

DEPARTMENT OF REVENUE

In the matter of the proposed adoption of an Amended Rule of the Minnesota Department of Revenue Governing Sales and Use Tax on Charitable, Religious, and Educational Organizations

**STATEMENT OF NEED
AND REASONABLENESS**

GENERAL STATEMENT

This document has been prepared as a verbatim affirmative presentation of the facts necessary to establish the statutory authority, need for, and reasonableness of the proposed rule. It is submitted pursuant to Minnesota Statutes, section 14.23 (1990) and Minnesota Rules Part 1400.0500 (1989) requiring a Statement of Need and Reasonableness.

A Notice of Intent to Solicit Outside Opinion regarding the Sales and Use Tax on Charitable, Religious, and Educational Organizations was published in the State Register on May 26, 1992. The notice specifically mentioned this rule and invited interested persons to submit comments or suggestions in writing to the Department by June 26, 1992. Two written comments were received. One comment was of a general nature and one comment was related to a topic not covered by this rule.

The Legislative Commission to
Review Administrative Rules

DEC 30 1992

This rulemaking proceeding proposes to amend the rules relating to the Sales and Use Tax on Charitable, Religious, and Educational Organizations. This rule was last amended in 1978. Since that time, The Minnesota Legislature has amended Minnesota Statutes chapter 297A significantly. Therefore, it is necessary to amend this rule to comply with the changes made in the law and address problems which have occurred since 1978.

The changes being proposed for this rule are of several types. (1) Some of the changes involve repeal of outdated information and grammatical and form changes. (2) Some of the changes to the proposed rule are the result of law changes. (3) The remainder of the changes and additions to the proposed rule are clarifications or explanations of problem areas or issues that have arisen as a result of audits, court cases, and taxpayer inquiries.

IMPACT ON SMALL BUSINESSES

The impact of this rule on small businesses has been considered. The proposed rule does not impose new filing, or payment requirements on small businesses and therefore is not expected to place any additional financial or administrative burden on small businesses.

SPECIAL NOTICE OF RULEMAKING

Pursuant to Minnesota Statutes, section 14.11 (1990), the proposed rule will not require the expenditure of public monies by local units of government and will not have any direct adverse effects on agricultural lands in this state.

AUTHORITY TO ADOPT RULES

Minnesota Statutes section 270.06 (1990) grants the Commissioner of Revenue authority to promulgate rules concerning administration and enforcement of the sales and use tax laws.

RULE ANALYSIS

Through this rule, the commissioner seeks to clarify the sales and use tax treatment of sales by charitable, religious, and educational organizations and the scope of the exemption for sales to and purchases by charitable, religious, and educational organizations. The purpose of this rule is to clarify what types of organizations qualify for an exemption from sales and use tax and the scope of this exemption. Its purpose is also to clarify what types of organizations do not qualify for the exemption. Statutory terms are defined. Tests for determining whether an organization qualifies for the exemption are given. Procedural matters, such as applying for and using

exemption certificates are explained. Related statutory provisions and rules are identified and cross referenced.

Subpart 1.

This subpart gives the statutory citation and generally explains the exemption granted by Minnesota Statutes, section 297A.25, subdivision 16. Statutory changes were incorporated. Other changes were nonsubstantive changes of grammar, form, and organization made to improve clarity. The subpart headnote was changed to more accurately describe the contents of the subpart. The examples given in paragraph 2 of the existing rule were moved to subpart 8.

Subpart 2.

The subpart headnote was changed to more accurately describe the contents of the subpart.

This subpart defines "charitable" and sets out the factors that are considered when determining whether an organization qualifies for the exemption for charitable organizations.

The definition of "charitable" in this item is generally the same definition used in the existing Minnesota Rule part 8130.6200. However, obsolete terms were deleted and the definition was expanded to more completely explain what is meant by "charitable" and to incorporate the definition of charitable found in In re Junior

Achievement of Greater Minneapolis, Inc. v. State, 271 Minn. 385, 390, 135 N.W.2d 881, 885 (1965); *cited with approval in Mayo Foundation v. Commissioner of Revenue*, 306 Minn. 25, 33, 236 N.W.2d 767, 771 (1975) and *Share v. Commissioner of Revenue*, 363 N.W.2d 47, 50 (1985).

The factors to be considered when determining whether an organization is a charitable organization are set out in this subpart. It is necessary to clarify what factors are considered in determining whether an organization will be granted a certificate of exempt status as a charitable organization. It is reasonable because it incorporates the factors set forth in *Mayo Foundation v. Commissioner of Revenue*, 306 Minn. 25, 34, 236 N.W.2d 767, 771 (1975) and *Share v. Commissioner of Revenue*, 363 N.W.2d 47, 50 (1985).

Subpart 3.

The subpart headnote was changed to more accurately describe the contents of the subpart.

The definition of "religious" in this item is generally the same definition used in existing Minnesota Rule part 8130.6200, subpart 3. The reference to "structure" was changed to "established place of worship" to clarify that while a physical structure is not required, worship services must be conducted in an established place that is owned, leased, or borrowed for that purpose. This is reasonable

because it recognizes that not all "religious" organizations will have a permanent structure in which to meet. Other changes were minor grammatical or form changes made to improve clarity.

A listing of criteria the department will use when determining whether an organization is an exempt religious organization for sales and use tax purposes was added. It is necessary to add this criteria because it is sometimes difficult to determine what actually constitutes a religious organization. It is also necessary because certain individuals or groups have formed "religious" beliefs and programs merely as a basis for seeking preferential tax treatment. In such instances, there is an obligation to inquire as to whether tax exempt status is appropriate. This additional language is meant to set out the factors the department will look to in determining whether an organization qualifies as a religious organization and to provide guidance to organizations in making the determination of whether they meet the requirements for exempt status as a religious organization. It is reasonable because the criteria listed are all reasonable indications of whether an organization is actually being operated for religious purposes.

Subpart 4.

The subpart headnote was changed to more accurately describe the contents of the subpart.

The definition of "educational" in this subpart is generally the same definition used in the existing Minnesota Rule part 8130.6200, subpart 4. The reference to professional and trade schools was modified with the word "nonprofit" to clarify that only nonprofit professional and trade schools qualify for the exemption. This was necessary because questions and problems relating to this issue have arisen on various occasions in the past.

The examples of educational organizations are generally the same as those in subpart 4 of the existing rule. Two additional examples of educational organizations were added. These are 4-H Clubs and historical societies. These examples were added for clarification and to address recurring questions.

Minor grammatical or form changes were made to improve clarity and enhance uniformity.

Subpart 5.

This subpart is generally the same as the existing subpart 5. Language was added to the introductory paragraph to clarify that exempt organization status for sales and use tax purposes is conditioned on the organization being exempt under section 501(c)(3) of the Internal Revenue Code of 1986 as amended through December 31, 1986. Language was also added to clarify that even though 501(c)(3) designation is required, this designation alone does not mean the organization is exempt for sales and use tax purposes.

This clarification is necessary to clear up a misunderstanding held by some nonprofit organizations that if they are exempt for income tax purposes they are automatically exempt for sales tax purposes and because many taxpayers seeking or claiming a sales and use tax exemption for their organization have not been aware of how their 501(c)(3) status is related to their exempt status for sales and use tax issues. It is reasonable because the exemption provided by Minnesota Statutes section 297A.25, subdivision 16 is more limited than the exemption provided by 501(c)(3).

Item A. Subitem 2 in the existing rule provides that "if it is determined that the services rendered by the organization are conditioned upon the receipt of a contribution the services rendered may be regarded as a commercial activity." The existing rule, however, does not explain what the consequences are for the services being regarded as commercial activity. Therefore, language was added to subitem 2 explaining the consequences. This addition is reasonable because it incorporates the court decision in Camping & Education Foundation v. State, 282 Minn. 245, 164 N.W.2d 369 (1969).

Additional examples of organizations that are not exempt organizations for purposes of the sales and use tax were also added to subitem 2. It is necessary to add these examples to clarify that these types of organizations are generally not exempt and to clear up common areas of misunderstanding. It is reasonable because, as a general rule, none of these organizations meet the requirements of

an exempt organization as defined in subpart 2a of this proposed amendment. The general sentence introducing these examples was also changed from "do not" to "may not" to allow some discretion in determining whether one of the listed organizations qualifies for the exemption. This change recognizes that an organization could be structured so it qualifies for the exemption even though it is included in the listing of organizations that do not generally qualify.

Item B. An obsolete statutory citation was changed to the correct citation.

Item C. This item is from the existing rule. No changes were made.

Item D. This item is from the existing rule. Minor grammatical or form changes were made to improve clarity and a gender change was made.

Item E. This item is from the existing rule. No changes were made.

Item F. Material that was obsolete due to a law change was deleted.

Subpart 6.

This subpart is the same as subpart 6 in the existing rule. No changes were made.

Subpart 7.

This subpart is generally the same as subpart 7 in the existing rule. Minor changes in form and organization were made. A general introductory sentence was added. Additional information and examples were added which clarify the procedures surrounding the application for and furnishing of exemption certificates. Obsolete references were corrected or deleted.

Item A. This language is from the existing rule. Language was added clarifying that youth athletic organizations as well as charitable organizations must apply for and receive a certificate of exempt status, form ST-17, to make purchases exempt from sales tax. This was necessary to allow the department to effectively administer this exemption. Examples were added to clarify what types of organizations may provide either form ST-3 or ST-17 and what types of organizations must provide form ST-17 to make exempt purchases. These additions are necessary to clarify the department's position in this area.

Item B. This language is from the existing rule. An obsolete reference to a division within the department was corrected. An obsolete date was deleted. No other changes were made.

Item C. This language is from the existing rule. No significant changes were made. Language was added to clarify that it is up to the exempt organization to provide information that is sufficient to allow the department to make a correct determination.

Subpart 8.

This is a new subpart. It clarifies that some sales to an exempt organization remain subject to sales and use tax even though the organization qualifies as an exempt organization for sales and use tax purposes. This subpart is necessary since there is a common misunderstanding among many exempt organizations that anything they purchase is exempt from tax. There is some duplication of statutory provisions in this subpart. This is necessary to clarify what types of sales to exempt organizations remain taxable and to aid in understanding the examples in this subpart. These examples are given to illustrate situations when sales to an exempt organization remain taxable and when they are exempt. The first two examples in this subpart are taken from the existing rule. No substantive changes were made to these examples, only minor grammatical, form, and organizational changes to improve clarity. The remaining examples in this subpart are new. They illustrate issues that are commonly questioned or misunderstood.

Subpart 9.

This is a new subpart. It clarifies that even if an organization is an exempt organization for sales and use tax purposes, the exemption only allows the organization to make certain purchases exempt from tax. It does not allow the organization to make sales exempt from tax unless they are making a sale that is exempt under some other provision of the statutes. Examples of taxable and nontaxable sales are provided for illustration. This is an area that is often ignored or misunderstood by exempt organizations as demonstrated by inquiries and compliance problems. Therefore, it is necessary to include a separate subpart that explains the taxability of sales by exempt organizations in greater detail.

Subpart 10.

This is a new subpart. Since local governments are no longer exempt from sales tax and use tax, many items used by local government fire departments can no longer be purchased by them exempt. This change, while not directly affecting volunteer fire departments, has caused confusion among them as to whether they may still make purchases exempt. This subpart is necessary to clarify the sales and use tax status of volunteer fire departments. The introductory paragraph of this subpart clarifies that volunteer fire departments may qualify as a charitable organization.

Item A. This item clarifies that a volunteer fire department that qualifies as a charitable organization may make purchases exempt if the purchase is used exclusively to prevent fire or to protect property in the community from fires. Some examples of items that may be purchased by a volunteer fire department exempt from sales and use tax are given. These are reasonable because section 297A.25, subd. 16, requires that the property purchased be used in the performance of charitable, religious, or educational functions. The charitable purpose of a volunteer fire department is to prevent fires in a community and extinguish them once they have occurred. All property that is used exclusively for this charitable purpose is exempt. The examples in subitems 1 through 6 are items that typically would be used exclusively for preventing or extinguishing fires.

Item B. This item clarifies that those items that aren't used exclusively to prevent or extinguish fires are subject to sales and use tax. The example of a washing machine used to wash fire protection clothing is given to illustrate the types of purchases that are not used exclusively to prevent or extinguish fires and therefore are taxable.

Subpart 11.

This is a new subpart. It cross-references some of the many statutes and rules which will often affect exempt organizations. A synopsis of this material is given in this subpart along with the cite to the applicable statute or part. While this is duplicative of statutory

language, it is necessary to include information that may be of value to the exempt organization and to avoid repeating information that is already adequately covered.

Items A through D. These are all cross references to statutory exemptions and any corresponding rules.

Item E. This item is more detailed than other items in this subpart. This is because there have been several law changes that affected meals and drinks since the last update of Minnesota Rule part 8130.0800. Consequently, some issues of concern to exempt organizations are not addressed in part 8130.0800. Also, some provisions of part 8130.0800 are obsolete due to law changes. While part 8130.0800 is in line to be updated, in the interim it is necessary to address some general areas of concern regarding meals and drinks and exempt organizations in this part.

For example, the primary exemption for meals served by an exempt organization is the fundraising exemption. This exemption did not exist at the time the existing rules were drafted. Likewise, at the time the existing rules were drafted there was an exception to the sales tax for occasional meals served by a charitable or church organization. This exception was dropped in 1987.

Items F through I. These are all cross references to statutory exemptions and any corresponding rules.