

JO Knows Sales Tax Exemptions for Nonprofits

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Exempt organizations have been granted exempt status from many taxes. Income taxes, sales taxes, real estate taxes, fuel taxes and other taxes have generally not applied to exempt organizations. Governmental entities have provided these exemptions in order to alleviate charitable organizations from taxes and costs that could otherwise be used for their exempt purposes. These indirect tax subsidies allow tax-exempt organizations to carry out programs that governmental agencies are not capable of running or are not willing to do so for a variety of reasons.

In recent years, many states, cities, and towns have started to curtail or deny these specific exemptions in order to increase revenue. [Payment in lieu of taxes](#) (PILOT) programs are a case in point. Cities and towns have recently demanded payments to compensate them for some or all of the property tax revenue lost due to tax-exempt ownership or tax-exempt use of real property.

For most states, there is an income tax and a sales tax. Whether a tax-exempt organization is subject to these depends on many factors. Most income generated by nonprofits is related to their exempt function and, therefore, is not subject to "unrelated business income tax". In many cases, the sales tax for certain sales is waived for transactions relating to the charity's "charitable mission." In many states, exemption from paying sales tax depends on the nature and volume of sales activities in that state and the IRS classification of the exempt organization.

A Look at the Sales-Tax Liability Landscape

Sales taxes are usually generated from the sales of tangible items and some services. Typically, most states will only exempt 501(c)(3) public charities from sales taxes for the purchase of tangible items or services but not for the sales of these items. States vary greatly in their definition and rules regarding tax applicability to tax-exempt organizations. It is imperative that exempt organizations understand state-specific rules and their implications.

The onus of determining whether sales tax is due lies with the nonprofit. The IRS may award or grant federal tax-exempt status, but a state or city can require additional documentation to secure a state or a city-specific exemption. For example, in Massachusetts, an organization that qualifies as a tax-exempt entity according to the IRS cannot assume that their exemption qualifies them for exemption from sales tax in Massachusetts. The entity must apply to Massachusetts for the sales tax exemption.

Massachusetts only exempts the purchases of an exempt organization from sales taxes and not the exempt organization's sales of products or services. Therefore, an organization can purchase an item and show their "exempt certificate" to the vendor and will not be charged sales tax. Conversely, if the charity sells a product, it will generally need to charge a sales tax on the sale of that item unless it is a sale to another charity. There are also some exemptions for fundraising. See [Massachusetts Directive 91-1: Tax Exempt Organizations Engaging in Fundraising Activities](#).

In Massachusetts, such organizations must demonstrate their status by filing for a [Certificate of Exemption](#) and a [Sales Tax Exempt Purchaser Certificate](#) (yes, those are two different documents). Sales to § 501(c)(3) organizations are exempt when (1) the organization has obtained and presents a valid Certificate of Exemption, Form ST-2, and a properly completed Form ST-5, Sales Tax Exempt Purchaser Certificate; (2) the goods purchased are used for the organization's stated purposes; and (3) the vendor keeps adequate records of the transactions. The types of organizations that are exempt are religious, scientific, charitable or educational organizations exempt from federal taxation under § 501(c)(3) of the Internal Revenue Code, all of which have obtained certification from the commissioner that they are entitled to such exemption.

Massachusetts sales tax exempt certificates are issued every 10 years. Representatives of nonprofit organizations should periodically check with their state of domicile to see if a valid exempt certificate is on file. Requests for a duplicate or amended copy of the Certificate of Exemption, Form ST-2, can be made in writing, on-line or by phone. For more information see [Massachusetts Administrative Procedure AP: 101 Organizations Exempt from Sales Tax](#).

And Then There's Nexus...

Another area of concern is nexus. Nexus for sales tax purposes is almost always created if a business has a physical presence in a state. With the recent increase in remote workers living in different jurisdictions than the exempt organization's normal business location, these employees may be establishing sales tax nexus for the exempt organization, as well as nexus for other types of taxes.

Additionally, sales tax nexus can be created through economic activity since the Supreme Court in the [South Dakota v. Wayfair decision](#) case upheld South Dakota's economic nexus law, overruling the Court's physical-presence precedents. Many states have adopted sales tax nexus when sales exceed a certain threshold of sales revenue or a certain number of transactions in a state, even if the exempt organization has no physical presence. For instance, the [District of Columbia](#) requires a taxpayer to register for sales tax purposes in that jurisdiction if the taxpayer has either gross receipts from all retail sales delivered in the district exceeding the threshold of \$100,000 or 200 or more separate retail sales transactions.

Executive Summary

Sales taxes are complex and ever-changing. Many states, counties, cities, and towns are implementing and revising their laws and are resorting to more aggressive methods to assess taxes to charitable organizations and ensure nonprofits pay what the government believes is their fair share.

Want to figure out where your nonprofit stands on sales tax liability? We're here to help.

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