SALES BY CHARITABLE ORGANIZATIONS EXEMPTION

EVALUATION SUMMARY | SEPTEMBER 2021 | 2021-TE25

TAX TYPE	Sales and use	REVENUE (TAX YEAR 2019)	$1.28 million
YEAR ENACTED	1995	NUMBER OF TAXPAYERS	Could not determine
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The exemption appears to reduce the administrative burden of collecting and remitting sales tax for charitable organizations with limited sales revenues. However, it appears that many eligible organizations are not aware of it.

WHAT DOES THE TAX EXPENDITURE DO?

The Sales by Charitable Organizations Exemption allows charitable organizations to exempt their sales of tangible personal property, commodities, or services from sales tax. In order to qualify for the exemption, an organization must not exceed $45,000 in net proceeds from sales throughout each calendar year and the funds raised by those sales must be used for the organization's charitable function.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the exemption; therefore, we could not definitively determine the General Assembly's original intent. However, based on our review of the statutory language, communication with the Department of Revenue, conversations with stakeholders, and legislative testimony, we considered the following potential purpose: to reduce the administrative burden of collecting and remitting sales tax for charitable organizations' that make a limited amount of sales.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider amending statute to establish a statutory purpose and performance measures for the exemption. Additionally, we found that some Department of Revenue regulations related to the exemption are not up to date.

SALES BY CHARITABLE ORGANIZATIONS EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Sales by Charitable Organizations Exemption [Section 39-26-718(1)(b), C.R.S.] allows charitable organizations to exempt their sales of tangible personal property, commodities, or services from sales tax. A charitable organization, as defined under Section 39-26-102(2.5), C.R.S., is an "entity organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international sports competition…, or for the prevention of cruelty to children or animals…" Also, charitable organizations must also not remit earnings to shareholders or individuals, influence legislation, or participate in a political campaign. In order to qualify for the exemption, an organization must not exceed $45,000 in net proceeds from sales throughout each calendar year and the funds raised by those sales must be used for the organization's charitable function. Net proceeds from sales are calculated as the total sales revenue minus any costs for acquiring or purchasing the items sold. If an organization exceeds the $45,000 net proceeds limit, then from that day of exceeding the limit through the rest of the calendar year, the organization must apply sales tax to all products sold and the organization cannot qualify for the exemption for the following calendar year.

House Bill 95-1145 created the exemption in 1995 and the General Assembly amended it in 2019 with House Bill 19-1323, which made the following changes:

- Increased the annual net proceeds limit from $25,000 to $45,000.

- Removed a restriction that only allowed organizations to make sales 12 days or fewer per year. For example, prior to this change, if an organization sold books one day each month for a calendar year, 12 days total, it would have been in compliance with the statute. However, if it sold books 13 days in a year, it would have been required to collect sales tax on its sales.

- Removed a requirement for organizations to remit sales tax on sales for the entire year if they apply the exemption but exceed the net proceeds limit during the year.

- Added the restriction on eligibility for organizations that exceeded the $45,000 net proceeds cap during the prior year.

The Department of Revenue (Department) designates which organizations have charitable status in Colorado for the purposes of state taxes. To receive charitable status, organizations generally must have Internal Revenue Code Section 501(c)(3) status and complete the Application for Sales Tax Exemption for Colorado Organizations (Form DR 0715). Religious organizations that have not qualified under Internal Revenue Code Section 501(c)(3) must also submit the Statement of Nonprofit Church, Synagogue, or Organization (Form DR 0716). Charitable organizations that make less than $45,000 in net proceeds from sales during the year do not have to apply for a sales tax license and do not have to report the exempt sales to the Department unless they make sales within a local government that has not adopted the exemption. Organizations that apply the exemption to their sales, but that meet or exceed the exemption's $45,000 limit during the year, must apply for a sales tax license with the Department and at the end of their fiscal year, report the total amount of exempt sales they made on line 6 in schedule B of the Colorado Retail Sales Tax Return (Form DR 0100).

Statute [Section 29-2-105 (1)(d)(I), C.R.S.] gives local governments that have their sales taxes collected by the State the option to adopt the exemption; 13 state-collected cities and 12 state-collected counties had done so at the time of this evaluation. Article XX, Section 6 of the Colorado Constitution gives self-collected, home rule cities the authority to establish their own sales tax policies. At the time of this evaluation, eight of the 15 most populous home rule cities had adopted an exemption for sales by charitable organizations.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not directly state the intended beneficiaries of the exemption. After reviewing the statute, Department rulings, and legislative hearings, we inferred that the direct beneficiaries of the exemption are purchasers of the exempt items since they do not pay sales tax on their purchases. Charitable organizations also benefit by being able to sell products without sales tax, which may encourage consumers to purchase from them and lessens the organizations' administrative costs, since they no longer need to collect and remit sales taxes to the State. As of 2019, according to Colorado Secretary of State data, there were about 8,000 charitable organizations in the state that reported revenue, which we estimate made about $95 million in sales during the year. However, because the exemption is limited to organizations with less than $45,000 in net proceeds from sales, we inferred that the exemption was primarily intended to benefit charitable organizations with a relatively small amount of sales revenue. Although sales of goods may be a significant source of revenue for some charitable organizations, our review of Internal Revenue Service (IRS) data for Tax Year 2017 indicates that nationwide, net proceeds from sales of goods made up only 0.33 percent of charitable organizations' revenue, with donations and sales of program services making up about 93 percent. Therefore, even some larger charitable organizations may qualify for the exemption if sales of goods are only a small part of their fundraising activities. For example, a nonprofit that raises most of its revenue through grant awards and donations might also sell souvenirs or clothing with the organization's logo or charge for food it sells at an event.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the exemption; therefore, we could not definitively determine the General Assembly's original intent. However, based on our review of the statutory language, communication with the Department, conversations with stakeholders, and legislative testimony, we considered the following potential purpose: to reduce the administrative burden of collecting and remitting sales tax for charitable organizations' that make a limited amount of sales. During committee hearings for the exemption's enacting legislation, both stakeholders and legislators noted that this exemption was meant to help reduce the administrative burden on charitable organizations. According to stakeholders, smaller organizations typically have limited staff and resources, so avoiding having to collect and remit sales tax allows those organizations to focus on their charitable work instead of having to spend time administering sales taxes.

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We could not definitively determine whether the Sales by Charitable Organizations Exemption is meeting its purpose because no purpose is provided for it in statute or its enacting legislation. However, we found that it appears to be meeting the potential purpose we considered in order to conduct this evaluation to a limited extent because not all eligible organizations are aware of the exemption.

Statute does not provide quantifiable performance measures for this exemption. Therefore, we created and applied the following performance measure to determine the extent to which the exemption is meeting its potential purpose:

PERFORMANCE MEASURE #1: *To what extent do qualifying charitable organizations use the exemption to reduce their administrative burden associated with collecting and remitting sales tax when they make eligible sales?*

RESULT: It appears that qualifying organizations may only apply the exemption to a limited extent due to a lack of awareness of the exemption. Although we lacked data to quantify the use of the exemption, a representative from an association that represents nonprofits reported that many eligible organizations probably are not applying the exemption to eligible sales because they are not aware of it. According to the representative, some smaller organizations whose sales qualify for the exemption may be less likely to be aware of it because they may not employ staff with specialized knowledge of the State's tax laws. Additionally, we spoke with two charitable organizations that reported that their sales were eligible for the exemption, but that they had not applied it because they were not aware of it until we spoke with them. These organizations reported that they do plan to apply the exemption in the future, now that they are aware of it.

Stakeholders reported that, to the extent that eligible organizations know about and apply the exemption, not having to collect and remit sales tax would help charitable organizations to devote more time and financial resources towards the mission of the organization instead of administering state sales tax. However, a factor that appears to reduce the effectiveness of the exemption is that many local governments have not adopted the exemption. As mentioned above, local governments that have their sales taxes collected by the State do not have to apply the exemption and, as of the time of this evaluation, only 13 of the 154 state-collected local governments and 12 of the 52 state-collected counties have adopted the exemption and eight of the 15 most populous self-collected home rule local governments have adopted a similar exemption. As a result, most organizations in Colorado are not located in local government jurisdictions that have an exemption. This may reduce the effectiveness of the exemption because charitable organizations that make sales within those jurisdictions are responsible for collecting and remitting local sales taxes on those sales. Therefore, they are required to follow the same administrative processes, such as collecting and accounting for sales taxes at the time of sale, and completing sales tax return forms, that would be necessary to collect the state sales tax. In contrast, charitable organizations in state-collected local jurisdictions that have adopted the exemption are not required to collect sales taxes or file sale tax returns, unless they make other non-exempt sales.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

We estimate that in Calendar Year 2019, the exemption resulted in up to $1.28 million in forgone state revenue. As discussed further below, the Department could not provide data for this tax expenditure, so in order to calculate this estimate, we first used IRS and Colorado Secretary of State data to estimate the amount of sales by Colorado charitable organizations and the associated revenue impact. Specifically, according to IRS data, charitable organizations' net proceeds from sales of goods in the United States make up about 0.33 percent of their total revenue. We then multiplied this percentage by Colorado charitable organizations' 2019 total revenue, as reported to the Colorado Secretary of State by organizations with $25,000 or more in revenue, to estimate the net proceeds from sales for each charitable organization. We then removed from our calculation charitable organizations that had an estimated net proceeds from sales greater than the exemption's $45,000 cap and combined the remaining organizations' net proceeds to estimate that eligible Colorado charitable organizations had approximately $17.7 million in net proceeds. We then estimated these organizations' total sales revenue that would be eligible for the exemption based on IRS data showing that U.S. charitable organizations typically have sales revenues from their sales of goods about 2.5 times greater than the net proceeds from those sales. Specifically, we multiplied the $17.7 million in estimated net proceeds by 2.5 to estimate that eligible organizations in Colorado had total eligible sales revenues of about $44.2 million. We multiplied this amount by the State's sales tax rate of 2.9 percent to estimate the exemption could have resulted in up to $1.28 million in forgone revenue.

Our revenue impact should be viewed as a general indicator of the scale of the exemption due to constraints in the data that was available. First, as discussed, we found that due to a lack of awareness, some eligible organizations may not apply the exemption to eligible sales. Because our estimate includes all organizations that were eligible, it likely overstates the true revenue impact to some extent. Second, only organizations that made more than $25,000 in revenue from all sources or had 10 or more donors are required to register and report revenue to the Secretary of State; thus, as mentioned above, organizations with less than $25,000 in revenue were not included in our estimate. Third, we used national data to estimate charitable organizations' revenue from sales and not Colorado-specific information because it was not available.

In addition to its impact on state revenue, the exemption also likely reduces revenue for the 13 state-collected local governments and 12 state-collected counties that have adopted the exemption. However, due to a lack of data, we could not estimate this impact.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating this tax expenditure could increase administrative costs for charitable organizations that currently use it. As discussed above, we estimate Colorado's charitable organizations made up to $44.2 million in eligible sales in 2019. If the exemption was not in place, these organizations would have to collect sales taxes on all of their sales, which stakeholders indicated could increase their administrative costs significantly. This impact would likely be larger for smaller organizations that have fewer staff to absorb the increased administrative requirements. Eliminating the expenditure might also decrease these organizations' sales due to consumers having to pay sales tax. Furthermore, without the exemption, smaller organizations that may make relatively few sales and do not employ staff with knowledge of the State's sales tax laws may not be aware of sales tax collection requirements and could be forced to remit uncollected taxes and pay fines if they do not properly remit sales tax and undergo a sales tax audit. However, as discussed above, most local governments that have their sales taxes collected by the State do not allow the exemption for local sales taxes and only about half of the 15 largest home rule jurisdictions provide a similar exemption. Therefore, many charitable organizations are already required to collect sales tax for their sales and may, therefore, face a less significant impact if the exemption was not available for state sales tax.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 45 states that levy a sales tax, 42 have an exemption from sales tax for sales by charitable organizations. Eleven states fully exempt charitable organizations from sales tax when making sales. In the other 31 states, the sales tax exemption is dependent on certain conditions in order to qualify. For example, in South Carolina, sales are only exempt from sales tax if the organization has a religious, educational, or scientific purpose. Furthermore, like Colorado, eight other states have limits on the net proceeds that a charitable organization can make and still qualify, which range from $5,000 to $100,000 per year, with some states' limits dependent on the type of property being sold.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

We identified one other tax expenditure that provides a sales tax exemption for sales by charitable and income tax-exempt organizations. Specifically, the School Related Sales Exemption [Section 39-26-725(2), C.R.S.] exempts sales by schools, booster organizations, or any other school organizations that benefit any public or private K–12 institution from sales tax. We published our evaluation of this exemption in January 2021.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

The Department could not provide data showing the revenue impact for the Sales by Charitable Organizations Exemption because charitable organizations are generally not required to report exempt sales. If the General Assembly wants additional information, it could consider instructing the Department to require charities to report exempt sales and add a reporting line just for sales by charitable organizations to the Colorado Sales Tax Return (Form DR 0100). However, this change would likely increase organizations' administrative costs and may reduce the benefit they receive from the exemption. Furthermore, according to the Department, this type of change would require additional resources to add a line to the form and program GenTax, its tax processing and information system, to collect the data (See the Tax Expenditures Overview section of the Office of the State Auditor's *Tax Expenditures Compilation Report* for additional details on the limitations of Department data and the potential cost of addressing the limitations.)

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE EXEMPTION. As discussed, statute and the enacting legislation for the exemption do not state the exemption's purpose or provide performance measures for evaluating its effectiveness. Therefore, in order to conduct our evaluation, we considered a potential purpose for the exemption: to reduce the administrative burden of collecting and remitting sales tax for charitable organizations' that make a limited amount of sales. We identified this purpose based on statute, legislative testimony, and conversations with stakeholders. We also developed a performance measure to assess the extent to which the exemption is meeting its potential purpose. However, the General Assembly may want to clarify its intent for the exemption by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the exemption's purpose and allow our office to more definitively assess the extent to which the exemption is accomplishing its intended goal(s).

DEPARTMENT REGULATIONS REGARDING THE EXEMPTION ARE NOT UP TO DATE. Specifically, in 2019 the requirement that organizations only make occasional sales was removed from statute and the net proceeds limit was increased to $45,000. Although the Department issued updated guidance that reflects this change, at the time of our review, some Department regulations were not updated and still stated that there is an occasional sales requirement and net proceeds limit of $25,000. As discussed, we found that some eligible organizations may not be using the exemption due to a lack of awareness. Up-to-date information could therefore improve the effectiveness of the exemption by helping to ensure organizations know they are eligible to apply it to their sales. According to Department staff, the Department is aware of this issue and is in the process of updating its regulations to reflect the statutory changes.