

STATE TAX ISSUES FOR TEXAS NONPROFIT ORGANIZATIONS

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I. INTRODUCTION

Although the terms “nonprofit” and “tax-exempt” often are used interchangeably, they are not synonymous. Under Texas law, a nonprofit corporation can be created for any lawful purpose not prohibited by the Business Organizations Code.¹ These purposes include:

- serving charitable, benevolent, religious, eleemosynary, patriotic, civic, missionary, educational, scientific, social, fraternal, athletic, aesthetic, agricultural, and horticultural purposes;
- operating or managing a professional, commercial, or trade association or labor union;
- providing animal husbandry; and
- operating on a nonprofit cooperative basis for the benefit of its members.²

Not all of the purposes for which a nonprofit corporation can be formed would qualify the organization for federal tax-exempt status, and a nonprofit corporation may be subject to certain state taxes, depending on its activities. This article examines the application of the Texas margin tax; sales and use tax; hotel occupancy tax; motor vehicle sales, rental, and use tax; and property tax to various types of nonprofit corporations and discusses how structuring decisions may improve tax efficiency.

II. TEXAS MARGIN TAX

Most Texas business entities (including nonprofit corporations) are subject to Texas margin tax unless an exception applies. Nonprofit corporations that have requested and been granted an exemption from the Comptroller do not have to file margin tax annual reports, including the Public Information Report or Ownership Information Report. However, if the entity has not requested or been granted an exemption, it must file all reports.³ Note that nonprofit periodic reports are required for organizations that are exempt from margin tax. The author has worked with a number of nonprofit corporations that obtained recognition of their federal (but not state) tax-exempt status and that had their corporate privileges revoked as a result of their

(unknowing) failure to file margin tax reports. When forming new entities, practitioners should make sure to file for state, as well as federal tax-exempt status. And, when undertaking a representation of a new tax-exempt client, a practitioner should check the Texas Comptroller’s and Secretary of State’s websites to make sure the organization has not undergone a tax forfeiture or had its corporate privileges forfeited for failure to file a nonprofit periodic report.

An entity that has been granted exemption from margin tax but that has unrelated business taxable income nevertheless is exempt from margin tax. It does not need to file a margin tax report based on unrelated business income.⁴

A. Margin Tax Exemption Based on Federal Exemption

Entities that are exempt from federal income tax under certain provisions of the Internal Revenue Code, including:

- §501(c)(3) (religious, charitable, scientific, literary, educational, amateur sports, prevention of cruelty to children or animals)
- §501(c)(4) (social welfare)
- §501(c)(5) (labor, agricultural, horticultural)
- §501(c)(6) (business leagues, chambers of commerce, boards of trade)
- §501(c)(7) (pleasure, recreation)
- §501(c)(10) (fraternal societies)⁵

are exempt from margin tax.

These organizations can obtain recognition of their exemption from margin tax based on their federal exempt status. To apply for margin tax exemption based on the federal exempt status, an organization must complete and submit Form AP-204, Texas Application for Exemption – Federal and All Others and must include a copy of its federal determination letter.⁶ The organization name on the determination letter must match the organization’s legal name as listed in the Articles of Incorporation, Certificate of

¹ Tex. Bus. Org. Code §22.051.

² Tex. Bus. Org. Code §2.002.

³ Texas Comptroller, Franchise Tax Frequently Asked Questions, Exemptions (*available at* <https://comptroller.texas.gov/taxes/franchise/faq/exemptions.php>).

⁴ *Id.*

⁵ Tex. Tax Code §171.063(a)(1).

⁶ Tex. Tax Code §171.063(c).

Formation or governing document. If the determination letter was issued more than four years ago, the organization must include a current verification letter obtained from the Internal Revenue Service.

If the Internal Revenue Service has not issued a corporation its determination letter, evidence establishing the corporation's provisional margin tax exemption is sufficient if the corporation timely files with the Comptroller evidence that it has applied in good faith for recognition of its federal exemption. The evidence must be filed not later than the 15th month after the last day that is (1) a calendar month; and (2) nearest to the date the corporation was formed.⁷ If the corporation's federal exempt status ultimately is denied, the corporation is not subject to any penalty from the date of its formation to the date of final denial.⁸

Whether a corporation obtains actual or provisional margin tax exemption, the exemption is effective as of the date the corporation was formed.⁹ If a corporation's federal exempt status is revoked, its margin tax exemption is withdrawn as of the effective date of the federal revocation. The effective date of the withdrawal is considered the corporation's beginning date for purposes of determining its privilege periods.¹⁰

i. LLCs Pose a Trap for the Unwary

Under federal tax law, a single-member LLC ordinarily is a disregarded and is treated as a division of its parent. This rule permits tax-exempt organizations to avail themselves of the state law liability protection that an LLC provides without having to obtain separate federal tax-exempt status for the LLC. However, it is important to recognize that the legal formation of an entity—not the entity's treatment for federal income tax purposes—determines filing responsibility for Texas margin tax. Each taxable entity that is organized in Texas or doing business is subject to margin tax (even if it is treated as a disregarded entity for federal income tax purposes) and is required to file margin tax reports.¹¹ Because the LLC does not have a federal determination letter issued to it, it will not be able to apply for margin tax exemption based on its federal tax-exempt status.

Depending on the nature of the activities that would be conducted by the LLC, it might make sense to

use a limited partnership (with a single-member LLC as the general partner) rather than an LLC. Assuming all the limited partner interests are owned by the tax-exempt parent, the limited partnership will be disregarded for purposes of federal income tax. Unlike LLCs, limited partnerships can qualify as "passive entities," which are exempt from margin tax, provided that:

- (a) the entity's federal gross income consists of at least 90 percent of passive income, including dividends, interest, distributive shares of partnership income, capital gains from the sale of real property, gains from the sale of commodities traded on a commodities exchange, gains from the sale of securities; and royalties, bonuses, or delay rental income from mineral properties and income from other nonoperating mineral interests; and
- (b) the entity does not receive more than 10 percent of its federal gross income from conducting an active trade or business.¹²

A limited partnership that qualifies as a passive entity is not liable for margin tax, but it must file an annual No Tax Due Report to affirm that it qualifies as passive for the period upon which the tax is based. A passive entity is not required to file an Ownership Information Report.¹³ If the limited partnership is not registered and is not required to register with the Secretary of State or Comptroller's office, it is not required to file a margin tax report.¹⁴

ii. Consider No-Tax Due Threshold and Margin Tax Rate When Making Structuring Decisions

When taking margin tax into account for purposes of making structuring decisions, it is important to consider the generous no-tax due threshold. Entities that have total revenue below this

⁷ Tex. Tax Code §171.063(d).

⁸ Tex. Tax Code §171.063(f).

⁹ Tex. Tax Code §171.063(e).

¹⁰ Tex. Tax Code §171.063(g).

¹¹ Texas Comptroller, Franchise Tax Frequently Asked Questions, Taxable Entities (available at <https://comptroller.texas.gov/taxes/franchise/faq/taxable-entities.php>).

¹² Tex. Tax Code §171.0003.

¹³ Texas Comptroller, Franchise Tax Frequently Asked Questions, Passive Entities (available at <https://comptroller.texas.gov/taxes/franchise/faq/passive-entities.php>).

¹⁴ *Id.*

threshold (currently \$1,130,000) are eligible to file No Tax Due Report. If the tax due is less than \$1,000 but annualized total revenue is greater than the no-tax due threshold amount, the entity must file a Franchise Tax Report or EZ Computation Report but does not owe any tax.¹⁵ Further, given that current margin tax rates are less than 1%, margin tax planning does not necessarily need to override business and practical considerations.

B. Margin Tax Exemption Based on Activities

As a practical matter, it is easier for a nonprofit corporation to obtain margin tax exemption based on its federal exempt status. The organization need only submit Form AP-204, Texas Application for Exemption – Federal and All Others and a copy of its federal determination letter. The Comptroller will grant a margin tax exemption with minimal review and inquiry. However, many organizations that enjoy federal exempt status do not have determination letters issued in their names. Some—like churches and their integrated auxiliaries, homeowners associations, disregarded entities, and very small (under \$5,000 gross receipts) organizations—are not required to apply for recognition of their federal exemption. Others are covered by group exemption letters under a central organization that has not gotten its group exemption established on the Comptroller’s records. Further, the tax exemption that is granted on the basis of federal exemption only applies to margin (and in applicable cases, sales) tax. It does not make the organization exempt from hotel occupancy tax even if the organization actually qualifies for exemption.

An organization that does not have a federal determination letter—or for which hotel occupancy tax would be a meaningful burden—and that qualifies to do so should file for margin tax exemption based on one of the separate statutory bases for exempt status. Because the statutory exemptions contain their own specific requirements above and beyond federal tax exemption, the applications require more information than is required with Form AP-204.

Note: the exemption statutes are written with reference to “a corporation.” Section 171.088 contains a savings provision that provides, “an entity that is not a corporation but that, because of its activities, would qualify for a specific exemption under this subchapter

if it were a corporation, qualifies for the exemption and is exempt from the tax in the same manner and under the same conditions as a corporation.

In order to apply for exemption on the basis of a separate statute, an organization must submit the required form (generally AP-204, unless noted below) and all required documentation as listed in the application. If the organization is unincorporated, it must include a copy of its governing document, such as the bylaws or constitution. The document must show that the organization is nonprofit. If the organization is incorporated, the Comptroller will review the corporation’s formation documents on file with the Texas Secretary of State to verify that the corporation’s purpose is consistent with the requirements of the specific statute. Non-Texas corporations must also include a copy of the corporation’s formation documents and a current Certificate of Existence issued by their state of incorporation.¹⁶

The following is a non-exhaustive list of the more common bases for exemption, with detail derived from Texas Comptroller Publication 99-122, “Guidelines to Texas Tax Exemptions”.

1. Agricultural Organizations

A nonprofit corporation organized to hold agricultural fairs and encourage agricultural pursuits is exempt from margin tax.¹⁷

2. Chambers of Commerce

A nonprofit chamber of commerce is exempt from margin tax if it represents at least one Texas city, county, or geographic area and promotes the general economic interest of all commercial enterprises in the area it represents.¹⁸ The exemption does not include organizations such as trade associations or business leagues that serve a single line or closely related lines of business within a single industry.

3. Charitable Organizations

A nonprofit charitable organization is exempt from margin tax if it devotes all or substantially all of its activities to the alleviation of poverty, disease, pain and suffering by providing food, drugs, medical treatment, shelter, clothing, or psychological

¹⁵ See generally, Texas Comptroller Franchise Tax Frequently Asked Questions, Reports and Payments (available at <https://comptroller.texas.gov/taxes/franchise/faq/reports-payments.php>).

¹⁶ See generally, Texas Comptroller, Publication 99-122, “Guidelines to Texas Tax Exemptions” (May 2018)

(available at <https://comptroller.texas.gov/taxes/publications/96-1045.php>).

¹⁷ Tex. Tax. §171.060.

¹⁸ Tex. Tax. §171.057.

counseling directly to indigent or similarly deserving individuals for little or no fee.

The organization's funds must be derived primarily from sources other than fees or charges for its services. Organizations with a broader range of activities will not qualify for exemption as charitable organizations.¹⁹

To apply for exemption a charitable organization, an organization must complete Form AP-205.

1. Conservation Organizations

Organizations organized solely to educate the public about the protection and conservation of fish, game, other wildlife, grasslands or forests are exempt from margin tax.²⁰

2. Convalescent Homes for the Elderly

A nonprofit organization organized to provide convalescent housing for persons who are at least 62 years old or who are handicapped or disabled is exempt from margin tax.²¹

3. Educational Organizations

A nonprofit educational organization is exempt from margin tax if it is devoted solely to systematic instruction (particularly in the commonly accepted arts, sciences and vocations) with a regularly scheduled curriculum, faculty and enrolled student body or students in attendance at a place where the educational activities regularly occur.

An organization with activities consisting solely of public discussion groups, forums, panels, lectures or other similar programs also will qualify if the presentations provide instruction in the commonly accepted arts, sciences and vocations.²²

Educational organizations apply for exemption using Form AP-207.

1. Homeowners' Associations

A homeowners' association that is a nonprofit corporation organized and operated primarily to obtain, manage, construct and maintain the property in or of a residential condominium or residential real estate development that is legally restricted for use as residences (the property cannot be used for any commercial activity) is exempt from margin tax if the

individual owners of the lots, residences or residential units have at least 51 percent voting control of the association.

A homeowners' association will not qualify for this exemption if voting control is held by a single individual, family or by one or more developers, declarants, banks, investors or similar parties.²³

Homeowners organizations apply for exemption using Form AP-206.

2. Religious Organizations

A nonprofit religious organization is exempt from margin tax if it is an organized group of people regularly meeting at a particular location with an established congregation for the primary purpose of holding, conducting and sponsoring religious worship services according to the rites of their sect.²⁴

Organizations that simply support and encourage religion as an incidental part of their overall purpose, or that further religious work or teach their membership religious understanding, will not qualify for exempt status under this category.

Religious organizations apply for exemption using Form AP-209.

1. Student Loan Funds and Scholarship Organizations

A organization organized solely to provide student loan funds or scholarships is exempt from margin tax.²⁵

2. Youth Athletic Organizations

A youth athletic organization is exempt from sales and franchise taxes. Qualifying organizations must be engaged exclusively in providing athletic competition among persons under 19 years of age.²⁶

III. TEXAS SALES AND USE TAX

A. In General

The Texas Sales and Use Tax (herein referred to as "sales tax") applies to sales of tangible personal property and to taxable services (collectively, "taxable items").²⁷ Sales tax is collected by the seller of the taxable item and remitted to the Texas Comptroller.²⁸

¹⁹ Tex. Tax §171.062.

²⁰ Tex. Tax §171.064.

²¹ Tex. Tax §171.067.

²² Tex. Tax §171.061.

²³ Tex. Tax §171.082.

²⁴ Tex. Tax §171.058.

²⁵ Tex. Tax §171.087.

²⁶ Tex. Tax. 171.057.

²⁷ Tex. Tax Code Ann. §151.051.

²⁸ Tex. Tax Code Ann. §151.052.

Certain entities are exempt from paying sales tax.²⁹ In particular, a nonprofit organization that applies for and obtains a determination letter or a group exemption ruling letter from the Internal Revenue Service that states that the organization qualifies for exemption from federal income tax under I.R.C. §501(c)(3), (4), (8), (10), or (19) may qualify for sales tax exemption.³⁰ In addition, as discussed in connection with the margin tax there are a number of separate statutory bases for exemption.

For the exemption to apply to a particular transaction, the item sold, leased, rented, stored, used, or consumed must relate to the purpose of the exempted organization and the item must not be used for the personal benefit of a private stockholder or individual.³¹

B. Obtaining Exempt Status

In order to obtain exemption from sales tax, an organization must apply for and obtain a letter of exemption from the Comptroller.³² In general, the same application for exemption from margin tax will result in exemption from sales tax, if available. Note that organizations that are exempt from margin tax on the basis that they are exempt from federal income tax under I.R.C. §501(c)(2), (5), (6), or (7) are not exempt from sales tax.

In its application, the organization must submit to the Comptroller a written statement that details the nature of the activities conducted or to be conducted as well as provide a copy of the bylaws, constitution and any applicable trust agreement.³³ If the organization is a corporation, it must include a copy of the articles of incorporation and any related amendments.³⁴ In addition, if the organization is claiming exemption on the basis that it has been recognized under I.R.C. §501(c)(3), (4), (8), (10), or (19), the organization must include a copy of all pages of a determination letter or a group exemption ruling letter from the Internal Revenue Service.³⁵

C. Purchases

The purchase, lease, or rental of a taxable item that relates to the purpose of the exempt organization is not subject to sales tax when the authorized agent of the organization pays for the item and provides the vendor with an exemption certificate.³⁶ When buying an item to be donated to an exempt organization, an individual can give the seller an exemption certificate in lieu of paying tax. If the individual uses the item before donating it, however, the exemption is lost and tax is due.³⁷

An employee of an exempt organization cannot claim an exemption when buying taxable items of a personal nature, even if the organization gives an allowance or reimbursement for such items. For example, meals, toiletries, clothing and laundry services are for personal use and are taxable. Anyone traveling on official business for an exempt organization must pay sales tax on taxable purchases such as parking, whether reimbursed per diem or for actual expenses incurred. A sales tax exemption does not include taxes on the purchase, rental or use of motor vehicles.³⁸

D. Sales

One area of frequent confusion concerns sales by exempt organizations.³⁹ Specifically, many exempt organizations mistakenly assume that because *purchases* by the organization are exempt from Texas Sales Tax, *sales* by the organization also are exempt.⁴⁰ In fact, an exempt organization that sells taxable items generally is required to obtain a sales tax permit and is responsible for collection and remittance of tax on all sales of taxable items that the organization makes, unless those sales are otherwise exempt from the Texas Sales Tax.⁴¹

1. Sales that are “Otherwise Exempt”

There are several limited exceptions to the rules regarding sales of taxable items by exempt organizations. Also, a number of items commonly sold

²⁹ For a complete list of exempt organizations, see 34 TAC §§3.322(b) and (c).

³⁰ 34 TAC §3.322(b)(5).

³¹ Tex. Tax Code Ann. §151.310(a)(2).

³² 34 TAC §3.322(e)(1).

³³ *Id.*

³⁴ *Id.*

³⁵ 34 TAC §3.322(e)(1)(B).

³⁶ 34 TAC §3.322(g)(1).

³⁷ Texas Comptroller, Publication 196-122 “Exempt Organizations: Sales and Purchases” (November 2012),

available at http://www.window.state.tx.us/taxinfo/taxpubs/tx96_122.pdf.

³⁸ *Id.*

³⁹ See, e.g., *T-Shirt Sales – Go Directly to Jail (and Other Consequences of Selling Things): What Nonprofits Need to Know about Texas Sales Tax Collection*, LEGAL MINUTE, Summer 2007 (available at http://www.texasbar.org/content/legal_library/pubs/downloads/Legal%20Minute08_07.pdf).

⁴⁰ *Id.*

⁴¹ 34 TAC §3.322(h)(1).

for fundraisers by exempt organizations are not taxable items.

a. Meals and Food Products Sales of prepared food, candy, and soft drinks are exempt if:

- Sold by a church or at a function of a church.⁴²
- Sold by a public or private elementary or secondary school, school district, bona fide student organization, booster club or other school support organization⁴³, or parent-teacher association if the items are sold or served during a regular school day pursuant to an agreement with the proper school authorities. This exemption includes food, soft drinks, snack items, and candy sold through vending machines.⁴⁴
- Sold by a parent-teacher organization during a fund-raising sale if the proceeds do not go to benefit an individual.⁴⁵
- Sold by a group associated with a private or public elementary or secondary school if the sale is part of a fund-raising drive sponsored by the organization for its exclusive use.⁴⁶
- Sold during an event sponsored or sanctioned by an elementary or secondary school or school district at a concession stand operated by a booster club or other school support organization formed to

support the school or school district, but only if the proceeds from the sale benefit the school or school district.⁴⁷

- Sold by a member or volunteer for a nonprofit organization devoted to the exclusive purpose of education or religious or physical training of persons under 19 years of age if the sale is part of a fund-raising drive sponsored by the organization for its exclusive use.⁴⁸
- Sold by a hospital, day care center, summer camp, or other institution licensed by the state for the care of humans if sold or served to the patients, children, students or residents of the facility. Sales to visitors or employees are taxable.⁴⁹
- Sold by a retirement facility if the sale is to its permanent residents.⁵⁰

b. Bake Sales

Sales tax is not due on sales of bakery items (e.g., bread, rolls, buns, biscuits, bagels, croissants, pastries, doughnuts, Danishes, cakes, pies, tarts, muffins, cookies, large pretzels, tortillas, etc.) as long as the items are sold without plates or eating utensils.⁵¹

c. Nontaxable Food Items

Sales tax is not due on sales of nontaxable food items. Examples of such items commonly sold through fundraisers include cookie dough, pizza kits, cheese spreads, meat sticks, jelly, salsa, fresh fruit, and mixes packaged for preparation at home.⁵²

d. Magazine Subscriptions

Texas sales tax is not due on sales of subscriptions to magazines entered as periodicals-class

⁴² 34 TAC §3.293(g)(1).

⁴³ 83(R) H.B. 697 (2013) amended Tex. Tax §151.314(d) to treat booster clubs and other school support organizations in the same manner as parent-teacher associations and other similar entities that are in place only to help students at the school.

⁴⁴ 34TAC §3.293(g)(2).

⁴⁵ 34 TAC §3.293(g)(3).

⁴⁶ 34 TAC §3.293(g)(4).

⁴⁷ Tex. Tax §151.314(d)(5), added by 83(R) H.B. 697 (2013).

⁴⁸ 34 TAC §3.293(g)(5).

⁴⁹ 34 TAC §3.293(g)(6).

⁵⁰ Tex. Tax Code Ann. §151.314(d)(1)

⁵¹ 34 TAC §§3.293(c)(7)(A), 3.293(c)(8).

⁵² See "School Fundraisers and Texas Sales Tax," Sales and Use Tax Bulletin (July 2009) at p.4 available at www.window.state.tx.us/taxinfo/taxpubs/tx94_183.pdf.

(formerly called “second-class”) mail and sold for six months or more.⁵³ Sales tax is due on single issues and subscriptions for fewer than six months.⁵⁴

e. Gift Certificates and Passbooks

Sales tax is not due on sales of intangibles such as gift certificates and coupon passbooks.⁵⁵ Retailers collect sales tax when certificates or coupons are redeemed for purchases of taxable items.⁵⁶

f. Car Washes

Washing a car is not a taxable service, so Texas sales tax is not due on sales of car washes.⁵⁷

2. Annual Banquets

All volunteer, nonprofit organizations can hold one tax-free banquet or other food sale per calendar year if all food is prepared, served and sold by members of the organization. The sale, however, cannot be professionally catered, held in a restaurant, hotel or similar place of business and cannot directly compete with a retailer required to collect tax. This exemption does not apply to the sale of alcoholic beverages.⁵⁸

3. Auctions, Rummage Sales and Other Fund-Raisers

An exemption is provided for religious, educational, charitable, eleemosynary organizations as well as organizations exempt under I.R.C. §501(c)(3), (4), (8), (10), or (19).⁵⁹ Specifically, these organizations (and each bona fide chapter of such an organization) may have two one-day (twenty four hours) tax-free sales or auctions each calendar year.⁶⁰ During a tax-free sale or auction lasting only one day, the organization is not required to collect sales tax on the sales price of taxable items sold for \$5,000 or less.⁶¹ If the item is manufactured by the organization or donated to the organization (and not sold to the donor),

the organization may sell the item during a one-day tax-free sale or auction regardless of price.⁶²

The designated one-day, tax-free sale day is either the day the vendor delivers the items to the exempt organization or the day the organization delivers the items to its customers. Persons buying from surplus inventory on the designated date do not owe tax. For example, a church group selling cookbooks may accept pre-orders without collecting tax if the day the cookbooks will be delivered to customers is designated as one of the group’s tax-free fundraisers. Surplus cookbooks sold during the same day also qualify for the exemption. Surplus cookbooks sold on other days are taxable unless sold at the group’s other tax-free fundraiser.⁶³

Organizations that hold a joint one-day tax-free sale or auction are each considered to have held one tax-free sale or auction during the calendar year; however, each such organization may hold one additional tax-free sale or auction during that calendar year.⁶⁴

If an exempt organization is purchasing taxable items for resale during its designated tax-free sale days, and it holds a sales tax permit, the organization may either give the retailer a resale certificate, Form 01-339 (front), or an exemption certificate, Form 01-339 (back), to purchase the items tax-free. A non-permitted exempt organization, however, may purchase items for resale tax-free by issuing an exemption certificate to the vendor for items sold during its two one-day, tax-free sales.⁶⁵

4. Higher Education Student Organizations

College or university student organizations affiliated with an institution of higher education can hold a one-day, tax-free sale each month. The organization must have a primary purpose other than engaging in business or performing an activity designed to make a profit, and the purpose of the sale must be to raise funds for the organization. This exemption does

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.* The tax is based on the item’s actual retail selling price, less any cash discount given at the time of sale (e.g., a deduction for a coupon).

⁵⁷ *Id.*

⁵⁸ The annual banquet exception is not codified in any statute or rule. It is a matter of administrative practice and frequently is cited in Comptroller publications. *See, e.g.*, Texas Comptroller, Publication 196-122 “Exempt Organizations: Sales and Purchases”, *supra* note 37; Comptroller’s Letter 8812L0922G06; <http://fundraisetaxlaw.org/tx.html>.

⁵⁹ Tex. Tax Code Ann. §151.310.

⁶⁰ Tex. Tax Code Ann. §151.310(c).

⁶¹ *Id.*

⁶² *Id.*

⁶³ Texas Comptroller, Publication 196-122 “Exempt Organizations: Sales and Purchases” (November 2012), *supra* note 37.

⁶⁴ Tex. Tax Code Ann. §151.310(d).

⁶⁵ Texas Comptroller, Publication 196-122 “Exempt Organizations: Sales and Purchases” (November 2012), *supra* note 37.

not apply to items sold for more than \$5,000, unless the item is manufactured by the organization or the item is donated to the organization and not sold back to the donor.⁶⁶

5. Amusement Services

Sales tax is not due on sales of amusement services by a nonprofit corporation (other than an I.R.C. §501(c)(7) organization) if the proceeds do not go to the benefit of an individual, except as a part of the services of a purely public charity.⁶⁷

Amusement services include live or recorded performances,⁶⁸ circuses,⁶⁹ ice skating shows,⁷⁰ motion pictures,⁷¹ musical concerts,⁷² exhibitions or displays,⁷³ antique shows,⁷⁴ arts and crafts shows,⁷⁵ auto shows,⁷⁶ zoos,⁷⁷ rodeos,⁷⁸ wrestling,⁷⁹ boxing,⁸⁰ bowling games,⁸¹ golf driving ranges,⁸² health clubs (admissions and memberships),⁸³ chartered boat excursions,⁸⁴ pool games,⁸⁵ swimming pools,⁸⁶ rides for pleasure,⁸⁷ and parties that radio stations, etc. sponsor (ticket price includes meal, set-ups, entertainment, and party favors).⁸⁸

For an event to qualify for exemption, the organization must distinguish itself as the sole provider in advertising (for example, billboards, radio, television and other media promoting the event), as well as on the face of the physical tickets. Tickets should reflect that the exempt organization is the provider, and that the event is exempt from Texas sales and use tax. A nonprofit organization is allowed to hire a for-profit entity to supply expertise required to produce an event as long as the for-profit entity is not also considered a provider of the amusement service.⁸⁹

IV. TEXAS HOTEL OCCUPANCY TAX

A. Organizations Exempt from Tax

Charitable, educational, and religious organizations that have received an exemption letter from the Texas Comptroller may claim exemption from the 6 percent state hotel occupancy tax.⁹⁰ Local taxes must be paid.

As stated above in connection with margin tax, in order for an organization to be exempt from hotel occupancy tax, it must obtain its exemption on the basis of a specific Texas statute, not on the basis of its federal exempt status.⁹¹ In simple terms, restated here,

For purposes of hotel tax exemption:

- Religious organizations are nonprofit churches and their guiding or governing bodies. Missionary organizations, Bible study groups or churches that are made up of only family members do not qualify.
- Charitable organizations are nonprofit organizations that devote all or substantially all of their activities to providing food, clothing, medicine, medical treatment, shelter or psychological counseling directly to indigent and similar individuals for little or no charge. Not included are fraternal organizations and social, professional and business groups.
- Educational organizations include independent school districts, public or nonprofit private elementary and secondary schools, and Texas institutions of higher education.⁹² A public or private institution of higher education is organized and operated

⁶⁶ *Id.*

⁶⁷ Tex. Tax Code Ann. §151.3101(3).

⁶⁸ 34 TAC §3.298(a)(1)(A).

⁶⁹ 34 TAC §3.298(a)(1)(A)(ii).

⁷⁰ 34 TAC §3.298(a)(1)(A)(iii).

⁷¹ 34 TAC §3.298(a)(1)(A)(iv).

⁷² 34 TAC §3.298(a)(1)(A)(v).

⁷³ 34 §3.298(a)(1)(B)(2009).

⁷⁴ 34 TAC §3.298(a)(1)(B)(ii).

⁷⁵ 34 TAC §3.298(a)(1)(B)(iv).

⁷⁶ 34 TAC §3.298(a)(1)(B)(v).

⁷⁷ 34 TAC §3.298(a)(1)(B)(vii).

⁷⁸ 34 TAC §3.298(a)(1)(C)(v).

⁷⁹ 34 TAC §3.298(a)(1)(C)(vii).

⁸⁰ *Id.*

⁸¹ 34 TAC §3.298(a)(1)(D)(ii).

⁸² 34 TAC §3.298(a)(1)(D)(vii).

⁸³ 34 TAC §3.298(a)(1)(D)(viii).

⁸⁴ 34 TAC §3.298(a)(1)(D)(x).

⁸⁵ 34 TAC §3.298(a)(1)(D)(xi).

⁸⁶ 34 TAC §3.298(a)(1)(D)(xiv).

⁸⁷ 34 TAC §3.298(a)(1)(E)(iv).

⁸⁸ 34 §3.298(a)(1)(E)(iii).

⁸⁹ Texas Comptroller, Publication 196-122 “Exempt Organizations: Sales and Purchases” (November 2012), *supra* note 37.

⁹⁰ Tex. Tax. §156.102.

⁹¹ See 34 TAC §3.161(a) for definitions of the various exemption categories.

⁹² Texas Comptroller 200311950L (11/01/2003).

exclusively for an educational purpose only if it is defined as a Texas institution of higher education or as a Texas private or independent institution of higher education under any subdivision of Section 61.003 of the Texas Education Code.⁹³

Texas does not recognize exemption for hotel occupancy tax on the basis of federal exemption.

B. When The Exemption Applies

Religious, charitable, and educational organizations and their employees, including college and university personnel, traveling on official business of the organization are exempt from payment of hotel occupancy tax.⁹⁴

C. Claiming The Exemption

If the exemption applies, the organization or individual claiming the exemption must present an exemption certificate to the hotel.⁹⁵ The individual also must provide:

- a letter of hotel occupancy tax exemption issued by the Comptroller; or
 - verification that the organization is on the Comptroller's list of entities that have been provided a letter of exemption (such as a printed copy of the Comptroller's website listing the organization as exempt for hotel tax).⁹⁶
- Caution:** The manner of payment by an *employee* of an exempt organization does not affect the exemption. To claim an exemption, a *nonemployee* traveling on behalf of an exempt organization must pay the hotel directly with the organization's funds, by organization check, organization credit card, or direct billing to the organization by the hotel.⁹⁷

⁹³ Tex. Tax. §156.102(b)(2).

⁹⁴ 34 TAC §3.161(b)(1).

⁹⁵ 34 TAC §3.161(b)(5).

⁹⁶ 34 TAC §3.161(c)(2)(D).

⁹⁷ 34 TAC §3.161(c)(2)(F).

⁹⁸ Texas Comptroller, Publication 196-122 "Exempt Organizations: Sales and Purchases" (November 2012), *supra* note 37.

V. MOTOR VEHICLE SALES, RENTAL, AND USE TAX

- Like hotel occupancy tax exemptions, motor vehicle sales, rental, and use tax ("motor vehicle tax") exemptions are extremely limited. The exemption for motor vehicle tax is available at the time of purchase on the Application for Certificate of Title. The exemption is available at the time of rental by including a Motor Vehicle Rental Exemption Certificate with the rental contract. The certificate must be signed by an authorized representative of the group or organization that is renting the vehicle.⁹⁸

A. Sales, Leases, and Use of Motor Vehicles

1. Motor Vehicles Driven By or Used to Transport Orthopedically Disabled Persons

Motor vehicle tax is not imposed on the sale or use of a motor vehicle that (1) has been or will be modified before the second anniversary of the date of purchase for operations by, or for the transportation of, an orthopedically disabled person; and (2) is driven (primarily) by or used (primarily) for the transportation of an orthopedically disabled person.⁹⁹ A vehicle is considered to meet the use requirement if it is driven by, or used for the transportation of, an orthopedically disabled person at least 80% of its operating time.¹⁰⁰

A corporation or association may purchase a vehicle under this exemption if the requirements of the statute and rule are met.¹⁰¹

2. Fire Departments/EMS Providers

Motor vehicle sales tax does not apply to the purchase, rental, or use of a fire truck, emergency medical services vehicle, or other motor vehicles used exclusively for fire-fighting purposes or emergency medical services when purchased by (1) a volunteer fire department, (2) a nonprofit emergency medical service provider that is exempt under I.R.C. §501(c)(3), or (3) an emergency medical service provider to which Section 502.204 of the Texas Transportation Code applies.¹⁰²

⁹⁹ Tex. Tax. §152.086. Regulations under this section include "primarily".

¹⁰⁰ 34 TAC §3.84(a)(5).

¹⁰¹ 34 TAC §3.84(c).

¹⁰² Tex. Tax. §152.087.

3. Motor Vehicles Used for Religious Purposes

Motor vehicle sales tax is not due on sale, rental, or use of a motor vehicle that (1) is designed to carry more than six passengers, (2) is sold to or used by a church or religious society, and (3) that is used primarily for the purpose of providing transportation to or from religious services or meetings.¹⁰³ A vehicle is “primarily” used for permitted purposes if it is used at least 80% of the time for such purposes.¹⁰⁴

The term “church or religious society” refers to a regularly organized group of people associating for the sole purpose of holding, conducting, and sponsoring, according to the rites of the sect, religious worship. An organization supporting and encouraging religion as an incidental purpose, or an organization with the general purpose of furthering religious work or instilling its membership with a religious understanding is not sufficient to qualify as a church or religious society.¹⁰⁵

The exemption does not apply to a vehicle registered as a passenger vehicle, the primary use of which is for the personal or official needs or duties of a minister.

4. Motor Vehicles Used By Licensed Child Care Facilities

Motor vehicle tax does not apply to the sale of a motor vehicle that is (1) purchased, used, or rented by a qualified residential child-care facility; and (2) intended for use primarily in transporting the children residing in the facility under a state license.¹⁰⁶ The facility must provide 24-hour residential care in a single residential group.¹⁰⁷

B. Gifts of Motor Vehicles

Ordinarily, motor vehicle tax is imposed on the receipt of a gift of a motor vehicle.¹⁰⁸ The transfer of a motor vehicle for no consideration results in the imposition of tax based—essentially—on the vehicle’s standard presumptive value. However, a vehicle that is donated to or given by an I.R.C. §501(c)(3) organization is subject only to a \$10 gift tax.¹⁰⁹

By rule, the \$10 gift tax is imposed on the recipient of an interest in a motor vehicle from or to a nonprofit organization that:

- Obtains a determination letter or group exemption ruling letter from the Internal Revenue Service that states that the organization is exempt from tax under I.R.C §501(c)(3); and
- Uses the motor vehicle exclusively for the purposes for which the organization was established.¹¹⁰

Note that the statute defines “gift” (in relevant part) only to the gratuitous transfers of a motor vehicle to a qualifying nonprofit organization. The regulations expand the definition to include a gratuitous transfer from a nonprofit organization, for the purposes of the organization.

To document a gift, both the donor and the recipient must complete a joint notarized Affidavit of Motor Vehicle Gift Transfer (Form 14-317) describing the transaction and the relationship between the parties. The affidavit should be provided to the county tax assessor-collector, along with the Application for Certificate of Title.¹¹¹

C. Motor Vehicles as Prizes

An interest in a motor vehicle that is transferred to the winner of a contest or drawing, regardless of how the contest or drawing is held, is subject to motor vehicle tax.¹¹² However, the way that the transaction is structured can dramatically affect the tax liability.

1. Contest Sponsor Pays Consideration for Vehicle

If the vehicle is purchased by the contest sponsor and transferred directly from the seller of the vehicle to the contest winner, it is subject to tax based on the total consideration paid for the vehicle. The tax is the liability of the contest sponsor and is due or payable before the vehicle can be titled or registered.¹¹³

¹⁰³ Tex. Tax. §152.088; 34 TAC §3.82.

¹⁰⁴ 34 TAC §3.82(c).

¹⁰⁵ 34 TAC §3.82(b).

¹⁰⁶ Tex. Tax §152.093.

¹⁰⁷ Texas Comptroller, Publication 196-122 “Exempt Organizations: Sales and Purchases” (November 2012), *supra* note 37.

¹⁰⁸ Tex. Tax. §152.025.

¹⁰⁹ Tex. Tax §152.025; 34 TAC §3.80(b).

¹¹⁰ 34 TAC §3.80(b)(4).

¹¹¹ 34 TAC §3.80(f); Texas Comptroller, Publication 196-122 “Exempt Organizations: Sales and Purchases” (November 2012), *supra* note 37.

¹¹² 34 TAC §3.80(e).

¹¹³ 34 TAC §3.80(e)(1).

If the vehicle is transferred directly from the seller to the contest sponsor for consideration, and the sponsor subsequently transfers the vehicle to the contest winner, the sponsor owes tax on the total consideration paid to the seller, and the winner owes tax on the total presumptive value (unless the transfer qualifies as a gift).¹¹⁴

*Note, pursuant to the Charitable Raffle Enabling Act, the value of a prize offered or awarded at a raffle that is purchased by an organization or for which the organization provides any consideration may not exceed \$50,000.*¹¹⁵

2. Contest Sponsor Does Not Pay Consideration for Vehicle

If the vehicle is transferred directly from the owner of the vehicle to a contest sponsor that qualifies as a nonprofit corporation pursuant to Rule 3.380(b)(4) for no consideration, and the sponsor subsequently transfers the vehicle to the contest winner, the sponsor and the winner both owe the \$10 gift tax.¹¹⁶

VI. TEXAS PROPERTY TAX

A. In General

Unlike margin tax and sales tax exemption applications, property tax exemption applications are filed with the local appraisal district, not with the Comptroller.¹¹⁷ The general deadline for filing an exemption application is before May 1.¹¹⁸ Charitable organizations improving property for low-income housing and community housing development associations must file the application for exemption within 30 days of acquiring the property.¹¹⁹ If a property owner fails to file a required application on time, the owner usually forfeits the right to the exemption unless late application provisions exist.¹²⁰

Some exemptions require the property owner to file an application only one time (although most of these allow the chief appraiser to request a new application to verify that the exemption requirements continue to be met), and others require the owner to file an application annually.

The various exemptions that might be available to nonprofit corporations are set forth in the Texas Property Code and are summarized in the Comptroller's Publication, "Texas Property Tax Exemptions: Complete and Partial Property Tax Code Exemptions Available to Property Owners Who Qualify" (February 2018).¹²¹ They also have been summarized in other State Bar articles.¹²²

B. A Caution, and a Potential Planning Technique

Practitioners are cautioned that—the number of different exemption provisions notwithstanding—many of the exemptions are more narrowly-tailored than their titles suggest, and an organization that is squarely within the requirements of I.R.C. §501(c)(3) or sales and margin tax exemption nevertheless might not qualify for property tax exemption. In particular, when considering whether to restructure a nonprofit enterprise for liability protection or other purposes, a practitioner should carefully consider whether a post-restructuring entity that owns property will qualify for property tax exemption. In particular, the practice of separating ownership of property from "risky" operations may result in loss of property tax exemption for the non-operating entity.

In terms of structuring options, the author has had success obtaining property tax exemption for property owned by a single-member LLC that is disregarded as an entity separate from its parent for federal income tax purposes where the parent qualifies as a charitable organization under Tex. Tax §11.18.

The support for this position is found in Texas Attorney General in Opinion No. GA-1092. In particular, the charitable tax exemption under Tex. Tax §11.18 stems from article VIII, section 2 of the Texas Constitution, which provides that "the legislature, may, by general laws, exempt from taxation...institutions engaged primarily in charitable functions." The Texas legislature enacted Tex. Tax §11.18 in implementation of this constitutional provision.¹²³

¹¹⁴ 34 TAC §3.80(e)(2).

¹¹⁵ Tex. Occ. §2002.056(b).

¹¹⁶ 34 TAC §3.80(e)(3).

¹¹⁷ Tex. Tax §11.45.

¹¹⁸ Tex. Tax §11.43(d).

¹¹⁹ Tex. Tax §11.436.

¹²⁰ Tex. Tax §§ 11.43(d), 11.431, 11.433, 11.435, 11.438, 11.439, and 11.4391.

¹²¹ Available at <https://comptroller.texas.gov/taxes/property-tax/docs/96-1740.pdf>.

¹²² See, e.g., John Brusniak, Jr., "Qualifying Your Client's Property for Property Tax Exemption in Texas," State Bar of Texas 11th Annual Governance of Nonprofit Organizations, August 22-23, 2013 (Chapter 14).

¹²³ See Tex. Tax §11.18; see also *N. Alamo Water Supply Corp. v. Willacy Cnty. Appraisal Dist.*, 804 S.W.2d 894, 895

Both Tex. Tax §11.18 and article VIII, section 2 allow tax exemption only for property that a charitable organization owns and uses. On multiple occasions, the Texas Supreme Court has held that an equitable ownership interest (rather than a legal ownership interest) is sufficient to support an entity's claim of property ownership for purposes of a tax exemption under Tex. Tax §11.182.¹²⁴ Texas courts of appeals also have recognized the sufficiency of equitable ownership in the context of a tax exemption for public property under Tex. Tax. §11.11.¹²⁵

Like Tex. Tax §11.18, Tex. Tax §11.182 and Tex. Tax §11.11 were adopted under article VIII, section 2.¹²⁶ Because Tex. Tax §11.18 was adopted under the same constitutional provision under which Tex. Tax §11.182 and Tex. Tax §11.11 were adopted, it should be interpreted to include equitable ownership on the same basis that the other two provisions are. Further, in *Comerica Acceptance Corp. v. Dallas Cent. Appraisal Dist.*,¹²⁷ the court noted that the Tax Code does not define “owner” and used a definition of “owner” that incorporated equitable title. Based on this authority, the Texas Attorney General has concluded that “it is likely that a court would determine the principles of equitable ownership are applicable to an entity seeking a charitable tax exemption under [Tex. Tax §]11.18.”

Equitable title is “the present right to [compel] legal title.”¹²⁸ Equitable title “is a current ‘right in the party to whom it belongs to have legal title transferred to him.’”¹²⁹ If an organization that qualifies as a charitable organization under Tex. Tax §11.18 is the sole member and manager of an property-holding LLC—such that it can cause a dissolution of the LLC such that all assets are transferred to it—it holds equitable title to the property of the LLC. Because, according to the Texas Attorney General, “it is likely that a court would determine that the principles of

equitable ownership are applicable to an entity seeking a charitable tax exemption under [Tex. Tax §]11.18,” the property should be exempt from property tax.

VII. CONCLUSION

By understanding the various state tax regimes to which their clients might be subject—and the exemption requirements for each—practitioners can ensure that their clients comply with applicable law and can make recommendations about how transactions or entities can be structured to improve tax efficiency.

(Tex. 1991) (noting that Tex. Tax §11.18 was enacted under article VIII, section 2).

¹²⁴ See e.g., *Galveston Cent. Appraisal Dist. v. TRQ Captain's Landing*, 423 S.W.3d 374 (Tex. 2014), *AHF-Arbors at Huntsville I, LLC v. Walker Cnty Appraisal Dist.*, 410 S.W. 3d 831 (Tex. 2012).

¹²⁵ See, e.g., *Travis Cent. Appraisal Dist. v. Signature Flight Support Corp.*, 140 S.W.3d 833, 837 (Tex. App.—Austin, 2004, no pet.); *Sweetwater Indep. Sch. Dist. v. ReCOR, Inc.*, 955 S.W.2d 703, 704 (Tex. App.—Eastland 1997, pet. denied).

¹²⁶ See *Harris Cnty. Appraisal Dist. v. Primrose Houston 7 Housing, L.P.*, 238 S.W.3d 782, 785 (Tex. App.—Houston [1st Dist.] 2007, pet. denied) (noting that Tex. Tax §11.182

is enabling legislation for article VIII, section 2), *Tex. Dep't of Corrs. v. Anderson Cnty. Appraisal Dist.*, 834 S.W.2d 130, 131 (Tex. App.—Tyler 1992, writ denied) (noting legislature's adoption of Tex. Tax §11.11 under article VIII, section 2).

¹²⁷ .52 S.W.3d 495, 497 (Tex. App.—Dallas 2001, pet. denied).

¹²⁸ *TRQ Captain's Landing, L.P. v. Galveston Cent. Appraisal Dist.*, 212, S.W.3d 726, 732 (Tex. App.—Houston [1st Dist.] 2006) aff'd, 423 S.W.3d 374 (Tex. 2014), cited in Opinion No. GA-1092 at 3.

¹²⁹ Opinion No. GA-1092 at 3, citing *Tanner v. Imle*, 253 S.W. 655, 668 (Tex. Civ. App.—San Antonio 1923, writ dismiss'd).