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NON-PROFITTS: SALES TAXES

House Bill 4661 (Substitute H-5)
House Bill 4662 (Substitute H-3)
First Analysis (3-8-94)

Sponsor: Rep. Terry London
Committee: Taxation

THE APPARENT PROBLEM:

Nonprofit organizations of some kinds do not have to pay the sales (or use) tax when making purchases of goods to be used in their operations. Exempt are sales to a school, hospital, home for children or the aged, "or other health, welfare, educational, cultural arts, charitable, or benevolent institution or agency", provided certain conditions are met. According to tax specialists, the Department of Treasury now must independently determine which nonprofit organizations qualify for this exemption. This has sometimes been controversial, as when the department decides an organization (e.g., a Little League) does not fit the description. People do not always agree whether an organization is educational or charitable or cultural. The independent determination is also said to be a costly, time-consuming procedure, both for the department and the nonprofit groups seeking exemption (who must as a result meet paperwork requirements of both state and federal governments). It has been proposed that new eligibility criteria be used that will allow the department to grant the exemption based on an organization's federal tax exemption as a nonprofit organization.

Although nonprofits can be exempt from paying the sales tax when making purchases, they are supposed to collect and remit sales taxes to the state when they sell taxable items. This requirement is unpopular, and, reportedly, widely misunderstood and ignored. Some people believe that small nonprofit organizations should not have to collect sales tax when engaged in fundraising sales.

THE CONTENT OF THE BILLS:

House Bill 4661 would amend the General Sales Tax Act (MCL 205.54a) in the following ways.

** Certain nonprofit entities with annual gross sales of less than \$5,000 would not have to collect sales tax when making sales of tangible personal

property for fund-raising purposes. This would apply to a school, hospital, church, parent cooperative preschool, an organization with an exemption ruling letter from the Department of Treasury, or an organization exempt from federal income tax under Section 501 (c)(3) or Section 501(c)(4) of the Internal Revenue Code. A club, association, auxiliary, or other organization affiliated with one of those nonprofit organizations would not be considered a separate person for the purposes of the exemption. The term "school" would mean each elementary, middle, junior high, or high school site within a local school district that represents a district attendance area as established by the local school board.

** The bill would add a new section to clarify which entities do not have to pay sales tax to retailers when making purchases and how the exemption would be achieved. Exempt would be sales to:

a) a health, welfare, educational, cultural arts, charitable, or benevolent organization not operated for profit that had been issued an exemption ruling letter from the treasury department before the effective date of the bill; and

b) a non-profit organization exempt from federal income tax under Sections 501(c)(3) and 501 (c)(4) of the Internal Revenue Code.

After the effective date of the bill, the treasury department would be required to reissue an exemption letter to organizations that had them prior to that date, and such a letter would remain in effect unless the organization failed to meet the requirements that originally entitled it to the exemption.

The exemptions would not apply to sales that gave rise to unrelated business taxable income and sales

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of vehicles licensed for use on the public highway that were not used primarily to carry out the purposes of the organization as stated in the bylaws or articles of incorporation of the exempt entity.

When purchasing property, an exempt entity would have to either a) present the exemption ruling letter and state that the property was to be used or consumed in connection with the operation of the organization or b) present a signed statement on a department-approved form and state that the property was to be used or consumed in connection with the operation of the organization and that the organization qualified as an exempt organization, along with a copy of the federal exemption letter.

The new provisions would replace a similarly worded exemption currently in the act for a "health, welfare, educational, cultural arts, charitable, or benevolent institution or agency" other than a nonprofit school, hospital, or home for the care and maintenance of children or aged persons that meets certain requirements. The general exemption for those specified institutions (schools, hospitals, etc.) would remain in the act in its current form as would the exemption for sales to a regularly organized church or house of religious worship.

House Bill 4662 would amend the Use Tax Act (MCL 205.94) to make similar amendments regarding tax exemptions for purchases by exempt entities.

FISCAL IMPLICATIONS:

The impact of the bills on state revenues would be "minimal", according to a spokesperson for the Department of Treasury. (3-4-94)

ARGUMENTS:

For:

House Bill 4661 is said to offer a compromise position on the collecting of sales taxes by nonprofit organizations when they sell goods for fundraising purposes. It would exempt organizations with annual gross sales of less than \$5,000 from collecting and remitting taxes. The sales tax collecting requirement would continue (from the first dollar) for organizations with sales totalling more than that. (Tax specialists say this figure was chosen because organizations with annual gross receipts below \$5,000 do not have to file for a federal tax exemption.) This removes a burden

from small nonprofits engaged in fundraising activities without permitting large nonprofit organizations from unfairly competing with commercial retailers.

The bills would also improve and simplify the process by which the state determines which nonprofit organizations are eligible for an exemption when purchasing goods. Generally, those organizations that are exempt under federal tax standards and those additional nonprofit organizations previously given temporary exemptions by the treasury department would be considered exempt. Currently, the Department of Treasury determines case by case who is exempt and uses a narrower definition. This is burdensome both to the state and nonprofit organizations. Under these bills, worked out by representatives of nonprofits and the treasury department, more nonprofits will be able to make tax-exempt purchases. The bills will make administration of this portion of the sales and use tax acts much easier for the department, nonprofits, and for vendors selling to nonprofit organizations.

Response:

The exemption from collecting sales tax on products sold applies to a very limited number of nonprofits. The \$5,000 cap on total sales (if that means both taxable and nontaxable items) is quite restrictive. No doubt some would prefer to see a higher threshold. Further, some people believe that the cap could be interpreted to apply to taxable sales only (which would benefit more nonprofits). If there is ambiguity on this point, it ought to be cleared up.

POSITIONS:

The Department of Treasury supports the bills. (3-2-94)