

Sales Tax Exemption Would Cut Red Tape for Nonprofits

Under current law, charitable nonprofits in North Carolina pay sales and use tax on their purchases and can apply for semi-annual refunds of the taxes they pay. A system of sales tax exemption would save nonprofits time and reduce administrative burdens. S.346 would replace the nonprofit sales tax refund system with sales tax exemption for most 501(c)(3) nonprofits.

How does the current nonprofit sales tax refund system work?

- Under current law, 501(c)(3) nonprofits pay sales tax when they purchase goods and services in North Carolina. Generally, these nonprofits are eligible to apply to the N.C. Department of Revenue (DOR) for semi-annual refunds of the sales and use taxes they have paid.
- North Carolina is one of two states with a sales tax refund system for nonprofits (Utah is the other). In most other states, 501(c)(3) nonprofits receive sales tax exemption certificates and vendors do not charge them sales tax at the point of sale.

What are the problems with the current system?

- The refund process adds recordkeeping and reporting burdens for nonprofits. For some small nonprofits, the time and expense of tracking sales tax paid and applying for refunds exceeds the amount of sales tax they receive as refunds.
- The process also delays nonprofits' use of some of their revenue for six months – and occasionally longer – while refunds are being processed. This temporary, interest-free “loan” to the state creates cash flow issues for some nonprofits.
- The additional costs and cash flow issues associated with the sales tax refund process are particularly problematic at a time when three-fifths of North Carolina's nonprofits lack the resources to fully meet demands for their services. With sales tax exemption, charitable nonprofits would be able to provide more essential services to North Carolinians.
- The refund process is also inefficient for state and local governments. It requires DOR to process thousands of extra filings every year and creates additional costs for local governments when the jurisdiction of a refund application is different than the jurisdiction where an original sales tax transaction was sourced.

Are there ways to ensure that nonprofit sales tax exemption is only used for proper purposes related to nonprofits' missions?

- In other states with nonprofit sales tax exemption, attorneys and tax professionals report that there has been no abuse of exemption for personal use by nonprofit staff, board members, or contractors.
- Nonprofits typically have strong internal controls to ensure that nonprofit assets – including tax exemption – are only used for proper nonprofit purposes. Any misuse of tax exemption or other nonprofit assets can lead to negative findings on audits or other financial reviews.
- Legislators could also create statutory penalties for misuse of nonprofit sales tax exemption for purchases that are for the personal use of nonprofit employees, board members, or contractors.