New Guidance Highlights Nonprofits’ Sales Tax Obligations and Opportunities

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Nonprofit organizations – entities formed for certain purposes other than to generate profits for their owners – often attempt to qualify as “tax-exempt organizations” for obvious reasons. But not all nonprofit entities will qualify for tax-exempt status. Even when a nonprofit obtains a determination letter from the Internal Revenue Service confirming its exempt status, that letter typically only indicates that the organization is exempt from paying U.S. federal income taxes (and, in the case of a 501(c)(3) organization, that it may receive tax-deductible contributions). While most organizations that are exempt from paying federal income taxes are also exempt from paying state income taxes, a tax-exempt nonprofit may still be liable for payroll taxes on employees’ earnings, property taxes, and sales taxes.

In New Jersey and New York, certain federally tax-exempt nonprofit organizations may qualify for an exemption from state-imposed sales taxes, but these exemptions do not apply to all such nonprofits, nor are they automatic. In both states, nonprofits that are organized and operated exclusively for religious, charitable, scientific, literary or educational purposes – in other words, 501(c)(3) organizations – may obtain a sales tax exemption. On the other hand, social welfare organizations (501(c)(4) organizations), business leagues (501(c)(6) organizations) and social clubs (501(c)(7) organizations), all of which are eligible for exemption from federal income taxes if certain conditions are met, are not eligible to be exempt from sales taxes in New Jersey or New York. Moreover, eligible nonprofit organizations must apply to obtain a sales tax exemption – to the New Jersey Division of Taxation (on Form REG-1E) or the New York Department of Taxation and Finance (on Form ST-119.2) – and they must furnish proof of their exempt status (via a New Jersey Form ST-5 or a New York Form ST-119.1) to vendors to avoid having to pay sales taxes on their purchases.
Of course, a nonprofit organization can be both (i) a purchaser of taxable goods and services, and thus a payer of sales tax absent an exemption, and (ii) a seller of otherwise taxable goods and services. While the exemptions described above provide a limited exemption from having to collect and remit sales taxes, if a 501(c)(3) organization with a New Jersey or New York sales tax exemption operates a shop or store that makes retail sales of taxable goods, that shop or store is still required to charge sales taxes to its customers and pay those taxes over to the state.

In both New Jersey and New York, sales tax-exempt organizations may also avoid sales tax on the sale of tickets to certain events. In the case of non-athletic events (other than carnivals, rodeos or circuses featuring paid professional performers or operators), if the event promoter agrees to donate all of the proceeds to an exempt organization (or to an opera or symphony substantially supported by voluntary contributions, a municipal police or fire department, or a volunteer fire company or first aid squad) the ticket sales may be exempt from sales tax despite the fact that the promoter is itself a for-profit business. So, for example, an amusement park or comedy club may decide to support a local charity by dedicating all admission proceeds on a particular day to that charity. To encourage such events, the park or club owner is not required to charge sales taxes on its ticket sales that day if certain requirements are met.

The New Jersey Division of Taxation recently issued a technical bulletin elaborating on the procedural requirements to qualify for this special exemption from charging sales taxes on admissions. To qualify:

- the promoter of the event – the person or business that agrees or otherwise arranges to hold, produce or sponsor the event – must sign a contract before tickets are sold mandating that the proceeds will benefit one or more named nonprofit organizations;
- the contract must limit compensation for any promoter or entertainer to an hourly, per diem or flat-fee payment, and not provide for compensation contingent on a percentage of net or gross admission receipts;
- the promoter must obtain a copy of each supported nonprofit’s Form ST-5; and
- the promoter must retain a copy of the contract, the Forms ST-5 and proof that the proceeds were transferred to the named nonprofit organizations for four years after the date of the event.

In addition, under New Jersey or New York Law, such a promoter is likely to be viewed as a “commercial co-venturer,” subject to an additional set of rules. The contract must meet certain additional requirements (and, if New Jersey law applies, it must be filed with the New Jersey Division of Consumer Affairs before the event), and the nonprofit must file a report with the New Jersey Division of Consumer Affairs or a statement with the New York Charities Bureau regarding the fundraising event afterwards.
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