

Notice

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Office of Policy & Research

NOTICE 99-14 **Sales Tax Exemptions for Religious Organizations**

This notice discusses the department's implementation of the 1998 and 1999 sales tax exemptions that the Kansas legislature granted to religious organizations. The notice updates Notice 98-05, which was rescinded because of the 1999 legislative changes, and incorporates Notice 99-05, which discusses the 1999 provisions for project exemptions and sales tax refunds.

The 1998 Kansas legislature enacted a new law to exempt certain direct purchases by religious organizations. As is discussed in Subsection III, the purchases must be used exclusively for religious purposes to qualify for exemption. The 1999 legislature broadened this law to provide a procedure to exempt the sale of materials to contractors for incorporation into a religious organization's qualifying real property. The exemption of a contractor's purchases for the benefit of an exempt entity is commonly referred to as a "project exemption," "indirect exemption," or "pass-through exemption." In Kansas, this type of exemption is secured by having an exempt entity apply to the department of revenue for a project exemption certificate. Once a project exemption certificate is obtained, the entity should provide copies to their contractors and subcontractors on the project to exempt their services and for the contractors and subcontractors to use to claim exemption on their purchases of materials and supplies for the project.

The two enactments, which will be codified at K.S.A. 79-3606(aaa), exempt:

all sales of tangible personal property and services purchased by a religious organization which is exempt from federal income taxation pursuant to section 501(c)(3) of the federal internal revenue code, and used exclusively for religious purposes and all sales of tangible personal property or services purchased by a contractor for the purpose of constructing, equipping, reconstructing, maintaining, repairing, enlarging, furnishing or remodeling facilities for any such organization which would be exempt from taxation under the provisions of this section if purchased directly by such organization. . . . When any such organization shall contract for the purpose of constructing, equipping, reconstructing, maintaining, repairing, enlarging, furnishing or remodeling facilities, it shall obtain from the state and furnish to the contractor an exemption certificate for the project involved, and the contractor may purchase materials for incorporation in such project. . . . *(1999 Sess Law. Ch. 154, Sec. 6; This subsection is set forth in its entirety in the Appendix).*

In addition to project exemptions, the 1999 legislature granted religious organizations the right to obtain a refund of any sales tax that their contractors may have paid on qualifying materials and supplies sold on or after July 1, 1998. Refunds are discussed in Subsection V of this notice.

Implementation of the two new laws requires a number of questions to be answered. These are: (1) What is a religious organization? (2) What qualifies as a direct purchase by a religious organization? (3) What constitutes exclusive use for religious purposes? (4) What steps must a religious organization take in order to claim exemption on direct purchases? (5) What steps must a religious organization take in order to secure a project exemption certificate or a refund of taxes paid? and (6) What sales to and sales made by a religious organization remain subject to sales and use tax? These questions will be discussed in order.

I. What is an Exempt Religious Organization?

- a) For purposes of the Kansas retailers' sales tax act, "religious organization" shall mean any organization, church, body of communicants, or other group that gathers in common membership for mutual support and edification, in piety, worship, and religious observance, at an established place of worship which the organization maintains for the purpose of conducting regularly scheduled religious services or meetings, and of which no part of the net earnings of such organization inures to the benefit of any private shareholder or individual member. *See K.S.A. 79-4701(e); K.S.A. 8-1730a.*
- b) In order to qualify for exemption from sales tax, a religious organization must qualify for exemption from federal income tax under I.R.C. §501(c)(3).
- c) An organization that is composed of religious organizations may derive exemption from its members if all of the members are themselves exempt religious organizations and the derivative organization is organized and operated exclusively to assist its member organizations in carrying out their religious purpose. Such an organization must itself be exempt from tax under I.R.C. §501(c)(3). *See Trustees of The United Methodist Church v. Cogswell, 205 Kan. 847 (1970).*
- d) An affiliated organization and affiliated corporation made up of church leaders, church supporters, and other lay persons, although operating in support of, or under the guidance of, an exempt religious organization, may not claim exemption as a religious organization.
- e) Certain auxiliary organizations may qualify as religious organizations under I.R.C. §501(c)(3). I.R.C. §501(c)(3) lists the organizations that are considered "religious organizations" as: "Churches, interchurch organizations of local units of a church, conventions or associations of churches, or integrated auxiliaries of a church, such as a men's or women's organization, religious school, mission society, or youth group." *IRS Publication 557.* Purchases by qualifying integrated church auxiliary are exempt when the purchases are used exclusively for religious purposes.
- f) Any organization may request an administrative letter ruling to determine whether or not it qualifies as a religious organization under K.S.A. 79-3606(aaa). Each request shall be accompanied by: (1) a copy of the by-laws and other documentation that establishes that it is organized and operated for religious purposes; and (2) if one has been issued, a copy of letter from the Internal Revenue Service (IRS) that recognizes the organization is exempt from federal income taxation pursuant to I.R.C. §501(c)(3). Under IRS rules, churches are exempt if they meet the various 501(c)(3) requirements. Churches may, but are not required to, secure a 501(c)(3) letter. *See IRS Publication 557, Ch. 3, p. 14.* Under Kansas law, the burden of proof that an organization is exempt lies with the organization. Any organization that erroneously claims exemption as a religious organization must be held liable for tax, penalty and interest if it is later determined that the organization does not qualify under K.S.A. 79-3606(aaa) and the organization has claimed exemption on its purchases.

II. What Qualifies as a Direct Purchase Made by a Religious Organization?

- a) A purchase is considered to be made directly by a religious organization when the item or service being purchased is paid for by the religious organization from its funds. To qualify as being paid from a religious organization's funds, payment must be made by a religious organization's check, warrant, or voucher or be charged to the organization's account. The religious organization must provide the vendor an exemption certificate that meets the requirements of K.S.A. 79-3651(f). This statute provides:

Exemption certificates issued by a nonprofit entity claiming a specific exemption under K.S.A. 79-3606, and amendments thereto, shall bear the name and address of the entity and indicate the subsection under which the exemption is being claimed. Such certificate shall be signed by an officer, office manager or other administrator of the nonprofit entity and contain the driver's license number of the signer. The certificate shall be substantially in such form as the director may prescribe. Payments made on an exempt entity's check, warrant, voucher or is charged to the entity's account shall relieve the vendor from collecting and remitting the tax if it is taken in good faith.

- b) The department's Form BT/st-28R, "Religious Organization Exemption Certificate," meets the requirements of

K.S.A. 79-3651(f). This and other exemption certificates are available from our offices or web site.

c) As noted above, auxiliary entities such as a men's or women's organizations, religious schools mission societies, or youth groups, may qualify as religious organizations. See *IRS Publication 557*. Payment by these auxiliary groups drawn on a church managed checking account is sufficient to indicate that the organization qualifies as an "interchurch organization" or "integrated auxiliary" whose purchases are exempt when the purchases are used exclusively for a religious purpose.

d) Purchases by employees of a religious organization should be taxed unless the purchases are paid for with a religious organization's check, warrant, or voucher, are charged to the organization's account, or a cash payment is accompanied by an exemption certificate. Purchases paid for with funds from a member or with funds from a group of members are not exempt from tax. These rules apply even when the employee or member is reimbursed for the purchase by the religious organization.

e) This exemption does not extend to a person who purchases property to be given or donated to a religious organization. For an item to be purchased exempt, the person must donate the funds to the organization, and the organization must purchase the item in accordance with K.S.A. 79-3651(f). A retailer donating an item from resale inventory is required to accrue tax on the cost of the item being donated.

III. What Constitutes Exclusive use for Religious Purposes?

a) Tangible personal property and services that are considered to be used exclusively for religious purposes include, but are not limited to, personal property and services:

- used exclusively in, or to facilitate, religious worship services by a congregation or church membership while meeting together at a single location;
- used exclusively in, or to facilitate, religious ceremonies;
- used exclusively in, or to facilitate, carrying out the religious work of the organization;
- used to construct, furnish, equip, remodel, or maintain a facility used exclusively for religious objectives including, but not limited to, a church, church grounds, church administration building, church camp, parsonage, rectory, or convent. Such property must be purchased directly by the religious organization or by a contractor doing work for the religious organization who is utilizing a project exemption certificate given to him by the organization, as discussed below in Section V. See *Kansas City Dist. Advisory Bd. v. Board of Johnson Country Comm'rs*, 5 Kan App. 2d 538, 542 (1980); or
- used exclusively to administer, manage, or operate religious facilities or to administer religious activities.

b) Tangible personal property and services will be considered to be "used exclusively" for a religious purpose as long as any other use of the item or service is minimal in scope, insubstantial in nature, and incidental to the exempt purpose. See *Midwest Presbytery v. Jefferson County Appraiser*, 17 Kan. App. 2d 676, 679 (1992).

c) Tangible personal property and services that are not exempt include: (1) personal property and services that are purchased by a religious organization for use in undertaking business activities, even though the profits from such enterprises may be used exclusively for religious purposes (*See Sunday School Bd. v. McCue*, 179 Kan. 1 (1956)); and (2) personal property and services, such as food, clothing, personal items, meals, drinks, motor vehicles, admission charges, and membership dues, that are for the personal use of ministers, priests, and other employees, rather than exclusively for a religious purpose.

d) Utility services provided to a parsonage, rectory, convent, minister's house, or similar residence that is used to house religious leaders are not exempt as purchases that are used exclusively for religious purposes. Similarly, clothing, food and other consumables purchased for such residences are not exempt. These are considered to be purchases for the personal consumption of ministers, priests, nuns, and other religious personnel, rather than purchases that are made "exclusively for religious purposes." However, exempt sales do include sales of furniture, furnishings, real property improvements, and other non-consumable, permanent items that are used to equip a parish, rectory, convent or minister's house if ownership of the property will remain with the church through successive employee changes. Such permanent church property is considered to have been purchased for a "religious purpose" when paid for with church funds.

e) Nursing home operations typically care for and house the sick and the elderly. Purchases by church-owned nursing homes used for nursing home operations do not constitute purchases that are made exclusively for religious purposes. However, many of the purchases made by non-profit nursing homes may be exempt under other provisions. See e.g. *K.S.A. 79-3606(hh)*; *K.S.A. 79-3606(w)*; *K.S.A. 79-3603(p)(4)*.

IV. What Steps Must a Religious Organization Take in Order to Claim Exemption on Direct Purchases?

- a) Unlike a number of other states, Kansas does not require a religious organization to either register with or secure a special exemption letter from the department of revenue in order to claim exemption on its purchases.
- b) To claim exemption on its purchases, a religious organization must provide its vendors with an exemption certificate that is completed in accordance with K.S.A. 79-3651(f), set forth above. Religious organizations may use the certificate designed for them by the department, Form BT/st-28R, "Religious Organization Exemption Certificate." Exemption certificate forms are available from the department of revenue or may be reproduced from K.A.R. 92-19-25b, which is available at the department's internet address. Vendors are required to maintain exemption certificates as part of their records, and may honor a single, blanket exemption certificate that is part of their records when a religious organization makes ongoing purchases from them that are all exempt.

V. What Steps Must a Religious Organization Take in Order to Secure a Project Exemption Certificate or a Refund of Taxes Paid?

a) *Project exemptions* -- To secure a project exemption certificate for their contractors to use, a religious organization must complete a "Request For Project Exemption Certificate," Form PR-76, and mail or fax it to the department. Religious organizations may use existing project exemption application forms until revised forms that specifically mention religious organizations are available. A project exemption certificate is a type of exemption certificate that is issued by the department or under its authority that exempts purchases made by contractors doing qualifying work for a qualifying entity. Religious organizations must take the following steps to obtain and use a project exemption certificate:

- 1) The church or other exempt religious organization must complete Form PR-76 and submit it to the department of revenue by mail or fax;
 - 2) The department will review the completed application form and approve or deny it;
 - 3) If approved, the department will issue a project exemption certificate to the church, which contains a project number;
 - 4) The church or religious organization must reproduce this certificate and provide a copy to the general contractor, who in turn would provide copies to all their subcontractors on the project;
 - 5) Contractors and subcontractors must provide a copy of the project exemption certificate to suppliers when purchasing materials and supplies for the project;
 - 6) Suppliers must place the project exemption number on each sales invoice in lieu of collecting Kansas sales tax and retain their copy of the project exemption certificate in their files; and
 - 7) Project exemption certificates should be maintained for five (5) years. Unlike political subdivisions, religious organizations may not apply for authority to issue their own project exemption certificates.
- b) *Refunds for purchases delivered and service performed between July 1, 1998 and May 27, 1999* -- To claim refunds for purchases delivered or services performed on or after July 1, 1998, and before May 27, 1999, religious organizations must contact their contractors and subcontractors and jointly complete refund forms provided by the department of revenue. (*Joint Application for Refund under 1999 Senate Bill 45 (ST-60 (5/99))*). The form must be completed and signed by both the contractor and the religious organization. This requires providing a description of the project, the dates the project was performed, and supplying copies of the vendor invoices showing the amount of Kansas sales tax paid by the contractor paid to the vendor. Contractor/retailers who accrued tax on a project must provide a statement or other documentation showing the amount of tax accrued and the reporting period during which it was accrued. To qualify for a refund, the sale must have been made on or after July 1, 1998. Retail sales are considered to be made when the seller delivers an item to the buyer or when the services are performed. Therefore, the documentation provided must reasonably establish delivery or contract performance occurred on or after July 1, 1998. The 1999 Kansas Legislature enacted this refund provision to benefit religious organizations whose building costs were affected because their contractors could not claim an exemption when buying building materials and supplies. Application for refunds must be jointly signed by the religious organization and by the contractor who paid the tax or by the contractor/retailer who accrued it. Refund checks issued by the department of revenue will be made payable to the religious organization.
- c) *Refunds for purchases delivered and service performed after May 27, 1999* -- To claim refunds for purchases delivered or services performed after May 27, 1999, religious organizations should follow the refund procedure

described in K.A.R. 92-19-66e.

VI. What Sales to and Sales Made by a Religious Organization Remain Subject to Kansas Sales and Use Tax?

K.S.A. 79-3606(aaa) only exempts purchases made by religious organizations. It does not exempt sales that such organizations make to others, including sales they make to members and employees. *See State Tax Comm. v. Board of Agriculture*, 146 Kan. 720 (1937). This means that, unless a religious organization qualifies as making an isolated or occasional sale as defined in K.S.A. 79-3602(j), it must register as a retailer and collect and remit sales tax on its retail sales. Retail sales include sales made at promotional booths, book sales, and other sales to final consumers. As with any other registered retailer, religious organizations may claim resale exemption when they purchase items to sell at retail.

This Notice supersedes and revokes Notice 98-05 and Notice 99-05.

Taxpayer Assistance

To obtain additional copies of this or any other notice call the Kansas Department of Revenue's voice mail forms request line at (785) 296-4937 or download them from our web site: www.ink.org/public/kdor. If you have any questions about this notice, please contact a customer service representative in one of our Taxpayer Assistance Centers.

Topeka Assistance Center

Docking State Office Building
915 SW Harrison St., 1st Floor
Topeka, KS 66625-0001
(785) 368-8222
Fax: (785) 291-3614

Metropolitan Assistance Center

Mill Creek Shopping Center
13420 W. 62nd, Terrace
Shawnee, KS 66216-1782
(913) 631-0296
Fax: (913) 631-6215

Wichita Assistance Center

Finney State Office Building
230 E. William, Room 7150
Wichita, KS 67202-4002
(316) 337-6140
Fax: (316) 337-6162

Appendix

K.S.A. 1999 Supp.79-3606(aaa) exempts: all sales of tangible personal property and services purchased by a religious organization which is exempt from federal income taxation pursuant to section 501 (c)(3) of the federal internal revenue code, and used exclusively for religious purposes, *and all sales of tangible personal property or services purchased by a contractor for the purpose of constructing, equipping, reconstructing, maintaining, repairing, enlarging, furnishing or remodeling facilities for any such organization which would be exempt from taxation under the provisions of this section if purchased directly by such organization. Nothing in this subsection shall be deemed to exempt the purchase of any construction machinery, equipment or tools used in the constructing, equipping, reconstructing, maintaining, repairing, enlarging, furnishing or remodeling facilities for any such organization. When any such organization shall contract for the purpose of constructing, equipping, reconstructing, maintaining, repairing, enlarging, furnishing or remodeling facilities, it shall obtain from the state and furnish to the contractor an exemption certificate for the project involved, and the contractor may purchase materials for incorporation in such project. The contractor shall furnish the number of such certificate to all suppliers from whom such purchases are made, and such suppliers shall execute invoices covering the same bearing the number of such certificate. Upon completion of the project the contractor shall furnish to such organization concerned a sworn statement, on a form to*

be provided by the director of taxation, that all purchases so made were entitled to exemption under this subsection. All invoices shall be held by the contractor for a period of five years and shall be subject to audit by the director of taxation. If any materials purchased under such a certificate are found not to have been incorporated in the building or other project or not to have been returned for credit or the sales or compensating tax otherwise imposed upon such materials which will not be so incorporated in the building or other project reported and paid by such contractor to the director of taxation not later than the 20th day of the month following the close of the month in which it shall be determined that such materials will not be used for the purpose for which such certificate was issued, such organization concerned shall be liable for tax on all materials purchased for the project, and upon payment thereof it may recover the same from the contractor together with reasonable attorney fees. Any contractor or any agent, employee or subcontractor thereof, who shall use or otherwise dispose of any materials purchased under such a certificate for any purpose other than that for which such a certificate is issued without the payment of the sales or compensating tax otherwise imposed upon such materials, shall be guilty of a misdemeanor and, upon conviction therefor, shall be subject to the penalties provided for in subsection (g) of K.S.A. 79-3615, and amendments thereto. Sales tax paid on and after July 1, 1998, but prior to the effective date of this act upon the gross receipts received from any sale exempted by the amendatory provisions of this subsection shall be refunded. Each claim for a sales tax refund shall be verified and submitted to the director of taxation upon forms furnished by the director and shall be accompanied by any additional documentation required by the director. The director shall review each claim and shall refund that amount of sales tax paid as determined under the provisions of this subsection. All refunds shall be paid from the sales tax refund fund upon warrants of the director of accounts and reports pursuant to vouchers approved by the director or the director's designee;

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