

SALES AND USE TAX EXEMPTIONS FOR NONPROFITS

By Ron Barrett, COGENCY GLOBAL INC.

“In this world nothing can be said to be certain, except death and taxes.” When Benjamin Franklin wrote this sardonic proverb to Jean-Baptiste Leroy in 1789, tax exemptions were likely few, and he certainly wasn’t talking about tax-exempt charities. Nowadays, the only things more pervasive than taxes are exceptions, deductions and exemptions from taxes. As for charities, not only are these entities potentially immortal in terms of their perpetual corporate existence, but they also have the keen ability to avoid most taxes.

Of course, immortality for nonprofit corporations is only assured if they make prudent business decisions, maintain public support and comply with state and federal laws and regulations. Many tax exempt entities died (or at least took a step toward death) in June 2011 when the IRS revoked the tax-exempt status of more than 275,000 nonprofit organizations for failing to file IRS Form 990 annual returns in the preceding three years. Similarly, nonprofits that fail to file required annual or periodic reports with the state corporate and charity authorities may find that they are susceptible to death in the form of revocation or involuntary dissolution.

THE ELUSIVE SALES TAX EXEMPTION

It is well known that most nonprofits are exempt from federal and state income tax. They are also frequently exempt from real property tax, but one tax exemption that even nonprofits sometimes find elusive is sales tax.* With sales tax rates approaching 10% in some jurisdictions that combine state and local sales taxes, it is an important exemption not to overlook. Some nonprofits, however, fail to take advantage of these exemptions because of the complexity of determining in which states an exemption exists and because of the lack of uniformity from state to state.

Though several states provide a variety of sales tax exemptions to various industries and organizations, most only make an exception for certain groups or types of nonprofits. For example, Georgia’s list of eligible sales tax exemptions is fifteen pages long, but there is no broad exemption for nonprofit organizations. In fact the opposite is true, with several narrow exemptions available to certain types or specific nonprofit organizations, such as nonprofit blood banks.

501(C)(3) TAX EXEMPTION IS KEY

In the majority of states the key to a sales tax exemption is the designation as a charitable, 501(c)(3) nonprofit organization. Fortunately for the nonprofit sector, there are nearly a million such organizations in the United States. These are organizations recognized under the Internal Revenue Code as tax-exempt, charitable organizations. For other types of tax-exempt nonprofits, a state sales tax exemption is much less certain and requires a careful reading of each state’s tax code and regulations.

● **CORPORATE HQ**
COGENCY GLOBAL INC.
10 E 40TH ST, 10TH FL
NY, NY 10016
D: +1.212.947.7200
P: 800.221.0102
F: 800.944.6607

● **EUROPEAN HQ**
COGENCY GLOBAL (UK) LIMITED
REGISTERED IN ENGLAND & WALES,
REGISTRY #8010712
6 LLOYDS AVE, UNIT 4CL
LONDON EC3N 3AX
+44 (0)20.3961.3080

● **ASIA PACIFIC HQ**
COGENCY GLOBAL (HK) LIMITED
A HONG KONG LIMITED COMPANY
UNIT B, 1/F, LIPPO LEIGHTON TOWER
103 LEIGHTON RD, CAUSEWAY BAY
HONG KONG
P: +852.2682.9633
F: +852.2682.9790



Even with a 501(c)(3) designation, charitable nonprofits in some states are still not exempt from sales taxes and, even if they are, procedural requirements must be strictly followed to actually receive the exemption. For example, in Washington, D.C., a charitable nonprofit organization must be physically located in D.C. and file an application to qualify for a sales-tax exemption. Once an exemption application is approved and a Certificate of Exemption is issued, exemptions from sales tax are granted only if the purchases, purchaser and the method of payment are in accordance with the requirements to receive an exemption from sales tax. In other words, the purchases must relate to a charitable purpose, by a person associated with the tax-exempt organization and the payment must be made by that organization. If all of these requirements are not met, then sales tax may be imposed, even when an organization has a legitimate sales-tax exemption and a certificate to prove it. This is true in D.C. and nearly all states that offer an exemption from sales tax to nonprofit organizations.

In Pennsylvania, it is not sufficient just to be a charitable nonprofit in order to receive a sales tax exemption. Under Act 55 of 1997, an organization must complete a cumbersome, six-page application and quantifiably demonstrate that it meets all five of the following criteria in order to qualify for the state sales tax exemption:

1. Advance a charitable purpose;
2. Operate entirely free from private profit motive;
3. Donate or render gratuitously a substantial portion of its services;
4. Benefit a substantial and indefinite class of persons who are legitimate subjects of charity; and
5. Relieve the government of some of its burdens

Sales tax exemption applications are frequently denied in Pennsylvania for failing to prove that an organization meets all of the above requirements. Fortunately, most states do not have such cumbersome requirements and the forms are somewhat consistent in terms of required information and supporting documents that must accompany a sales-tax exemption application.

GENERAL REQUIREMENTS IN MOST STATES

Most states that broadly offer sales tax exemptions to charitable nonprofits require the completion of a short application form along with some or all of the following items in support thereof:

1. IRS Determination Letter and/or IRS Form 1023 or 1024
2. Articles of Incorporation and/or Bylaws
3. Financial Statements and/or Form 990

A fee is rarely required and, in most states, this is a one-and-done type of filing. Some states such as Maryland, Missouri and Florida require annual, triennial, or quinquennial (every 5 years) renewal filings.

VARYING STATE REQUIREMENTS

Not all states require an exemption application or certificate to obtain an exemption from sales tax, but this does not necessarily mean that obtaining the actual exemption is any easier. For example, states such as Kansas and Illinois require a

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 10 E 40TH ST, 10TH FL
 NY, NY 10016
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letter of request, while others simply require that purchasers provide to each vendor a form that claims they are exempt from state sales tax (e.g. Connecticut and Michigan). In North Carolina, charities must pay sales taxes, but nonprofit entities defined in G.S. 105-164.14(b) can file semiannually for a refund of sales taxes paid. In Wyoming, all that is required is for nonprofits to provide the state with a copy of the organization's IRS determination letter in order to receive an exemption approval letter. Also, in a handful of states, there is no sales tax (Alaska, Delaware, Montana, New Hampshire and Oregon), so everyone is spared the additional expense in these states.

For most nonprofits, a sales tax exemption usually makes sense only in the state they are domiciled or in nearby states where they conduct a lot of business. For larger nonprofits that conduct business in multiple states and regularly make exempt purchases from the same vendor(s), it sometimes makes sense to obtain sales-tax exemptions in multiple states. For these organizations, it might also be helpful to use the Streamlined Sales and Use Tax Agreement Certificate of Exemption (SSUTA-COE) when making tax exempt purchases.

MULTISTATE CERTIFICATE OF EXEMPTION

The SSUTA-COE was created by the Streamlined Sales Tax Governing Board pursuant to the Streamlined Sales and Use Tax Agreement. This board and agreement were created by multiple state members with the goal of streamlining the administration of sales tax collection and reporting, including procedures for claiming an exemption from sales tax in multiple states. The SSUTA-COE is accepted by vendors in 24 states and in some nonmember states. Not all states, however, allow all exemptions listed on the form and, therefore, purchasers are still responsible for knowing if they qualify to claim an exemption from taxes in the states that would be due taxes on otherwise taxable sales. Also, nonprofits that use this form will be held liable for any tax and interest, and possibly civil and criminal penalties imposed by the member state(s), if the nonprofit is not eligible to claim a tax exemption. So, while this form can be a time saver, it does not relieve a nonprofit organization from first obtaining a sales tax exemption in the state(s) or performing the proper due diligence of knowing whether or not the organization qualifies for a sales-tax exemption in the states that accept this form.

NONPROFITS NEED NOT FEAR DEATH AND TAXES

Varying sales tax exemptions from state to state, specific nonprofit, entity-based exemptions, specific charitable use, purchaser and payment requirements and multistate exemption certificates all add to the confusion of determining where, when and how a nonprofit organization qualifies for a sales tax exemption. Yet nonprofits need not fear death or sales taxes. Assistance in making these determinations can be obtained by consulting an attorney, tax advisor or knowledgeable service company.

*For the purposes of this article, the term "sales tax" includes use taxes.

This article is provided for informational purposes only and should not be considered, or relied upon, as legal advice.

Ron Barrett is the Vice President of Nonprofit Services at COGENCY GLOBAL, a leading provider of nationwide registered agent, corporate and secured transactions services. He is the co-author of "Nonprofit Fundraising Registration: The 50-State Guide" (2nd ed., Nolo, 2012). Feel free to contact Ron with any questions you have about state nonprofit compliance. He can be reached by phone at 800.494.5225 extension 4755 or by e-mail: RBARRETT@COGENCYGLOBAL.COM.

● **CORPORATE HQ**
COGENCY GLOBAL INC.
10 E 40TH ST, 10TH FL
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