



TAX FACTS

From the
State of Hawaii, Department of Taxation

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TAX ISSUES FOR HAWAII NONPROFIT ORGANIZATIONS

98-3

Due to the generous nature of the people of Hawaii, we have a multitude of groups that are organized as "not-for-profit" in nature. Tax Facts No. 95-1, "All About the Hawaii Use Tax" and Tax Facts No. 96-1, "General Excise vs. Sales Tax" also may be helpful when reading this issue of Tax Facts. The Department has also issued a Tax Advisory on the application of the general excise tax (GET) to tourist wedding activities of churches dated April 21, 1997, that contains specific information about the GET exemption for churches and, in particular, their tourist wedding activities. The following are some of the commonly asked questions regarding the taxation of tax-exempt organizations.

1. What is the difference between "nonprofit" and "tax-exempt" organizations?

For federal income tax purposes (federal Internal Revenue Code of 1986 — the "IRC"), tax-exempt status is accorded to certain kinds of organizations whether they be corporations, associations, trusts, or other entities. To achieve tax-exempt status, the organization must be organized and operated in a manner that conforms to the requirements set out in the IRC in addition to those prescribed under state law. Some organizations must also apply for determination of their exempt status with the Internal Revenue Service ("IRS"). The federal rules are complex and explained in IRS Publication 557, "Tax-Exempt Status for your Organization."

These "tax-exempt" organizations include those that are organized as not-for-profit, such as corporations organized under Hawaii nonprofit corporation laws. However, merely organizing as a nonprofit entity does not necessarily mean that the IRS will recognize it as tax-exempt. Again, the IRC imposes additional requirements to achieve tax-exempt status.

2. How do we qualify for tax-exempt treatment under Hawaii tax laws?

Hawaii imposes two taxes that are potentially applicable to organizations seeking tax-exempt status—the income tax and the GET.

The organization will be exempt from Hawaii *income* tax if the organization qualifies for exemption for federal income tax purposes under the IRC. If the organization is the type that must obtain a determination of exempt status from the IRS, then Hawaii will follow the determination of the IRS in this regard. No separate determination is required for Hawaii income tax purposes from the Hawaii Department of Taxation. Organizations organized and operated exclusively for religious, charitable, scientific, or educational purposes as described in IRC section 501(c)(3) are generally required to submit an application to the IRS to request recognition of exemption from federal income taxes. Certain organizations

are not required to obtain from the IRS a determination of their exempt status. These organizations are exempt from Hawaii income tax if they meet the requirements of the IRC section under which they claim to be exempt provided that Hawaii has adopted those IRC provisions. Hawaii has adopted the federal provisions of IRC section 501, except for IRC sections 501(c)(12), (15), and (16). IRC section 501(a) provides an exemption from federal income taxes to organizations described in IRC sections 501(c), 501(d), and 401(a). See IRS Publication 557 for procedures on how to apply for recognition of exempt status with the IRS.

3. We have been recognized as a tax-exempt organization by the IRS. When is our State income tax exemption effective?

The effective date for the exemption from Hawaii income taxes is the same as the effective date for federal purposes. You are not required to separately register or otherwise apply for recognition of exemption from the Hawaii Department of Taxation for *income* tax exemption purposes; however, as you will see in Question #6, you will need to do this for GET exemption purposes. As with the IRS, you must substantiate your organization's status as tax-exempt in the event that you are audited by the Hawaii Department of Taxation. If the organization is not required to file an application with the IRS, the effective date for Hawaii income tax will be the same date that the organization meets the requirements of the IRC section under which it is claiming to be exempt. In the event that the IRS revokes your exemption, Hawaii will treat the organization as taxable upon the effective date of that revocation.

4. We have been recognized as a tax-exempt organization by the IRS, what are my reporting requirements for Hawaii Income Tax purposes?

IRS publication 557 discusses the filing requirements and required disclosures of tax-exempt organizations for federal income tax purposes. If you are required to file Form 990-T with the IRS, you are required to file the corresponding Form

N-70NP and pay any tax due for Hawaii income tax purposes on this unrelated business income. Although you may be required to file a Form 990 or Form 990-EZ with the IRS, you are not required to file any corresponding information return for Hawaii income tax purposes. Private foundations, however, are required to file a copy of their federal filings with the Attorney General.

5. *The IRS has stated that we must file Form 990-T for "unrelated business income". What type of income is this and do we have to file a return with Hawaii?*

The IRS has issued guidelines regarding unrelated business income in IRS Publication 598, "Tax on Unrelated Business Income of Exempt Organizations". Hawaii follows the federal determination of unrelated business income for Hawaii *income* tax purposes. This refers to income from sales activity regularly carried on that is not in furtherance of an exempt purpose.

6. *If we are treated as tax-exempt for income tax purposes, does this mean we also are exempt from paying the GET?*

Not necessarily. The GET law provides that certain organizations created for purposes enumerated in sections 237-23(a)(3) through (6), of the Hawaii Revised Statutes (HRS), must apply for exemption from the payment of GET by filing Form G-6, Application for Exemption from the Payment of General Excise Taxes, with the Hawaii Department of Taxation. A one-time \$20 registration fee must be paid with Form G-6. If your organization already has paid the \$20 fee to obtain a general excise license number, you do not need to submit the \$20 registration fee — just fill in your GET license number on the Form G-6 in the box provided. See the Instructions for Form G-6 for a more detailed discussion of organizations which qualify to apply for a GET exemption.

7. *We filed Form G-6 and received a letter approving the GET exemption for our organization. If approved, when is the exemption effective?*

The law requires that the Form G-6 be filed within three (3) months of the commencement of business (with extensions of up to two (2) months for good cause). If the Form G-6 is filed within the required or extended period, the exemption shall apply to income earned from the date of commencement of business. If filed after this period, the exemption applies only to income received on or after the date the Form G-6 was filed. Once the exemption is allowed, no further application is necessary unless there is a material change in your objectives or operations.

8. *If granted the exemption, is all of the income we now receive exempt from the GET?*

It depends. Amounts received as dues, donations, or gifts are not included in gross income subject to the GET.

However, gross receipts derived from any activity the primary purpose of which is to produce income are subject to the GET even though used to fund the exempt purposes or activities of the organization. Consequently, gross income received from the conduct of any fundraising activity is subject to the GET. Other income may be exempt from the GET depending on the nature of the activity giving rise to the income in relation to the organization's stated exempt purpose (see Question #9).

9. *What types of activities are considered "fundraising activities"?*

In general, "fundraising activities" are activities conducted with the intention of generating income, and are outside of the organization's stated exempt purpose. The activity does not have to be profitable in order to be taxable, and can include gross receipts from a single event. (Do not confuse this with "unrelated business income" as defined for *income* tax purposes.)

Although casual sales are exempt from the GET, this exemption is not applicable to fundraisers. A fundraising activity would not be considered a "casual sale" since the activity is not a single occasional sale nor an incidental sale. It is an infrequent activity comprised of numerous sales or transactions, e.g., white elephant sales, fairs, bazaars, and the like. Furthermore, it does not matter that the items being sold were donated to the organization.

Example: An educational institution's stated purpose is "to educate students in an environment conducive to learning". The institution charges tuition to attend the institution and also sells learning materials. Occasionally, the institution has a fair or sells baked goods or other merchandise to raise funds for the institution to operate.

The gross income from the tuition and sale of learning materials is exempt from the GET since it is generated in the performance of the organization's stated exempt purpose. The gross income from the fair and other fundraising activities, although the income received from the activities is to be used in the fulfillment of the organization's stated purpose, is generated from activities outside the scope of the organization's stated purpose with the object of gain or economic benefit and is taxable for GET purposes.

10. *If we are registered with the State as tax-exempt under the GET law, does this mean we also are exempt from paying the GET visibly passed on by a vendor when we purchase items from the vendor?*

No. Because the GET is levied on the business receiving the income rather than on the customer, businesses still are subject to the GET on their sales to tax-exempt organizations. The business is not tax-exempt, even if the customer is. Therefore, tax-exempt organizations may have the GET visibly passed on to them when they buy goods and services. The

pass on of the GET is a matter of contract between the vendor and the tax-exempt customer.

11. Our organization rents out facilities it owns to other nonprofits, members, and the general public. Are these rents subject to the GET?

Yes. In general, when an organization leases or rents its facilities out to others, it is considered to be engaging in a business activity even if the rent may be just a cost recovery amount. Some organizations whose stated primary purpose is to provide facilities to the underprivileged or other exempt organizations may not be subject to the GET if they have been properly registered with the Department. See Question #6.

12. What type of income qualifies as donations and why aren't donations subject to the GET?

A donation is a gift which is voluntarily given without compensation or any expectation of return. Section 237-24(4), HRS, exempts "the value of all property of every kind and sort acquired by gift, bequest or devise". If a donor purchases a ticket for a dinner, concert, bowl of chili, or the like, the ticket sale is not a donation because something of value is being received for the donation. This remains true whether or not the donor has any intention of redeeming the ticket. Whether a receipt is a true donation depends on the circumstances of the activity involved, not on the name given to the transaction. For example, if an organization offers the use of its facilities in exchange for a "donation", the receipt will be treated as rental income subject to the GET.

13. We received payments for a benefit dinner. Why are we taxable on the gross amount and not just the amount designated as the cost of the dinner?

The rules for determining the amount of the contribution deductible for income tax purposes and the amount subject to the GET differ. For income tax purposes, federal rules permit under some circumstances the subtraction of the value of the goods or services provided by the charity from the total contribution to determine the deductible portion of the contribution. The GET, as a gross receipts tax, does not allow for such deductions to reduce the gross receipts subject to the GET even if a portion of the ticket price is considered a "donation".

14. We sell items and services which are donated to our organization. Are the amounts received from the sale of these donated items and services taxable for GET purposes?

Yes. The sale (including sales by auction) by a tax-exempt organization of donated items for fundraising purposes is an "activity the primary purpose of which is to produce income"; consequently, the gross proceeds derived from the activity is subject to the GET.

15. Does an activity have to be "profitable" in order for it to be subject to the GET?

No. See Questions #9 and #13.

16. We receive interest income from interest bearing checking and savings accounts. Are these amounts taxable for GET purposes?

The law provides that gross income subject to the GET includes, among other things, all receipts, actual or accrued by reason of the investment of the capital of the business engaged in, including interest. The contributions, donations, and dues received by the organization, as well as the income derived in conjunction with the organization's tax-exempt purpose and deposited in the bank, do not constitute "investment of the capital of a business in which engaged". A tax-exempt organization is not created for the purpose of making profits and, in theory, the interest received is deemed incidental to the primary purpose of depositing the monies in the bank for safekeeping, not for a business purpose, and consequently is not subject to the GET. However, interest earned from funds derived from an unrelated trade or business activity would be subject to the GET. See Question #5. (For a general discussion on the application of the GET to interest income, see Tax Information Release No. 42-74.)

17. If we are registered with the State as an exempt organization under the GET law, does this mean we also are exempt from paying the use tax?

No. Although section 237-23, HRS, exempts certain nonprofit organizations which have properly registered for exemption from the GET, the use tax law does not provide a corresponding exemption. The use tax levels the playing field for local merchants by requiring customers who acquire goods from out-of-state sellers to pay a tax on that purchase at the same rate that an in-state seller would have paid in GET if the sale had occurred in Hawaii. For more information on the use tax law, see Tax Facts No. 95-1, "All About the Hawaii Use Tax".

18. Where can we get additional information and assistance on how to start a nonprofit organization?

Act 120, Session Laws of Hawaii 1996, effective July 1, 1996, eliminated the requirement that charitable organizations register or file a statement of exemption with the Business Registration Division of the Department of Commerce and Consumer Affairs (DCCA) prior to soliciting funds in Hawaii. Act 120 did not eliminate the annual report requirements for foreign or domestic nonprofit corporations or any tax return filing requirements. For information on how to organize your nonprofit organization under Hawaii's Nonprofit Corporation Act (Chapter 415B, HRS), contact the Business Registration Division of the DCCA at (808)586-2727.

There also is a nonprofit organization which has an

assistance program to help individuals set up a nonprofit organization. Contact the Hawaii Community Services Council, Help for Nonprofits Program, 200 N. Vineyard

Boulevard, Suite 415, Honolulu, Hawaii 96817, or call them at (808) 521-3861.

STATE DISTRICT TAX OFFICE ADDRESSES & TELEPHONE NUMBERS

Website (Forms & Information)
<http://www.state.hi.us/tax/tax.html>

CD-ROM (Forms & Info)
Nominal Cost (Limited Supply)

Forms by Mail
808-587-7572
Toll-Free: 1-800-222-7572

Recorded Tax Updates
808-587-1234 and press 7700

Forms by FAX
Oahu 587-7572
Outside Oahu 808-678-9522 from
your fax machine

Telephone Devices for the Deaf (TDD)
Tax Service & Processing
808-587-1418
Toll-Free: 1-800-887-8974

Oahu District Tax Office
830 Punchbowl Street
P. O. Box 3559
Honolulu, HI 96811-3559

Maui District Tax Office
54 South High Street
P. O. Box 913
Wailuku, HI 96793-0913

Hawaii District Tax Office
75 Aupuni Street
P. O. Box 1377
Hilo, HI 96721-1377

Kauai District Tax Office
3060 Eiwa Street
P. O. Box 1688
Lihue, HI 96766-5688

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Toll-Free: 1-800-222-3229
Fax No.: 808-587-1488

Telephone No.: 808-984-8500
Fax No.: 808-984-8522

Telephone No.: 808-974-6321
Fax No.: 808-974-6300

Telephone No.: 808-274-3456
Fax No.: 808-274-3461

The following publications are available from the Department of Taxation:

"An Introduction to the General Excise Tax"
"An Introduction to the Use Tax"
"An Introduction to the Tax Clearance Procedure"
Tax Facts 95-1: *"All About the Hawaii Use Tax"*
Tax Facts 96-1: *"General Excise vs. Sales Tax"*
Tax Facts 96-3: *"Tax Clearances Now Needed by Businesses Entering into State & County Contracts"*
Tax Facts 97-3: *"Starting a Business - Licenses and Taxes"*
Tax Information Release No. 21-69, *"General Excise Tax and Real Property Tax Exemptions as Applicable to Preschools or Day-Care Centers Operated by Churches"*
Tax Information Release No. 42-74, *"Application of the General*

Excise Tax to Interest Income"
Tax Information Release No. 89-6, *"General Excise Tax on the Fundraising Activities of Public School Sponsored Groups"*
Tax Information Release No. 89-13, *Application for Exemption from the General Excise Taxes for Nonprofit Organizations"*
Tax Information Release No. 91-2, *"Taxability of Gross Proceeds Received by a Nonprofit Organization From the Sale of Donated Services or Tangible Personal Property"*
Tax Information Release No. 91-4, *"Hawaii Tax Obligations of Nonprofit Organizations"*

Some of the information contained in this Tax Facts was obtained from the Internal Revenue Service Publication 557, *"Tax Exempt Status for Your Organization"*

Tax Facts is a publication of the Department of Taxation on tax subjects of current interest and is not intended to be a complete statement of the law. Subsequent developments in the law (legislation, rules, cases, etc.) should be consulted.

FOR MORE INFORMATION CONTACT: TAXPAYER SERVICES (808) 587-4242