

State and Local Tax Considerations for Nonprofits Overview

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Agenda

At the end of this session, you will be able to:

- Understand some of the complexities related to State and Local Tax Nexus and how this applies to nonprofits
- Understand general income tax concepts for nonprofits
- Understand general sales and use tax considerations for nonprofits

If Tax Exempt - Why Worry About State Tax?

The term nonprofit and tax exempt are not one in the same!

Each state has different rules and requirements related to the taxation of nonprofits. Understanding these rules and filing requirements is critical to your organization.

Overview

- Tax-exempt status is determined under IRC Subchapter F, Ch. 1
- Many states' tax-exempt status depends, at least in part upon whether an organization qualifies under Sec. 501(c)3 or 501(c)4
- 501(c)3 organization –
 - Organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes
 - Net income must not inure, in whole or in part, to the benefit of private shareholders or individuals; and
 - Must not attempt to influence legislation by propaganda or otherwise except for certain lobbying activities

Overview

- 501(c)4 –
 - Civic leagues operated exclusively for the promotion of social welfare
 - Employees, associations, the membership of which is limited to the employees of a designated person or persons in a particular municipality

Overview

- There may be a perception that tax-exempt status of IRS purposes renders and organization tax-exempt for all state purposes
- Nonprofit does not necessarily mean tax-exempt for state purposes
- Income Tax – Federal status often controls state status
- Sales and use Tax – many purchases may be exempt, but sales may often be taxable

State and Local Tax Considerations

- Does the organization have nexus -connection that allows a state to impose a tax?
- If the organization does have nexus what exemptions apply for:

Sales Tax

Income Tax

Franchise Tax

Gross Receipts Tax

State and Local Tax Considerations

- What other state compliance requirements should be given consideration?

Registration for solicitation

Unclaimed funds

Other miscellaneous filing requirements

What does this mean for your organization?

- Ensure tax on UBI is being handled properly. **There are opportunities to reduce tax!**
- Continually monitor the ever changing state and local rules related to the taxation of nonprofits

Income Tax Overview

- Most States automatically grant tax-exempt status upon an organization's receipt of tax-exempt status from the IRS
 - Most states also conform to the federal rules regarding the taxation of unrelated business income (UBI)
- Some state require separate notification of IRS tax-exempt status approval
- A handful of states have a separate, but simple application process for state tax exemption

Income Tax - Arizona

- Non-profit organizations are exempt from Arizona income tax.
 - Nonprofit status may be established by a letter of determination issue by the IRS
- An otherwise exempt organization must pay income tax on its unrelated trade or business income (UTBI)
- All exempt organizations with gross receipts over \$50,000 must file an annual information return except;
 - Certain organizations are excluded i.e. religious organizations

Income Tax - Arizona

- Educational organizations
- Organizations for the prevention of cruelty to children or animals
- Organizations that are Non-profit organizations are exempt from Arizona income tax.
- Nonprofit status may be established by a letter of determination issue by the IRS

Sales and Use Tax - Number One Rule For All States

- All sales of tangible personal property and some services are taxable unless a specific exemption exists
 - Does the state recognize the IRS tax exempt status of the non-profit for sales and use taxes?
 - For nonprofits, does this mean purchases are exempt from sales and use tax?
 - Is the nonprofit required to collect tax on the sale of goods?

Providing Charitable Services

- Many states allow nonprofits to be exempt for sales/use tax if the nonprofit engages in charitable activities
- The test is whether products or services are delivered based on the recipient's ability to pay

Special State Requirements

- Some exemptions are limited to 501(c)(3) organizations
- Other states are more broad allowing exemption to other 501 entities
- Some states simply honor the federal exemption without more action by the nonprofit
- Others require a special state application for a sales tax exemption.

An organization cannot assume a 501(c)(3) is automatically exempt from sales and use taxes

Some States Tax Nonprofit Organizations

- Many states tax nonprofit organizations with some specific exemptions:

AL, AR, AZ, CA, GA, IA, ID, LA, ME, NC, ND, NE, OK, SC, SD, TN, and WA

States With More Favorable Exemptions

- These states have more favorable exemptions for non-profit organizations:
 - CO, CT, DC, HI, IL, IN, KS, KY, MA, MD, MI, MO, MS, NJ, NM, NV, NY, OH, PA, RI, TX, UT, VA, VT, WV, WY

Sales By Nonprofits

- States consider sales of tangible personal property as taxable
- Even nonprofits may be required to collect sales tax on sales of tangible personal property
- Exemptions
 - Fundraising
 - De minimis sales
 - Product itself is exempt

Nonprofit Purchases

- Nonprofit purchases are presumed taxable unless a specific exemption exists
- The most common exemption is for the purchase of goods used in the charitable purpose
 - software, office equipment & furniture, supplies, etc.
- Exemption certificates should be issued to suppliers where appropriate
- Don't assume that because no tax was assessed on an invoice that the product is exempt

Sales and Use Tax - exemptions

- AZ and ID have no exemption for religious organizations
- AL, AR, CA, LA, MS have no tax exemptions for to 501(c)(3) organizations
- IL, MN, and NE exemptions only for those deemed to be exclusively religious, educational or charitable
- PA must be “purely public charity”

Transaction Privilege Tax – Arizona

- AZ does not provide an overall exemption from TPT for nonprofit organizations except for:
 - Retail sales made by 501(c)3 organizations
 - Retail sales by certain non-profit organizations associated with a national touring professional golfing association or major league baseball team
 - Retail sales by certain non-profit organizations sponsoring, operating or conducting a rodeo that primarily features farm and ranch animals
 - Retail sales by certain 501(c)6 organizations that produce, organize, or promote, cultural or civic related events

Transaction Privilege Tax – Arizona

- AZ does not provide an overall exemption from TPT for nonprofit organizations except (continued)
 - Sales of food or drink for immediate consumption by any veteran's service organization
 - TPP sold or lease to qualifying healthcare organizations if the property is used solely to provide health and medical related educational and charitable services
 - TPP sold or leased to a qualifying hospital
 - TPP sold or leased to a qualifying community health center
 - TPP sold or leased to a 501(c)3 organization that regularly serves free meals to the needy

Transaction Privilege Tax – Arizona

- AZ does not provide an overall exemption from TPT for nonprofit organizations except (continued)
 - TPP sold or leased to a 501(c)3 organization that regularly uses such property exclusively for training, job placement, or rehabilitation programs or testing for mentally or physically handicapped.

Questions When Doing Business in a State

- Do you have nexus in a given state?
- Are you required to specifically apply for a sales/use tax exemption?
- What are the limitations of the exemption?
 - Purchases used for exempt purpose?
 - Sales of tangible personal property or services?
 - Fund raising exemption?
 - Filing requirements for subsidiary or disregarded entity?
 - Intercompany transactions?

Questions

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