

# Sales to Charitable Organizations Exemption



OFFICE OF THE STATE AUDITOR

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**The Sales to Charitable Organizations Exemption exempts purchases made by charitable organizations from sales tax.** The exemption was likely intended to avoid imposing a tax burden on charitable organizations, since these organizations may benefit the public and reduce the need for government services.

## We found that charitable organizations are aware of and able to use the exemption.

- Most stakeholders indicated that charitable organizations are aware of this exemption and commonly use it, and some also noted that this exemption has a major impact on Colorado's non-profit sector and allows charitable organizations to provide more assistance to those they serve.
- Although veterans organizations are exempt from state sales tax, depending on where a sale occurs, they might not qualify for a local sales tax exemption and, therefore, may have to pay local sales taxes.
- We could not determine the exemption's impact on state revenue because vendors report exempt sales to charitable organizations on the same line of their Colorado sales tax returns as sales to a number of other exempt entities, including schools, housing authorities, the State of Colorado, and local governments.

## Policy Consideration

We did not identify any new policy considerations for the exemption.

|                     |  |                         |                            |
|---------------------|--|-------------------------|----------------------------|
| Tax Type:           | <b>Sales &amp; Use Tax</b>             | Year Enacted:           | <b>1935</b>                |
| Expenditure Type:   | <b>Exemption</b>                       | Repeal/Expiration date: | <b>None</b>                |
| Statutory Citation: | <b>Section 39-26-718(1)(a), C.R.S.</b> | Revenue Impact:         | <b>Could not determine</b> |

Purpose given in statute or enacting legislation? **No**



# Sales to Charitable Organizations Exemption

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## Background

**The Sales to Charitable Organizations Exemption exempts purchases made by charitable organizations from sales tax.**

Charitable organizations that are registered with the Secretary of State and that qualify as exempt from federal income tax under Internal Revenue Code 501(c)(3) for charitable organizations, or Internal Revenue Code 501(c)(19) for veterans services organizations, can qualify for the exemption. In order to claim the exemption, eligible organizations must apply for a certificate of exemption from the Department of Revenue (Department). Organizations then present the certificate to retailers at the point-of-sale, and retailers apply the exemption by not collecting the State's 2.9 percent sales tax on eligible sales. According to the Department, retailers are expected to verify the validity of the certificate of exemption and report the total exempt sales when they remit the sales taxes they collected to the State. If the exemption is not applied at the time of sale, the charitable organization can also apply for a refund by submitting the appropriate forms to the Department within 3 years.

**The exemption was likely intended to avoid imposing a tax burden on charitable organizations, since these organizations may benefit the public and reduce the need for government services.** The exemption was established in 1935 at the same time as the Colorado sales tax, indicating that the General Assembly's intention was to exempt charitable organizations from sales tax when it was created. The only substantial change to the exemption occurred in 2018 when the General Assembly amended it to include nonprofit veterans organizations with 501(c)(19) tax status.

### Technical Note

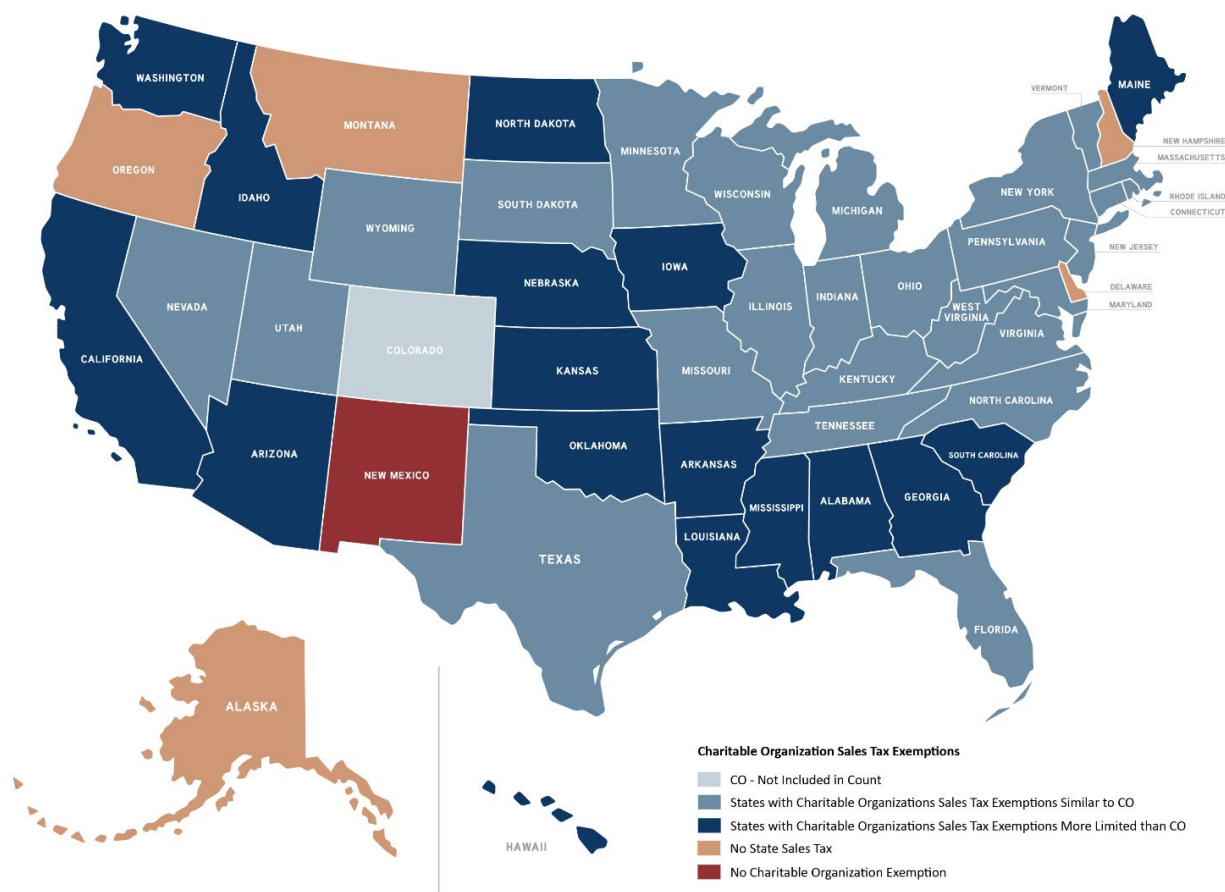
According to statute, a charitable organization may qualify if they meet the following criteria:

- a. Must be organized and operated exclusively for certain purposes given in statute, such as religious, charitable, scientific, testing for public safety, literary, or educational purposes; fostering national or international amateur sports competition; or the prevention of cruelty to children or animals; or be a veterans organization recognized under 501(c)(19).
- b. None of the organization's net earnings may inure to any private shareholder or individual.
- c. May not participate in, or intervene in, any political campaign on behalf of any candidate for public office, carry on propaganda, or be organized primarily to influence legislation.

The exemption is consistent with the general tax policy of the State and federal governments to avoid taxing charitable organizations. Specifically, in addition to being exempt from sales tax, charitable organizations are also exempt from Colorado and federal income taxes and Colorado property taxes on real and personal property.

Similar to Colorado, most other states exempt charitable organizations from paying sales tax. As provided in Exhibit 1, 26 of the 44 other states (excluding Colorado) that impose a state sales tax and the District of Columbia have broad exemptions similar to Colorado's, and 17 of the 44 other states offer some form of exemption that is not as broad as Colorado's. For example, Oklahoma offers an exemption to enumerated organizations, such as the Boy and Girl Scouts of U.S.A., while Louisiana exempts food banks but no other types of organizations. Only New Mexico, which has a gross receipts tax which is paid by vendors, offers no form of sales tax exemption to charitable organizations.

### Exhibit 1 Charitable Organization Sales Tax Exemptions by State



Source: Office of the State Auditor analysis of data from Bloomberg Law 2022.

The direct beneficiaries of the exemption are the charitable organizations that save money by not paying sales tax. Additionally, individuals who receive expanded services from the exempt organizations due to the tax savings also likely benefit from the exemption. Studies have found that government support of charitable organizations has a beneficial impact to society. For example, research published in 2009 from the Congressional Research Service, a Federal agency, found that government subsidization of charitable activities can increase society's overall well-being by improving access to community resources such as education and improved infrastructure. Further, an article published in 2021 in the Journal of Public Administration Research and Theory found that a robust nonprofit industry supports higher levels of social capital, self-reported health, infant health, and good mental health in communities. In addition, a study published in 2017 supported by non-profits, local governments, and academic organizations to show the non-profit sector's impact in Colorado estimated that the non-profit industry accounts for 5.1 percent of employment (nearly 190,000 jobs) in Colorado. This industry accounts for approximately a quarter of the state's educational services sector and a third of the health care and social assistance sector.

## Evaluation Results

### **We found that charitable organizations are aware of and able to use the exemption.**

Stakeholders have generally reported that they are aware of the exemption and claim it on eligible purchases. We conducted a survey of charitable organizations during our 2018 evaluation of the exemption, and 124 of the 152 survey respondents (82 percent) indicated that they used the exemption for most of their purchases. We conducted more limited outreach during the current evaluation because the only significant change to the exemption since our previous survey was the expansion of the exemption's eligibility to include veterans organizations. Of the 37 stakeholders that we contacted in 2023, we received responses from an industry association representing non-profit organizations in Colorado, one Veterans Service Officer, and one director of a veterans organization registered under Internal Revenue Code 501(c)(19). During both evaluations, most stakeholders indicated that charitable organizations are aware of this exemption and commonly use it, and some also noted that this exemption has a major impact on Colorado's nonprofit sector and allows charitable organizations to provide more assistance to those they serve. We did note that about one-third of respondents to our 2018 survey reported some difficulty accessing the exemption at point of sale, but we were unable to determine how frequently these issues may occur.

Although veterans organizations are exempt from state sales tax, depending on where a sale occurs, they might not qualify for a local sales tax exemption and, therefore, may have to pay local sales taxes. Statute requires local governments that have their local sales taxes collected by the State on their behalf to apply most of the State's sales tax exemptions, including the Sales to Charitable Organizations Exemption. Therefore, both charitable organizations and veterans organizations would receive an exemption from local sales tax in these jurisdictions. However, home rule municipalities that collect their own taxes have the authority to set their own tax policies

independent from the State and are not required to exempt sales to charitable organizations from their local sales taxes. Colorado's top 12 most populous cities are home-rule jurisdictions that collect their own taxes. All 12 offer exemptions from sales tax for charitable organizations, but not all offer an exemption for veterans organizations. Specifically, seven of these cities have a process similar to the State, requiring an application for a certificate of exemption, but only recognize charitable organizations that have been granted tax-exempt status from the federal government under Internal Revenue Code 501(c)(3). The City of Denver no longer requires a letter of exemption for their charitable exemption but does require the organization to have 501(c)(3) status. Thus, veterans organizations, which are granted tax-exempt status under Internal Revenue Code 501(c)(19), would not be eligible for an exemption certificate in these cities and would be required to pay local sales taxes, which range from 2 to 7 percent. The remaining 4 of the 12 honor the state-issued exemption certificate, so veterans organizations would receive a local sales tax exemption in addition to the state exemption in these jurisdictions.

We could not determine the exemption's impact on state revenue because vendors report exempt sales to charitable organizations on the same line of their Colorado sales tax returns as sales to a number of other exempt entities, including schools, housing authorities, the State of Colorado, and local governments. As such, it is not possible to use Department data to determine how much sales tax revenue was forgone as a result of exempt sales to charitable organizations as opposed to sales to these other qualifying entities. According to Department data, in 2021, the State forwent about \$479 million in sales tax revenue due to sales to all of these qualifying entities. In our previous evaluation, we used information from our stakeholder survey and IRS data on charitable organizations to estimate that the exemption for sales to charitable organizations alone resulted in about \$45 million in forgone revenue to the State in 2016. However, since we did not conduct a new survey for the current evaluation, we did not repeat this methodology to develop a new revenue impact estimate for 2021.

## Policy Consideration

**We did not identify any new policy considerations for the exemption.** In our previous evaluation of the exemption, released in September 2018, we included a policy consideration informing the General Assembly that some charitable organizations reported experiencing issues with receiving the exemption due to retailers not applying it consistently. The General Assembly did not take any legislative action on this policy consideration.

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|                       |   |
|-----------------------|---|
| State Auditor         | <b>Kerri L. Hunter, CPA, CFE</b>                      |
| Deputy State Auditor  | <b>Michelle Colin, JD</b>                             |
| Evaluation Managers   | <b>Trey Standley, JD</b><br><b>James Taurman, MPA</b> |
| Evaluation Supervisor | <b>Jacquelyn Combellick</b>                           |
| Evaluation Team       | <b>Amora Lenzi</b>                                    |



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