

14-1880
TAX TYPE: SALES TAX EXEMPTION REQUEST
TAX YEAR: 2015
DATE SIGNED: 7-21-2015
COMMISSIONERS: R. PERO, M. CRAGUN
RECUSED: J. VALENTINE
CONCURRENCE: R. ROCKWELL
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, vs. TAXPAYER SERVICES DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	INITIAL HEARING ORDER Appeal No. 14-1880 Account No. ##### Tax Type: Sales Tax Exemption Request Judge: Phan
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Presiding:

Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: REPRESENTATIVE-1 FOR TAXPAYER, Treasurer, TAXPAYER
REPRESENTATIVE-2 FOR TAXPAYER, President, TAXPAYER
REPRESENTATIVE-3 FOR TAXPAYER, Member, TAXPAYER
REPRESENTATIVE-4 FOR TAXPAYER, President Elect
REPRESENTATIVE-5 FOR TAXPAYER, Former President,
TAXPAYER

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT-1, Assistant Director Taxpayer Services Division
RESPONDENT-2, Manager, Taxpayer Services Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on March 9, 2015 for an Initial Hearing in accordance with Utah Code §59-1-502.5. The issue appealed and before the Commission is Respondent's ("Division's") denial to issue to Petitioner ("Taxpayer") a sales tax exemption number. On November 12, 2004, Taxpayer had filed a Form TC-160 Application for

Sales Tax Exemption Number for Religious or Charitable Institutions. The Division denied the application on September 12, 2014.

APPLICABLE LAW

Certain exemptions from sales and use tax are set out at Utah Code Sec. 59-12-104. At issue in this appeal is the exemption from sales and use tax at Subsection 104(8) which provides:

The following sales and uses are exempt from the taxes imposed by this chapter:

....

(8) sales made to or by religious or charitable institutions in the conduct of their religious or charitable functions and activities, if the requirements of Section 59-12-104.1 are fulfilled;

Utah Code Sec. 59-12-104.1 provides procedure requirements for the exemption or obtaining a refund but does not define “charitable institutions” or what would constitute “charitable functions or activities.” In pertinent part the section provides:

- (1) Except as provided in Section 59-12-104, sales made by religious or charitable institutions or organizations are exempt from the sales and use tax imposed by this chapter if the sale is made in the conduct of the institution or organization’s regular religious or charitable functions or activities.
- (2) (a) Except as provided in Section 59-12-104, sales made to a religious or charitable institution or organizations are exempt from the sales and use tax imposed by this chapter if the sale is made in the conduct of the institution or organization’s regular religious or charitable functions and activities.
(b) In order to facilitate the efficient administration of the exemption granted by this section, the exemption shall be administered as follows:
 - (i) the exemption shall be at point of sale if the sale is in the amount of at least \$1,000; . . .
- (3) (a) Religious or charitable institutions or organizations entitled to a refund under Subsection (2)(b)(ii) may apply to the commission for the refund of sales or use taxes paid.
(b) The commission shall designate the following by commission rule adopted in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act;
 - (i) Procedures for applying for a sales and use tax refund;
 - (ii) Standards for determining and verifying the amount of purchase at the point of sale;
 - (iii) Procedures for submitting a request for refund on a monthly basis anytime the taxpayer has accumulated \$100 or more in sales tax payments; and
 - (iv) Procedures for submitting a request for refund on a quarterly basis for any amount of sales tax payments.

The Utah State Tax Commission adopted a rule regarding the exemption for religious and charitable institutions set out at Utah Code Sec. 59-12-104(8). Utah Admin. Rule R865-19S-43 provides in pertinent part the following:

- A. In order to qualify for an exemption from sales tax as a religious or charitable institution, an organization must be recognized by the Internal Revenue Service as exempt from tax under Section 501(c)(3) of the Internal Revenue Code.
.....
- B. Every institutions claiming exemption from sales tax under this rule must submit form TC-60, Application for Sales Tax Exemption Number for Religious or Charitable Institutions, along with any other information that form requires, to the Tax Commission for its determination

Section 501(c)(3) of the Internal Revenue Code provides an exemption to:

Corporations, and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.

DISCUSSION

The parties did not present an issue or dispute regarding the facts, the issue was one of interpretation of the law and applicable rules. The Taxpayer had submitted its request (TC-160) for a sales tax exemption number for a religious or charitable organization. The Division had denied the request by Statutory Notice dated September 12, 2014. The reason the Division gives for denying the request was that the Taxpayer was not designated by the Internal Revenue Service as an exempt organization under Section 501(c)(3). It was not disputed at this hearing that the Taxpayer was a nonprofit entity, and the Taxpayer has been recognized by the IRS as exempt under Section 501(c)(4). It was, however, the Division’s position that in order to qualify for the sales tax exemption number, the Taxpayer must be exempt under Section 501(c)(3) of the Internal Revenue Code. The Division relies on Utah Admin. Rule R865-19S-43(A) which states, “In order to qualify for an exemption from sales tax as a religious or charitable institution, an organization must be recognized by the Internal Revenue Service as exempt from tax under Section 501(c)(3) of the Internal Revenue Code.”

The representatives for the Taxpayer explain that the statute itself does not limit the exemption to entities designated by the IRS to Section 501(c)(3) of the Internal Revenue Code, that it is only the Tax Commission’s rule that provides the restriction. They explain that the Taxpayer is a service organization and has fund raisers to raise money for social welfare programs. It has three main programs for which it raises money. It puts on a large (A) for the

CITY-1 area helping low income families at HOLIDAY TIME. It also raises funds to provide a high school “(B)” program as well as a (C). The Taxpayer’s representatives explain that it has one main fundraiser which is to sell FOOD at the CITY-1 CELEBRATION. All the proceeds from this fundraiser go towards purchasing gift cards for the needy families in the (A) program. They do point out the recipients of the gift cards will pay sales tax when they use the gift cards. They indicated that from this one event they had paid \$\$\$\$ in sales taxes on the sales, which they state could have provided additional money for gift cards for the needy families. Additionally, they point out that all the work for this event is done by volunteers who donate their time.

Based on this, the representatives for the Taxpayer asserts that the Taxpayer qualifies for exemption under the statute, although the rule requires the 501(c)(3) status. The Taxpayer’s representatives cited to Private Letter Ruling 10-003,¹ in which the Tax Commission allowed the exemption for an entity that was not a 501(c)(3). Additionally, the Taxpayer asked if there was a way that they could qualify for a temporary or single event exemption just on their main, once a year fundraiser. The Taxpayers did not know of any statutes or case law that might provide a temporary exemption.

The Division explained that its position was consistent with Utah Admin. Rule R865-19S-43 and because the Taxpayer was a 501(c)(4) entity it did not qualify for the sales tax exemption. The Division noted that the Private Letter Ruling 10-003 was distinguishable because in the Private Letter Ruling the entity requesting the exemption was a 501(c)(2) entity and was a wholly owned subsidiary of a 501(c)(3) entity. The sole purpose of the 501(c)(2) entity was to hold title to real property that was owned and used by the 501(c)(3) parent entity in its charitable purposes.² The Division did point to a recent Tax Commission Decision, *Initial Hearing Order, Appeal No. 13-1872*, in which the Tax Commission considered the similar arguments made by a

¹ Private Letter Rulings are available for review in a redacted format at <http://tax.utah.gov/commission/ruling>.

² The decision in *Private Letter Ruling 10-003*, had been issued by the Tax Commission on March 24, 2010. In that ruling the Commission considered whether a 501(c)(2) organization would qualify for a sales tax exemption under Utah Code Sec. 59-12-104(8). The Commission noted in that opinion that the statute did not define religious or charitable institutions and that it was Rule R865-19S-43 that set the limitation that it be a 501(c)(3) organization. The 501(c)(2) organization, held title to real property, and was wholly owned by a 501(c)(3) organization. The property was used in furtherance of the 501(c)(3)’s charitable purposes. In that ruling the conclusion was, “the Commission finds that [501(c)(2) entity] qualifies for the sales tax exemption in spite of Rule 43 because [501(c)(2) entity] meets the requirements of the statute.” Later the Commission notes, “Rule 43 is unduly restrictive in this case.”

taxpayer that they qualified for a charitable exemption based on the language of the statute but had been denied based on the rule.³

After review of the facts and the arguments presented by the parties at the hearing, the denial of the exemption should be upheld. The Courts have long held that exemptions should be strictly construed against the one seeking the exemption⁴ and that recently has been codified at Utah Code Sec. 59-1-1417(2)(b) which states that the Tax Commission shall, “construe a statute providing an exemption from or credit against the tax, fee, or charge strictly against the taxpayer.” Utah Admin. Rule R865-19S-43 does require that in order to qualify for the exemption the institution must be exempt by the IRS as a 501(c)(3) entity. There are different requirements and different purposes under the federal law for the various types of exempt entities. A 501(c)(3) entity has a higher level of scrutiny and transparency than other types of entities that are exempt from federal taxes and of the various federal exemptions was the one most applicable to the charitable or religious exemption set out at 59-12-104. Therefore, Utah Admin. Rule R865-19S-43 provides a reasonable interpretation that can be practically implemented. The facts in this appeal are dissimilar from *Private Letter Ruling 10-003*. In that case there were two entities that were working together to provide a charitable function. One was a 501(c)(3) and the other was a wholly owned subsidiary ancillary to the 501(c)(3). Absent a revision to Utah Admin. Rule R865-19S-43 or a change in legislation, the Taxpayer does not qualify for this exemption.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Taxpayer’s appeal in this matter is denied. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed, or emailed, to the address listed below and must include the Petitioner's name, address, and appeal number:

³ The *Initial Hearing Order* issued by the Tax Commission in Appeal No. 13-1872 had been appealed to a Formal Hearing, which means the decision is no longer in effect and the Utah State Tax Commission has not yet issued its Formal Hearing decision in that appeal.

⁴ See *Nucor Corp., Nucor Steel Utah Div. v. Utah State Tax Comm’n*, 832 P.2d 1294 (Utah 1992) and *Ivory Homes, Ltd. v. Utah State Tax Comm’n*, 266 P.3d 751, 759-60 (Utah 2011).

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

or emailed to:
taxappeals@utah.gov

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2015.

RECUSED

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

CONCURRENCE

I concur with my colleagues that the denial of the Taxpayer’s exemption should be upheld. However, I disagree that the determination of whether a sales and use tax exemption should be granted hinges on whether the Taxpayer is an organization recognized by the Internal Revenue Service as exempt from federal income taxation under Section 501(c)(3), Internal Revenue Code.

Utah Code Subsection 59-12-104(8) grants a sales and use tax exemption for “sales made to or by religious or charitable institutions in the conduct of their religious or charitable functions and activities” Utah Admin. Rule R865-19S-43 provides that in order to qualify for the exemption, “an organization must be recognized by the Internal Revenue Service as exempt from tax under Section 501(c)(3) of the Internal Revenue Code.” The Utah Supreme Court has found that “[i]t is a long-standing principle of administrative law that an agency’s rules must be consistent with its governing statutes.” *Sanders Brine Shrimp v. Audit Division*, 846 P.2d 1304, 1306 (Utah 1993) citing *Merrill Bean Chevrolet, Inc. v. State Tax Comm’n*, 549 P.2d 443, 445 (Utah 1976); *Robert H. Hinckley, Inc. v. State Tax Comm’n*, 404 P.2d 662, 668 (1965). The administrative rule does not comport with the plain language of the statute by narrowing the exemption for “religious and charitable institutions” to 501(c)(3) organizations.

The Utah Supreme Court has recognized that “[i]n undertaking statutory construction, ‘[w]e look first to the plain language of a statute to determine its meaning. Only when there is ambiguity do we look further.’” *MacFarlane v. State Tax Comm’n*, 134 P.3d 1116, 1118-1119 (Utah 2006) citing *J. Pochynok Co., Inc. v. Smedsrud*, 116 P.3d 353 (Utah 2007). There is an additional presumption “that the legislature used each word advisedly and read each term according to its ordinary and accepted meaning.” *Martinez v. Media-Paymaster Plus/Church of Jesus Christ of Latter-day Saints*, 164 P.3d 384, 396 (Ut. App. 2007). The Utah Revenue and Taxation title contains examples of the Legislature using the term “Section 501(c)(3)” when that is what the Legislature intended. One such example is in Title 59, Chapter 18, Charitable Trust Act, where “[c]haritable organization” is defined to mean “an organization described in Section 501(c)(3) and exempt from tax under Section 501(a).” Had the Legislature intended a restrictive meaning of the term “religious or charitable” institution, the Legislature could have limited the exemption to 501(c)(3) organizations in statute.

I agree with my colleagues that narrowing the exemption to 501(c)(3) organizations provides an “interpretation that can be practically implemented.” A more expansive application of the term “charitable institution” may result in challenges for the Division in determining which institutions qualify for the exemption. However, this is an issue for the Legislature, not the Commission, to correct.

I also agree with my colleagues that, in general, exemptions should be strictly construed against the one seeking the exemption. However, the Utah Supreme Court has stated that “this rule is only a secondary consideration that does not always come into play. ‘[T]he rule of strict construction should not be utilized to defeat the intent of the legislative body’ The best evidence of that intent is the plain language of the statute.” *MacFarlane*, at 1121, citing *State Dep’t of Assessments and Taxation v. Belcher*, 553 A.2d 691, 695 (Md. 1989). It is not the role of the Commission to interpret a statute more narrowly than the plain language actually used by the Legislature.

IRS guidance recognizes that “the concepts of ‘social welfare’ under [S]ection 501(c)(4) and ‘charity’ under [S]ection 501(c)(3) are not mutually exclusive,” noting that “...the distinction between [[S]ection 501(c)(3) and [S]ection 501(c)(4)] is more apparent than real.”⁵ Indeed, “[a]n organization whose purposes are charitable within the meaning of Code [S]ection

⁵ See IRS Publication Social Welfare Purposes and link to internal training article G. Social Welfare: What Does It Mean? How Much Private Benefit Is Permissible? What Is A Community? citing *Monterey Public Parking Corp. v. United States*, 321 F. Supp. 972, 975 (N.D. Cal. 1970),

501(c)(3) may also be a social welfare organization under [S]ection 501(c)(4).⁶ Thus, it is possible that a 501(c)(4) organization, like the Taxpayer, could be a “charitable institution” even though not a 501(c)(3) organization. The facts of this case indicate that certain activities of the Taxpayer serve a charitable purpose, including relief of the poor and distressed or of the underprivileged. 26 C.F.R. § 1.501(c)(3)-1. However, the Taxpayer does not assert that it is a “charitable institution” as described in Utah Code Subsection 59-12-104(8). Utah Code Subsection 59-1-1417 provides that the burden of proof is on the petitioner. In this case, the denial of the exemption should be upheld because the Taxpayer has not met this burden of proof.

Rebecca L. Rockwell
Commissioner

www.irs.gov/Charities-&-Non-Profits/Other-Non-Profits/Social-Welfare-Purposes, accessed July 10, 2015.

⁶ *Id.*