

# Kentucky Sales Taxes & Nonprofit Organizations

BY: ERICA HORN



In 2018, the Kentucky General Assembly made significant changes to Kentucky's sales tax laws.<sup>1</sup> The Department of Revenue's application of some of the changes resulted in the proverbial "unintended consequences" for many of Kentucky's nonprofit organizations. An outcry from impacted organizations was met by promises of a remedy in the 2019 session. Legislators made good on those promises in 2019 House Bill 354, which was signed by the Governor and became law on March 26, 2019.<sup>2</sup>

The majority of the fallout from the 2018 legislation revolved around nonprofit organizations having to collect and remit sales tax on "admissions," including tickets to fundraising events. Additionally, a significant number of nonprofits were surprised to learn they should have been collecting and remitting sales tax on items sold at fundraising auctions if those items were otherwise subject to sales tax.

House Bill 354 exempts from sales tax nearly, if not all, admissions sold by nonprofit organizations. This article examines the application of Kentucky's sales taxes to nonprofit organizations prior to 2018, the Department of Revenue's actions regarding the 2018 legislative changes, and the 2019 changes made in House Bill 354, which ended the nightmare for nonprofits. As an introductory matter, however, the phrase "nonprofit organizations" should be defined.

### WHAT DO YOU MEAN BY "NONPROFIT ORGANIZATIONS?"

Generally, Kentucky's sales tax statutes address three types of organizations exempt from sales tax: (1) resident, educational, charitable, and religious organizations exempt from income tax pursuant to Section 501(c)(3) of the Internal Revenue Code ("501(c)(3)s"); (2) nonprofit civic, governmental, or other nonprofit organizations ("civic and other nonprofits");<sup>4</sup> and (3) public and private elementary and secondary schools ("elementary and secondary schools").<sup>5</sup> The 501(c)(3)s, governmental entities, and the elementary and secondary schools are, for the most part, readily identifiable. However, there is no statutory or regulatory definition for "nonprofit civic" and "other nonprofit organizations."

### THE STATUTES RELATED TO NONPROFIT ORGANIZATIONS

Purchases by nonprofit organizations generally are exempt from sales tax. This exemption extends to 501(c)(3)s and elementary and secondary schools, but not to civic and other nonprofit organizations.<sup>6</sup>

The statute applicable to 501(c)(3)s, KRS § 139.495, provides a purchase exemption for property and services used in connection with the mission of the organization, and states, "All other<sup>7</sup> sales made by [501(c)(3)s] are taxable and the tax may be passed on to the customer as provided in KRS 139.210."<sup>8</sup> (Footnote and emphasis added.) This declaration was altered slightly by KRS § 139.496, which, prior to 2019, provided an exclusion from sales tax for the first \$1,000.00 in sales for a fundraising event. KRS § 139.496 was also the *only* statute that expressly applied to civic and other nonprofit organizations.

Unlike 501(c)(3)s and civic and other nonprofit organizations, the sales tax treatment of public and private elementary and secondary schools is very broad. These entities, and groups affiliated with them, such as school-sponsored clubs and parent-teacher organizations, enjoy both the purchase exemption and a broad exemption from tax for sales of admissions to events, activities, and fundraisers. The sole caveat for schools is that the funds received be used in furtherance of their educational purposes.<sup>9</sup>

Overlaying this "nonprofit regimen of taxation" is sales taxation of "admissions".

### THE PRE-2018 STATUTORY AND ADMINISTRATIVE TREATMENT OF "ADMISSIONS"

Traditionally, sales tax has been applied to retail sales of tangible personal property and a few services. Prior to 2018, Kentucky imposed sales tax on retail sales of tangible personal and digital property; hotel and similar rooms; sewer and telephone services; distribution of natural gas; and "admissions."<sup>10</sup> There was no statutory definition of "admissions," but the term was defined by regulation – 103 KAR 28:010. Of particular interest are Sections 1 and 6 of the regulation. In pertinent part, those sections provide:

Section 1. Definition. "Admissions" means the right of entrance to a display, program, sporting event, music concert, performance, play, show, movie, exhibit, fair, or other entertainment event or amusement.

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Section 6. The admissions listed in this section shall not be subject to sales tax: ... (3) Admissions sold by nonprofit charitable and educational institutions qualifying for exemption under KRS 139.495 [501(c)(3)s]; ....

Section 1 provided a list, although not all-inclusive, of the types of admissions subject to sales tax. Section 6 appeared to provide an exemption for 501(c)(3)s, including most colleges and universities, from sales tax on admissions to their events and activities. The section was broad, exempting admissions to art museums, theatre performances, and other college and university activities, including athletic events.

Many of Kentucky's 501(c)(3)s were, either knowingly or unknowingly, following Section 6 of the regulation to exempt admissions. Upon closer examination, however, this section appears to have been in direct conflict with KRS § 139.495(8), which required 501(c)(3)s to collect tax on all sales, with the exception of the first \$1,000.00 in fundraising sales exempted by KRS § 139.496(1).

### THE 2018 REGULAR SESSION OF THE GENERAL ASSEMBLY

At the end of the 2018 Regular Session of the General Assembly ("2018 Session"), the Legislature passed House Bill 366. This bill contained sweeping changes to Kentucky's tax code, including changes to the sales tax statutes.<sup>11</sup> Governor Bevin vetoed

this legislation.<sup>12</sup> On the second to last legislative day of the 2018 Session, both chambers of the General Assembly overrode the Governor's veto.<sup>13</sup>

The next day, the final day of the 2018 Session, the General Assembly passed a second tax bill, House Bill 487, which included all the provisions of House Bill 366 and a few additional provisions.<sup>14</sup> The Governor did not veto House Bill 487, nor did he sign it. As a result, the bill became law.<sup>15</sup>

One of the 2018 legislative changes was moving the definition of "admission" from the regulation, 103 KAR 28:010, Section 1, to KRS § 139.010(1) and expanding that definition.<sup>16</sup> The expanded definition is as follows:

"Admissions" means the fees paid for: (a) The right of entrance to a display, program, sporting event, music concert, performance, play, show, movie, exhibit, fair, or other entertainment or amusement event or venue; and (b) The privilege of using facilities or participating in an event or activity, including but not limited to: 1. Bowling centers; 2. Skating rinks; 3. Health spas; 4. Swimming pools; 5. Tennis courts; 6. Weight training facilities; 7. Fitness and recreational sports centers; and 8. Golf courses, both public and private; regardless of whether the fee paid is per use or in any other form, including but not limited to an initiation fee, monthly fee, membership fee, or combination thereof.<sup>17</sup>

The addition to the statutes of this definition of "admission," in and of itself, would not have changed the treatment of admissions for 501(c)(3)s, whatever that treatment should have been, because of the express exemption from sales tax set forth in Section 6 of 103 KAR 28:010. However, the Department of Revenue soon advised that Section 6 was no longer lawful.<sup>18</sup>

### THE DEPARTMENT OF REVENUE'S APPLICATION OF THE DEFINITION OF "ADMISSION"

The Kentucky Alliance of YMCAs ("Alliance") was the first to recognize the potential problems with 2018 House Bill 366. With the 2018 Session waning, the chair of the Alliance sent a letter to the chairs and vice-chairs of the House and Senate Appropriation and Revenue Committees expressing concern about taxation of YMCA memberships, because the new law imposed sales tax on the privilege of using "fitness and recreational sports centers" as part of the definition of "admission."<sup>19</sup> The Alliance had no success with the Legislature, which should not have been problematic because the sale of the YMCA memberships would have been covered by Section 6 of the regulation. However, at a June 2, 2018 meeting between the author, leaders in the nonprofit sector, the Commissioner of the Department of Revenue, and the Executive Director of the Division of Sales and Excise Taxes, the Department advised that Section 6 was no longer good law and could not be followed.

According to the Department of Revenue, the legal authority for Section 6 was a 1970 decision by the Kentucky Court of Appeals<sup>20</sup>, then the state's highest court. The Department asserted the 1970 case had been overruled in March 2018 by the Kentucky Supreme Court in *Commonwealth v. Interstate Gas Supply, Inc.*<sup>21</sup> The Department articulated its position as follows:

Non-profit 501(c)(3) groups must collect sales tax on their charges for all categories of taxable admissions for periods beginning July 1, 2018, forward.

The Kentucky Supreme Court recently held that the Ky. Const. Section 170 exemption for charitable institutions applied only to property taxes and not to excise taxes (sales and use tax). The only sales tax exemptions for 501(c)(3) charitable, educational, and religious organizations are those explicitly listed in KRS Chapter 139. Except for the very narrow exemptions for horse racetracks, historical sites, county fairs, elementary and secondary schools, and non-profit 501(c)(3) school-sponsored clubs and organizations, all other entities engaged in sales of admissions must begin collecting tax on these sales.<sup>22</sup>



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A discussion of Kentucky Constitution Section 170, the two cases cited by the Department, and the merits of the Department's argument are beyond the scope of this article. Suffice it to say, repeal of Section 6 of 103 KAR 28:010 created a sea change for 501(c)(3)s. Football, basketball and other tickets to events at Kentucky's colleges and universities were now subject to sales tax, as well as tickets to the ballet, a theatre performance, or a philharmonic performance sponsored by a 501(c)(3). Also subject to sales tax were admissions or tickets to nonprofit fundraising events. Effective July 1, 2018, a \$100.00 ticket to a gala was \$106.00, and a \$10,000.00 sponsorship of the same gala, if the sponsorship came with tickets, was \$10,600.00.

Shortly after learning of the Department's position, local news outlets began reporting that the nonprofit community was reaching out to state legislators, and those legislators were promising to fix the "unintended consequences" flowing from the 2018 changes and the Department's application of those changes. The first bill addressing the situation was pre-filed by House Speaker David Osborne in July 2018.<sup>23</sup>

## RELIEF – 2019 HOUSE BILL 354

The members of the General Assembly that had promised relief for the nonprofits made good on that promise with the introduction and passage of House Bill 354.<sup>24</sup> In its final form, the bill exempts from sales tax: (1) sales of admissions by 501(c)(3)s and civic and other nonprofit organizations; and (2) fundraising event sales made by the same groups.<sup>25</sup> "Fundraising event sales" is defined to exclude "sales related to the operation of a retail business, including, but not limited to thrift stores, bookstores, surplus property auctions, recycle and reuse stores, or any ongoing operations in competition with for-profit retailers." The bill makes clear that sales of admissions by 501(c)(3)s to events and fundraisers and other fundraising sales are exempt from sales tax and extends those exemptions to civic and other nonprofit organizations. The previous \$1,000.00 exemption for fundraising sales was repealed.<sup>26</sup>

After the Governor signed House Bill 354 on Tuesday, March 26, 2019, Kentucky's non-profit sector joined in a collective sigh of -- thank goodness that's over. **BBB**

## ENDNOTES

1. 2018 Ky. Acts ch. 207 (House Bill 487).
2. The General Assembly adopted Free Conference Committee Report 1 on House Bill 354 on March 13, 2019. The legislation included an emergency clause making the relevant sections of the bill, sections 28 and 29, effective upon the Governor's signature or the bill otherwise becoming law. The bill was signed by the Governor on March 26, 2019 and may be accessed at <https://apps.legislature.ky.gov/record/19rs/hb354.html#actions>.
3. KRS § 139.495 (2017). All cites to the Kentucky Revised Statutes will be to the statutes in effect as of December 31, 2017, except when otherwise indicated.
4. KRS § 139.496(1)(b).
5. KRS § 139.497.
6. KRS § 139.495, KRS § 139.496, and KRS § 139.497.
7. KRS § 139.495(3)-(5) provides that certain sales by bookstores and school cafeterias are exempt from sales tax.
8. *Id.* at (8).
9. KRS § 139.497.
10. KRS § 139.200.

## ABOUT THE AUTHOR

**ERICA HORN, CPA, J.D.**, is an associate director of tax services with Dean Dorton Allen Ford. Horn has over 30 years of professional experience advising clients on business matters including issues related to state and local tax. Horn received her B.A. in business administration (*summa cum laude*) from Transylvania University in Lexington and was awarded her J.D. degree (*with high distinction*) from the University of Kentucky College of Law. She is a member of the American Bar Association, Section of Taxation, the Kentucky Bar Association, the American Institute and Kentucky Society of Certified Public Accounts, the Institute for Professionals in Taxation, and a graduate of the 2018 Class of Leadership Kentucky. Horn is a co-founder of GleanKY and has been recognized for her work in the community with a Doctor of Humane Letters (*Honoris Causa*) from Transylvania University. She is widely published and a frequent speaker on state and local taxation and other tax related issues.



11. 2018 Ky. Acts ch. 171.
12. The bill history for 2018 House Bill 366 may be accessed at <https://apps.legislature.ky.gov/record/18rs/hb366.html>.
13. *Id.*
14. The bill history for 2018 House Bill 487 may be accessed at <https://apps.legislature.ky.gov/record/18rs/hb487.html>.
15. *Id.* (2018 Ky. Acts ch. 207).
16. *Id.* at § 36, effective for transactions occurring on or after July 1, 2018. In addition to adding a statutory definition of "admission" and expanding that definition, the sales tax changes imposed, for the first time, sales tax on the following services: landscaping services; janitorial services; small animal veterinary services; pet care services; industrial laundry services, including but not limited to industrial uniform supply services, protective apparel supply services, and industrial mat and rug supply services; non-coin-operated laundry and dry cleaning services; linen supply services; indoor skin tanning services; non-medical diet and weight reducing services; limousine services, if a driver is provided; and extended warranty services. The most controversial of these new services subject to tax was small animal veterinary services. *Id.* at § 37(g)-(q).
17. *Id.*, codified as KRS § 139.010(1) (2018) (*emphasis added*).
18. Of note is that no changes were made in 2018 to the "nonprofit statutes," KRS § 139.495, KRS § 139.496(1), and KRS § 139.497.
19. April 11, 2018 letter from David Martorano, Chair of the Alliance, to Sen. Christian McDaniel, Sen. Stan Humphries, Rep. Steven Rudy, and Rep. Ken Fleming.
20. *Kennedy Book Store, Inc. v. Department of Revenue*, 450 S.W.2d 524 (Ky. 1970).
21. 554 S.W.3d 831 (Ky. 2018).
22. <https://taxanswers.ky.gov/Sales-and-Excise-Taxes/Pages/Facility-and-Event-Admission-Fees-FAQs.aspx>.
23. 2019 Bill Request 76, <https://apps.legislature.ky.gov/record/19rs/prefiled/BR76.htm>.
24. <https://apps.legislature.ky.gov/record/19rs/hb354.html>.
25. 2018 House Bill 354, Sections 28 and 29, available at <https://apps.legislature.ky.gov/record/19rs/hb354.html>. As in 2018, no changes were made in 2019 to KRS § 139.497, which governs purchases and sales by elementary and secondary schools.
26. 2018 House Bill 354, Section 30, available at <https://apps.legislature.ky.gov/record/19rs/hb354.html>.