemption, and the trial court followed his recommendation. Being a revenue matter, the case was appealed directly to the Illinois Supreme Court.

The Home was so administered that for one to become a resident he had to file an application with the board. The board screened the applicants to ascertain that they were in good mental, emotional and physical health. Upon acceptance of the applicant, a contract was entered into requiring the applicant to pay a founder's fee varying from \$6,250 to \$25,000 and a monthly charge from \$175 to \$375, the exact sum depending upon the size and location of the individual's apartment within the home. The parties then underwent a sixty day trial period, during which either party could rescind the contract.

The court took particular note of the organization's charter, which stated its purpose of providing "proper accommodation and care for the sick and homeless aged."<sup>25</sup> Judging from the chartered purpose of the organization it is apparent that it met the first part of the test, which is that of ownership by a charitable organization.

The court then undertook a detailed examination of the facts of the property's use and determined that the facts did not evidence a charitable use. But rather than state that the test requiring a charitable organization's ownership of the property and a charitable use was not fulfilled the court went further. It made particular reference to the failure of the use to meet the purpose as expressed in its charter. The relationship of the use, which was disclosed by the facts of operation, was correlated to the purpose, as evidenced by the charter. The court summed up its analysis of the property's use with this statement:

It is undisputed that plaintiff's corporation structure and its abstinence from profit making in a private sense are akin to that of a charitable institution. However, *the variance between its stated chartered purpose* of providing "proper accommodations and care for the sick and homeless aged;" and the health requirements contained in its bylaws that "applicants shall be in good mental, emotional and physical health, and free of any communicable disease," *militates strongly against the requirement that it hold property in trust for the objects and purposes expressed in its charter.*<sup>26</sup> (Emphasis added.)

The fact that the court devoted a minor portion of its opinion to the

<sup>24</sup> 39 Ill. 2d 149, 233 N.E.2d 537.

<sup>25</sup> *Id.* at 152, 233 N.E.2d at 539.

<sup>26</sup> *Id.* at 157-8, 233 N.E.2d at 542.

traditional two part test and devoted the greater portion of its opinion to testing the facts of use against the chartered purpose seemingly points to a more stringent test. The new test, if indeed *Methodist Old Peoples Home v. Korzen* expresses one, will be the requirement of the property's ownership by a charitable institution and a charitable use factually compatible to the institution's charter. This test will be much more stringent than the old. It indicates the court's recognition of the revenue drain which is taking place through pseudo-charitable exemption from the real property tax, the drain which is widening the gap between the state government's revenue and expenses and is heightening the state's financial crisis.

W. D. ROMOSER