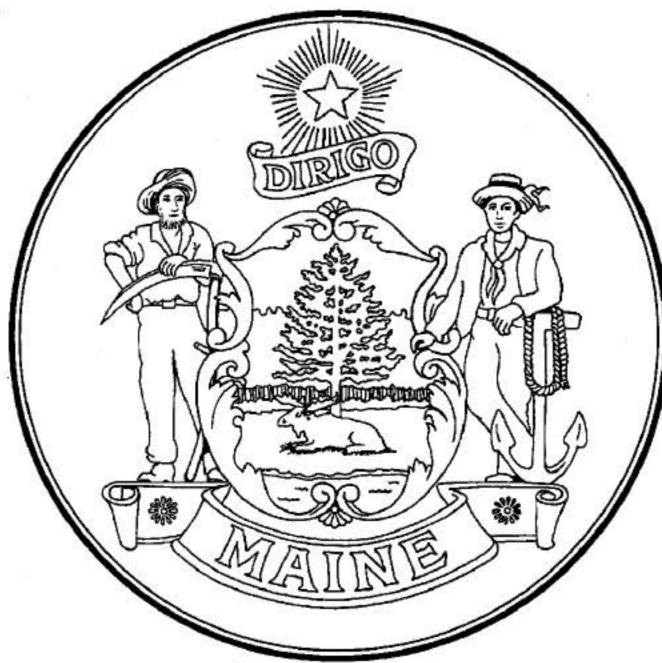


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# **Study of the Impact of Exempting Certain Nonprofit Organizations from the Sales and Use Tax and the Service Provider Tax**



**Report Prepared for the  
Joint Standing Committee on Taxation**

**January 15, 2024**

**Department of Administrative and Financial Services  
Maine Revenue Services  
Office of Tax Policy**

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## Executive Summary

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Nonprofit organizations play a vital role in Maine's economy, employing more than 100,000 people and contributing more than \$14 billion to the economy according to the Maine Association of Nonprofits.<sup>1</sup> The Legislature has recognized the important role of nonprofit organizations and the value that an exemption from sales tax can play in allowing these organizations to better serve the public at large by enacting more than 50 separate sales tax exemptions for nonprofit organizations since the sales tax began in 1951.

While these exemptions are valuable to the organizations that qualify, Maine's current patchwork of narrowly crafted exemptions creates inequities between similar organizations and confusion for taxpayers, leaving some nearly identical organizations with different eligibility. In addition, the multitude of narrow exemptions enacted over the last 70 years, along with a countless number of exemptions that have been proposed and failed during that same period, has required a considerable time investment by the Legislature and the Executive branch. Efforts to expand or create new exemptions come with opportunity costs. The time spent by the Legislature deliberating on dozens of new proposals to change exemption provisions, while often in relation to deserving nonprofit organizations, means time that the Legislature cannot devote to other policy issues.

To the extent possible, tax law should be simple and accessible to the public. Under current law, even when exemptions exist, the number and complexity mean many organizations, particularly small nonprofit organizations who are often staffed with volunteers, may lack the resources to take advantage of the available tax benefits. There are more than 50 separate applications, reflecting the different information required for each exemption, that taxpayers must sort through, and Maine Revenue Services ("MRS") must maintain and update, before an exemption is approved. Further, many of the eligible organizations may not even be aware that they are eligible for exemption, while other nonprofit organizations may incorrectly assume they are exempt already because of their federal exemption status. Thus, creating a clear, recognizable standard that is understandable to the public would reduce confusion and time for taxpayers, MRS, and the Legislature.

Looking to other states, the majority have some form of blanket sales tax exemption for nonprofit or charitable organizations, including all the states in the Northeast except for Maine. Some states base that exemption strictly on a determination by the Internal Revenue Service ("IRS") that the organization is exempt from federal income tax under the Internal Revenue Code ("I.R.C."), section 501(c)(3), while other states base it on a state-level definition of charitable or nonprofit.

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<sup>1</sup> *Maine Nonprofits at Work*, 2021 Edition, Maine Association of Nonprofits.



To that end, this report recommends the Legislature simplify the structure of the current sales tax exemption statutes by creating a blanket exemption to allow all organizations who have been granted tax-exempt status by the IRS under section 501(c)(3) to be eligible for a sales tax exemption. Approximately 80% of the existing nonprofit-related sales tax exemptions are held by section 501(c)(3) organizations who would be unaffected by the change. A blanket exemption would result in 5,278 additional organizations becoming eligible for exemption,<sup>2</sup> with an estimated fiscal impact of approximately \$10 million<sup>3</sup> when fully implemented. The additional qualifying nonprofit organizations include organizations promoting the arts, culture and humanities; education; human services; philanthropy, voluntarism and grantmaking; environmental quality, protection and beautification; and more.<sup>4</sup>

The proposed blanket exemption would create parity between organizations that have all been deemed by the IRS to be operating for a valuable public purpose, while reducing confusion, streamlining the process, and giving these organizations more time to devote to their important work. Further, it would reduce the amount of time the Legislature and the Executive branch would need to commit to these types of exemptions and free them up to pursue other policy goals. Similarly situated organizations should receive similar tax benefits, and a blanket exemption for 501(c)(3) organizations would be a significant step towards the goal of creating a fairer, simpler sales tax.

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<sup>2</sup> This is based on the total number of section 501(c)(3) organizations that may be eligible. However, 3,381 of those organizations did not report any income to the IRS in the most recent filing period, which is often the case for small nonprofits. This also may not reflect a complete list, as some organizations registered with out-of-state addresses could have exempt activity in Maine.

<sup>3</sup> This includes and assumes a blanket exemption for both sales and use tax and service provider tax.

<sup>4</sup> For a full list of the categories of nonprofits that would be newly exempt under the blanket exemption, see Chart 5.

## Introduction

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L.D. 68—Resolve, Directing the Office of Tax Policy to Study the Impact of Exempting Certain Nonprofit Organizations from the Sales and Use Tax and the Service Provider Tax, enacted as Resolves 2023, Ch. 88, directs the Office of Tax Policy (“OTP”) at MRS to study the legislative history of entity-based exemptions provided to qualifying nonprofit organizations from sales and use tax and service provider tax. The study must include a review of the entities currently covered and excluded, the impact of changes to statutes if criteria were broadened, and a review of exemptions in other states. OTP must submit a report detailing the results of the study to the Joint Standing Committee on Taxation no later than January 15, 2024.

## Background

The sales and use tax in Maine dates to 1951. The original law imposed a 2% tax on the sale or use of tangible personal property in the State, along with 13 listed exemptions.<sup>5</sup> Since the tax was established, the number of exemptions has grown exponentially, with more than 120 separate exemption provisions in the statute through the first session of the 131<sup>st</sup> Legislature.<sup>6</sup>

The service provider tax was enacted much later, in 2004. Several services that were previously taxed under the sales and use tax were transferred over to the new service provider tax, along with the addition of new taxable services. The original law imposed a 5% rate on the value of the taxable services, and included 30 listed exemptions, derived largely from the relevant sales and use tax exemptions in place at that time.<sup>7</sup> As with sales and use tax, the number of service provider tax exemptions has expanded since enactment, with more than 40 exemption provisions in place through the first session of the 131<sup>st</sup> Legislature.<sup>8</sup>

For both the sales and use and service provider taxes, there are three basic categories of exemptions from the tax. “Product exemptions” allow the exempt purchase of certain specified goods and services, such as grocery staples or diabetic supplies, without regard to the identity or status of the purchaser. “Use exemptions” allow the exempt purchase of certain products, such as products used in manufacturing, based on how the product will be used. The third category, “entity exemptions,” allows the tax-free purchase of most

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<sup>5</sup> P.L. 1951, c. 250, §§ 3, 10.

<sup>6</sup> 36 M.R.S. § 1760.

<sup>7</sup> P.L. 2003, c. 673, § V-25.

<sup>8</sup> 36 M.R.S. § 2557.

otherwise taxable products and services<sup>9</sup> when the purchases are made by certain types of organizations, such as schools or the government.<sup>10</sup> Entity exemptions are created for diverse policy reasons and cover a wide range of different organizations. This study focuses on the most common category of entity exemption—those covering various types of nonprofit organizations.

## Nonprofit Organizations Under Federal Law

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### Overview

Section 501 of the I.R.C. exempts certain entities from federal income tax. Subsection 501(c) lists the different types of entities qualifying for exemption in paragraphs (c)(1) through (c)(29). Eligible entities include social and recreational clubs, cemetery companies, state-chartered credit unions, pension and benefit trusts, and more—a full chart of entities covered by 501(c) can be found in the Appendix, Chart 1. While there are twenty-eight different categories of exempt organizations,<sup>11</sup> the overwhelming majority (more than 81%) fall under section 501(c)(3).<sup>12</sup>

Section 501(c)(3)<sup>13</sup> exempts entities that are organized and operated exclusively for certain limited purposes, as listed in the table below. In addition to being organized and operated exclusively for one of the listed purposes, none of the organization’s net earnings may benefit any private shareholder or individual, and the organization may not attempt to influence legislation or participate in a political campaign for public office.<sup>14</sup>

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<sup>9</sup> While entity exemptions allow qualifying organizations to purchase most taxable products and services tax-free, the purchases made must still be used or intended to be used primarily in the organization’s charitable activities. *See* 36 M.R.S. § 1760-C.

<sup>10</sup> There are a handful of exemptions that straddle categories, such as 36 M.R.S. § 1760(22)—the sale of automobiles to amputee veterans. This report focuses exclusively on true entity exemptions, i.e., those that exempt all sales to a particular organization (or at least, those sales that are made consistent with the organization’s exempt purposes; *see* 36 M.R.S. § 1760-C).

<sup>11</sup> The paragraphs range from “(c)(1)” to “(c)(29),” although I.R.C. § 501(c)(24) was repealed in 2006.

<sup>12</sup> For Fiscal Year 2022, the IRS reported that 1.48 million of the 1.8 million recognized section 501(c) organizations qualified under the section 501(c)(3) designation. IRS Data Book, 2022, Publication 55-B, Table 14—*Tax-Exempt Organizations, Nonexempt Charitable Trusts, and Nonexempt Split-Interest Trusts, Fiscal Year 2022*.

<sup>13</sup> The full language of section 501(c)(3) exempts from taxation all “[c]orporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”

<sup>14</sup> I.R.C. § 501(c)(3).

<b>I.R.C. § 501(c)(3) Exempt Purposes<sup>15</sup></b>
Charitable (see below);
Religious;
Educational;
Scientific;
Literary;
Testing for public safety;
Fostering national or international amateur sports competition; and
Preventing cruelty to children or animals.

The IRS broadly classifies the types of organizations qualifying under section 501(c)(3) into charitable organizations, churches and religious organizations, and private foundations. The term “charitable” for the purposes of 501(c)(3) is broad and often overlaps with the section’s other specific exempt purposes, such as religion or education:

<b>I.R.C. § 501(c)(3) Definition of “Charitable” Purposes<sup>16</sup></b>
Relief of the poor, the distressed, or the underprivileged;
Advancement of religion;
Advancement of education or science;
Erecting or maintaining public buildings, monuments, or works;
Lessening the burdens of government;
Lessening neighborhood tensions;
Eliminating prejudice and discrimination;
Defending human and civil rights secured by law; and
Combating community deterioration and juvenile delinquency.

## Federal Administration & Enforcement

To receive federal tax-exempt status, most prospective section 501(c)(3) organizations must first file Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* with the IRS. A simpler application, Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* is available for small organizations with assets and gross receipts below certain thresholds.<sup>17</sup> Churches who meet the requirements of section 501(c)(3), on

<sup>15</sup> IRS, *Exempt Purposes - Internal Revenue Code Section 501(c)(3)*, [www.irs.gov/charities-non-profits/charitable-organizations/exempt-purposes-internal-revenue-code-section-501c3](https://www.irs.gov/charities-non-profits/charitable-organizations/exempt-purposes-internal-revenue-code-section-501c3) (last visited Sep. 21, 2023).

<sup>16</sup> *Id.*

<sup>17</sup> Form 1023-EZ may be used by organizations seeking exemption who have assets of \$250,000 or less and annual gross receipts of \$50,000 or less. IRS Pub. 557, *Tax-Exempt Status For Your Organization*, 4 (Jan. 2023).

the other hand, are automatically considered tax-exempt and are not required to apply with the IRS to be recognized as a tax-exempt organization.<sup>18</sup>

Form 1023 generally requires applicants to provide the following information and/or documentation: (1) details of the organization and its officers, directors, and trustees; (2) organizing documents for the organization, such as articles of incorporation and bylaws; (3) a full description of the current or proposed activities of the organization; (4) financial data on revenues and expenses, along with compensation arrangements for organizational officers, employees, etc.;<sup>19</sup> (5) other information as applicable.<sup>20</sup> The form must be signed by an officer, director, or trustee under penalty of perjury.

To qualify for exemption, the completed application and supporting documents must demonstrate to the IRS that the entity is organized and will be operated exclusively for an eligible purpose under section 501(c)(3), and that the organization does not engage in any activities that may disqualify it from eligibility, such as attempting to influence legislation or participating in a political campaign for public office.<sup>21</sup> If the IRS determines that the organization qualifies for nonprofit status under section 501(c)(3), it will issue the organization a favorable determination letter. A determination letter recognizing exemption is generally effective from the date of formation of the organization if the application is filed within 27 months of formation.<sup>22</sup>

Under federal law,<sup>23</sup> most organizations with section 501(c)(3) status are required to file information returns with the IRS annually; generally, the Form 990, *Return of Organization Exempt From Income Tax*.<sup>24</sup> Form 990 is an extensive 12-page return which requires the organization to provide detailed information regarding its organizational activities, governance, revenues, expenses, assets, and other data, as well as any updates to its mission or purposes.<sup>25</sup> Form 990-EZ is shorter and requires less detailed financial data but is only available for organizations with gross receipts of less than \$200,000 and total assets of less than \$500,000. Under IRS guidance,<sup>26</sup> organizations with normal annual gross receipts of

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<sup>18</sup> IRS Pub. 1828, *Tax Guide for Churches & Religious Organizations*, 2 (Aug. 2015).

<sup>19</sup> Financial and compensation data is not required for organizations filing Form 1023-EZ.

<sup>20</sup> See IRS, *Instructions for Form 1023*, [www.irs.gov/instructions/i1023](http://www.irs.gov/instructions/i1023) (Jan. 2020) (last visited Oct. 25, 2023).

<sup>21</sup> IRS Pub. 557, *Tax Exempt Status for Your Organization* (Jan. 2023). Certain 501(c)(3) organizations may “attempt to influence legislation” if they elect provisions allowing limited lobbying expenditures.

<sup>22</sup> IRS Pub. 557, *Tax Exempt Status for Your Organization*, 6 (Jan. 2023).

<sup>23</sup> I.R.C. § 6033.

<sup>24</sup> Private foundations who are exempt under section 501(c)(3) must file Form 990-PF, *Return of Private Foundation*.

<sup>25</sup> Form 990 has its basis in federal law, I.R.C. § 6033(b), which lists 16 specific pieces of information required to be reported by organizations exempt under section 501(c)(3), as well as “such other information...[as the IRS] may require.” See also 26 C.F.R. § 1.6033-2.

<sup>26</sup> Rev. Proc. 2011-15.

\$50,000 or less are only required to file Form 990-N annually—a one-page “e-postcard” which requires basic organizational information and a confirmation that the organization’s gross receipts continue to not exceed \$50,000. Finally, there are a number of section 501(c)(3) organizations, including churches and certain related religious organizations, who are not required to file an annual return of any kind.<sup>27</sup>

The annual filing requirement is one means by which the IRS enforces the laws around nonprofit exemptions. According to the IRS, failure of an organization to fulfill its annual reporting obligation is one of the primary ways in which an organization can lose its tax-exempt status.<sup>28</sup> This is in part due to a change in federal law in 2006 which provided for automatic revocation of tax-exempt status for organization’s that failed to file the required annual return for three consecutive years.<sup>29</sup> Following the law change, the IRS revoked the tax-exempt status of more than 275,000 organizations.<sup>30</sup>

In addition to the annual filing requirement, the IRS lists several other areas in which a section 501(c)(3) organization can run afoul of the requirements to maintain its tax-exempt status. These include: (1) engaging in activities that benefit private interests; (2) not operating in accord with its stated exempt purposes; (3) allowing its income or assets to benefit insiders such as board members, otherwise known as inurement; (4) engaging in lobbying or political activity; and (5) earning too much unrelated business income (UBI),<sup>31</sup> i.e., income from a regularly carried-on trade or business that is not substantially related to the organization’s exempt purpose.<sup>32</sup>

The Tax Exempt and Government Entities Division of the IRS maintains an Exempt Organizations Examination program to ensure compliance with the laws around tax-exempt organizations, including section 501(c)(3) entities. Under the program, the IRS may request and review financial data and other related documents from the organization to verify its tax-exempt status. This may range from a compliance check, where the IRS simply confirms that an organization is adhering to recordkeeping requirements or still operating consistent with its stated purpose, to a full-blown audit, where the IRS will completely review an organization’s books and records and may independently investigate

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<sup>27</sup> See I.R.C. § 6033(a)(3); 26 C.F.R. § 1-6033-2(g).

<sup>28</sup> *How to lose your 501(c)(3) tax-exempt status (without really trying)*, [www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf](http://www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf) (last visited Dec. 13, 2023).

<sup>29</sup> Pension Protection Act of 2006, Pub. L. No. 109-280, § 1223, 120 Stat. 780, 1090 (2006); I.R.C. § 6033(j)(1)(B).

<sup>30</sup> *How to lose your 501(c)(3) tax-exempt status (without really trying)*, [www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf](http://www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf) (last visited Dec. 13, 2023).

<sup>31</sup> Note that tax-exempt organizations are not exempt from tax on their UBI. An organization with \$1,000 or more in UBI must file and pay tax on the UBI using Form 990-T, *Exempt Organization Business Income Tax Return*.

<sup>32</sup> *How to lose your 501(c)(3) tax-exempt status (without really trying)*, [www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf](http://www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf) (last visited Dec. 13, 2023).



the organization's activities.<sup>33</sup> As a result of an audit, the IRS may revoke its determination that an organization is tax-exempt.

Apart from its own audit and review process, the IRS also provides a method for the public to communicate concerns or complaints about a tax-exempt organization to the agency for review and possible enforcement action using Form 13909, *Tax-Exempt Organization Complaint (Referral)*.

## Legislative History

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### Enacted Exemptions

When the sales and use tax went into effect in July of 1951, the statute exempted two categories of non-governmental entities from the tax—hospitals and churches.<sup>34</sup> The statutory language did not explicitly require nonprofit status<sup>35</sup> to qualify.<sup>36</sup> However, these initial exemptions appear to have been somewhat predicated on the charitable or nonprofit activities of the entities, since they excluded from exemption “such sales, storage or use in activities as are mainly commercial enterprises.”<sup>37</sup>

In 1953, additional entity exemptions were included in the statute, and the existing exemptions amended. Exemptions were added for research centers and schools, and the previous exemption for hospitals was amended to provide an exemption for both “incorporated hospitals” and “proprietors of unincorporated hospitals.”<sup>38</sup> For the first time, the concept of the “incorporated nonprofit” was added to an exemption, with the research center exemption limited to “institutions incorporated as nonprofit corporations for the sole purpose of conducting medical research.”<sup>39</sup> An exemption was added in 1957 for sales to incorporated volunteer fire departments, although the new exemption did not include a nonprofit requirement.<sup>40</sup>

In 1961, an exemption was added for entities operating educational television or radio stations.<sup>41</sup> Unlike the volunteer fire department exemption passed four years earlier, the

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<sup>33</sup> IRS Pub. 4386, *Compliance Checks—Examination, Audit or Compliance Check?* (Apr. 2006).

<sup>34</sup> P.L. 1951, c. 250, § 10.

<sup>35</sup> While there were income tax exemptions for certain nonprofits prior, the passage of the sales and use tax in 1951 predates the current section 501(c)(3) income tax exemption, which was enacted as part of the Internal Revenue Code of 1954. Pub. L. No. 83-591, 68 Stat. 730 (1954).

<sup>36</sup> P.L. 1951, c. 250, § 10.

<sup>37</sup> *Id.*

<sup>38</sup> P.L. 1953, c. 109.

<sup>39</sup> *Id.*

<sup>40</sup> P.L. 1957, c. 354.

<sup>41</sup> P.L. 1961, c. 380, § 1.



television and radio station exemption required that the entity be an incorporated nonprofit to qualify.<sup>42</sup> From 1961 on, the overwhelming majority of entity exemptions passed by the Legislature required the organization to be an incorporated nonprofit to qualify.

The 105<sup>th</sup> Maine Legislature passed several new exemptions, with exemptions for incorporated nonprofit organizations who establish and maintain laboratories for scientific study and investigation in the field of biology or ecology;<sup>43</sup> incorporated private nonprofit residential child caring institutions;<sup>44</sup> incorporated nonprofit nursing homes;<sup>45</sup> and incorporated volunteer nonprofit ambulance corps.<sup>46</sup>

An exemption for community mental health facilities and community mental retardation facilities was added in 1976, although without the nonprofit requirement.<sup>47</sup> In 1977, an exemption for incorporated nonprofit home health care agencies was added,<sup>48</sup> while 1981 saw the addition of incorporated nonprofit rural community health care centers.<sup>49</sup>

The Legislature in 1983 continued to dramatically expand the list of exempt nonprofit organizations, adding incorporated nonprofit dental health centers;<sup>50</sup> incorporated nonprofit historical societies and museums;<sup>51</sup> licensed, nonprofit nursery school and day-care centers;<sup>52</sup> incorporated nonprofit organizations providing temporary residential accommodations to medical patients and their families;<sup>53</sup> nonprofit free public lending libraries;<sup>54</sup> and church affiliated nonprofit organizations which operate adult residential homes.<sup>55</sup>

In 1985, sales to incorporated nonprofit community action agencies was added;<sup>56</sup> along with incorporated nonprofit Veterans' Memorial Cemetery Associations;<sup>57</sup> incorporated,

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<sup>42</sup> *Id.*

<sup>43</sup> P.L. 1971, c. 23.

<sup>44</sup> P.L. 1971, c. 507.

<sup>45</sup> P.L. 1971, c. 508.

<sup>46</sup> P.L. 1971, c. 604.

<sup>47</sup> P.L. 1975, c. 773.

<sup>48</sup> P.L. 1977, c. 559.

<sup>49</sup> P.L. 1981, c. 502.

<sup>50</sup> P.L. 1983, c. 560, § 2.

<sup>51</sup> P.L. 1983, c. 560, § 3.

<sup>52</sup> *Id.*

<sup>53</sup> P.L. 1983, c. 851.

<sup>54</sup> P.L. 1983, c. 859, Pt. M, § 6.

<sup>55</sup> P.L. 1983, c. 562.

<sup>56</sup> P.L. 1985, c. 535, § 3.

<sup>57</sup> P.L. 1985, c. 417.

nonprofit volunteer search and rescue organizations;<sup>58</sup> and incorporated nonprofit hospice organizations.<sup>59</sup>

During the 1987-1988 term, the Legislature defined the term “nonprofit” in the sales tax statute for the first time, thereby tying eligibility for the nonprofit sales tax exemptions to federal income tax exemption under I.R.C. § 501(c).<sup>60</sup> It also further expanded the exempt list by adding incorporated nonprofit boarding care facilities;<sup>61</sup> nonprofit youth organizations;<sup>62</sup> incorporated nonprofit educational organizations who provide certain educational programs;<sup>63</sup> nonprofit animal shelters;<sup>64</sup> incorporated nonprofit charitable suppliers of medical equipment;<sup>65</sup> and incorporated nonprofit organizations fulfilling the wishes of children with life-threatening diseases.<sup>66</sup> In addition, while not an entity exemption, the Legislature also added an exemption from sales tax for construction contractors when purchasing materials pursuant to a contract with any entity exempt from sales tax, including the nonprofit and other organizations discussed above.<sup>67</sup>

The 114<sup>th</sup> Legislature continued the expansion of the sales tax exemptions, adding incorporated nonprofit organizations conducting research for the Maine Science and Technology Commission;<sup>68</sup> incorporated nonprofit Vietnam veteran registries;<sup>69</sup> incorporated nonprofit organizations providing services to the hearing impaired;<sup>70</sup> incorporated nonprofit providers of support systems for single-parent families;<sup>71</sup> incorporated nonprofit monasteries and convents;<sup>72</sup> incorporated nonprofit home construction organizations;<sup>73</sup> and nonprofit housing development organizations.<sup>74</sup> An exemption for state-chartered credit unions was also added.<sup>75</sup> While the language of the statute does not require the credit unions to be nonprofit to qualify, credit unions are nonprofit organizations as discussed in the section below on current exemptions.

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<sup>58</sup> P.L. 1985, c. 737, § 97.

<sup>59</sup> P.L. 1985, c. 789, § 1.

<sup>60</sup> P.L. 1987, c. 343, § 3.

<sup>61</sup> *Id.*, § 4.

<sup>62</sup> *Id.*, § 5.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*, § 6.

<sup>65</sup> P.L. 1983, c. 822.

<sup>66</sup> P.L. 1983, c. 825.

<sup>67</sup> P.L. 1987, c. 497, § 39.

<sup>68</sup> P.L. 1989, c. 533, § 8.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> P.L. 1989, c. 28.

<sup>73</sup> P.L. 1989, c. 871, § 13.

<sup>74</sup> P.L. 1989, c. 872, § 15.

<sup>75</sup> P.L. 1989, c. 533, § 8.

After the rush of new exemptions during the prior decade, the 1990s saw a limited number of new exemptions added. This included nonprofit eye banks;<sup>76</sup> incorporated nonprofit emergency shelter and feeding organizations;<sup>77</sup> incorporated nonprofit child abuse and neglect and child advocacy councils;<sup>78</sup> and incorporated nonprofit organizations who provide literary assistance to children with dyslexia.<sup>79</sup> The Legislature added one exemption that did not include a nonprofit requirement—for substance abuse facilities who receive state or federal funding.<sup>80</sup> In addition, the existing exemption for volunteer fire departments was amended to remove the requirement that the fire department be volunteer but add the requirement that it be nonprofit.<sup>81</sup>

From the 120<sup>th</sup> through 126<sup>th</sup> Legislatures, there were few additions to the list of entity exemptions. Those added included: centers for innovation;<sup>82</sup> incorporated nonprofit assisted housing programs for the elderly;<sup>83</sup> incorporated nonprofit medical clinics who provide free medical care to the indigent or uninsured;<sup>84</sup> and air ambulance services owned by an LLC if all members are nonprofit organizations.<sup>85</sup>

In 2004, the service provider tax also went into effect. Many of the existing entity exemptions in the sales and use tax statute were mirrored in the new service provider tax statute. At the time of enactment, the service provider tax contained a considerable number of exemptions for nonprofit organizations, including: nursing homes, residential care facilities, home health agencies, rural community health centers, dental health centers, medical research facilities, educational television and radio stations, organizations providing assistance to children with dyslexia, child care institutions, fire departments, air ambulance services, historical societies, museums, memorial foundations that provide free cultural programs, nursery schools, daycare centers, church-affiliated residential homes, organizations providing temporary residential accommodations to medical patients and their families, organizations providing free temporary or emergency shelter or food, child abuse and neglect councils, child advocacy organizations, free public lending libraries, Veterans' Memorial Cemetery Associations, volunteer search and rescue organizations, hospice organizations, youth athletic organizations, organizations fulfilling the wishes of children with life-threatening diseases, home construction organizations, providers of support systems for single-parent families, Vietnam veteran registries, organizations

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<sup>76</sup> P.L. 1993, c. 532.

<sup>77</sup> P.L. 1995, c. 625, § B-14.

<sup>78</sup> P.L. 1995, c. 499.

<sup>79</sup> P.L. 1999, c. 485.

<sup>80</sup> P.L. 1999, c. 708.

<sup>81</sup> P.L. 1997, c. 723.

<sup>82</sup> P.L. 2001, c. 95.

<sup>83</sup> P.L. 2003, c. 705, § 4.

<sup>84</sup> P.L. 2007, c. 416.

<sup>85</sup> P.L. 2007, c. 419.

providing services to the hearing impaired, housing development organizations, and eye banks.<sup>86</sup>

Since 2015, there has been an acceleration of new entity exemptions being added to the statute. The 127<sup>th</sup> Legislature added exemptions for incorporated nonprofit veterans support organizations and nonprofit library collaboratives to both the sales/use and service provider tax law.<sup>87</sup> An exemption for veterans' service organizations was also added.<sup>88</sup> Although not required to be nonprofit by Maine statute, veterans' service organizations are generally exempt from federal income tax as nonprofit organizations under I.R.C. § 501(c)(19). Veterans' service organizations, however, were *not* simultaneously included in the service provider tax exemption.

The 2017-2018 term saw the inclusion of incorporated nonprofit support organizations for combat-injured veterans in both the sales/use and service provider tax exemptions.<sup>89</sup> The Legislature also added the first direct reference in a sales tax exemption to I.R.C. § 501(c)(3), the provision that exempts charitable organizations from federal income tax, when it passed an exemption for nonprofit heating assistance organizations that required the organization to have been determined exempt under that provision by the IRS.<sup>90</sup> That exemption was not included in the service provider tax.

The 129<sup>th</sup> and 130<sup>th</sup> Legislatures added several new entity exemptions, including five nonprofit organizations. Those added were nonprofit youth camps;<sup>91</sup> incorporated nonprofit pet food assistance organizations;<sup>92</sup> community-based independent incorporated nonprofit member organizations of a nonprofit worldwide charitable organization;<sup>93</sup> cemetery companies that are exempt from federal income tax under I.R.C. § 501(c)(13);<sup>94</sup> and area agencies on aging.<sup>95</sup> None of these new exemptions were mirrored in the service provider tax.

## Failed and Modified Exemptions

The legislative history of newly enacted exemptions does not fully capture the work the Legislature engages in related to the topic, however. Because tax exemptions are construed

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<sup>86</sup> P.L. 2003, c. 673, § V-25.

<sup>87</sup> P.L. 2015, c. 267, § 0000-4.

<sup>88</sup> P.L. 2015, c. 465, § C-1.

<sup>89</sup> P.L. 2017, c. 445.

<sup>90</sup> P.L. 2017, c. 399.

<sup>91</sup> P.L. 2019, c. 550.

<sup>92</sup> P.L. 2019, c. 551.

<sup>93</sup> P.L. 2019, c. 552.

<sup>94</sup> P.L. 2021, c. 416.

<sup>95</sup> P.L. 2021, c. 399, § 1. Entity exemptions were also added for Maine's tribes, tribal members, and tribal entities, P.L. 2021, c. 681, Pt. D.

narrowly,<sup>96</sup> new exemptions are proposed frequently, with mixed success. During the 129th Legislature alone, for example, the Joint Standing Committee on Taxation considered 17 separate sales tax exemptions, with seven of the bills aiming to create new entity exemptions. Three of these entity exemptions passed and became law,<sup>97</sup> while the remainder were voted down or died on adjournment.

Even successful entity exemptions often require work across multiple legislatures to be enacted. The current exemption for area agencies on aging, for example, was proposed and first worked by the Taxation Committee during the First Session of the 129th Legislature.<sup>98</sup> The bill died with the adjournment of the 129th but a similar bill returned and was worked by the Committee again in the 130th two years later, where it was eventually passed into law.<sup>99</sup>

In addition, legislative action is often required to modify existing exemptions or add new exemptions to keep pace with changing circumstances. Two examples of how certain areas of exemption have changed over time are detailed below.

### *Exemptions for Veterans' Organizations*

A category of exemption that has been a frequent subject of debate in the Legislature is organizations serving veterans. The first sales tax exemption enacted was the exemption for sales to incorporated nonprofit Veterans' Memorial Cemetery Associations.<sup>100</sup> Four years later, a new exemption was added to include Vietnam veteran registries.<sup>101</sup>

The 127<sup>th</sup> Legislature added two new exemptions. The first was an exemption for sales to “incorporated nonprofit organizations organized for the purpose of providing direct supportive services in the State to veterans and their families living with service-related post-traumatic stress disorder or traumatic brain injury.”<sup>102</sup> An exemption was also established for sales to “an organization that provides services to veterans and their families that is chartered under 36 United States Code, Subtitle II, Part B, including posts or local offices of that organization, and that is recognized as a veterans' service organization by

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<sup>96</sup> *BCN Telecom, Inc. v. State Tax Assessor*, 2016 ME 165, ¶ 13, 151 A.3d 497.

<sup>97</sup> The passed exemptions included sales to nonprofit youth camps, P.L. 2019, c. 550; incorporated nonprofit pet food assistance organizations, P.L. 2019, c. 551; and community-based independent incorporated nonprofit member organizations of a nonprofit worldwide charitable organization, P.L. 2019, c. 552.

<sup>98</sup> L.D. 726 (129th Legis. 2019).

<sup>99</sup> See L.D. 86 (130th Legis. 2021); P.L. 2021, c. 399; 36 M.R.S. § 1760(108).

<sup>100</sup> P.L. 1985, c. 417.

<sup>101</sup> P.L. 1989, c. 533.

<sup>102</sup> P.L. 2015, c. 267, § 0000-4.

the United States Department of Veterans Affairs.”<sup>103</sup> Although not required to be nonprofit by Maine statute, veterans’ service organizations are generally exempt from federal income tax as nonprofit organizations under I.R.C. § 501(c)(19).

Most recently, in 2018 the Legislature passed an exemption for sales to “incorporated nonprofit organizations organized for the primary purpose of operating a retreat in the State for combat-injured veterans and their families free of charge.”<sup>104</sup> Per the testimony provided on the bill by Adria Horn, Director of the Maine Bureau of Veterans’ Services, the new sales tax exemption was necessary because certain entities providing valuable services to veterans met some, but not all, of the qualifications required by the two exemptions for veterans’ service groups passed by the Legislature just one session earlier.<sup>105</sup>

### *Emergency Services Exemption*

Another area of exemption that the Legislature has regularly modified is exemptions around emergency services and related entities. The exemption for fire departments was an early addition to the statute, coming six years after the passage of the original bill enacting the sales tax. The original language simply exempted sales to “incorporated volunteer fire departments.”<sup>106</sup> However, in 1971, the Legislature expanded the exemption to also include other first responders, amending the statute to exempt sales to “incorporated volunteer fire departments and to incorporated volunteer nonprofit ambulance corps.”<sup>107</sup>

The Legislature added to the statute in 1985 to include another category of emergency service provider, adding an exemption for sales to “incorporated, nonprofit volunteer search and rescue organizations.”<sup>108</sup> In 1998, the statute was again modified to remove the requirement that the fire department and ambulance corps be volunteer but add in the requirement that they both be nonprofit.<sup>109</sup> Per the bill’s sponsor, the exemption was proposed to create parity between rural and urban emergency service providers in response to the development of regional ambulance services to serve rural areas of the State.<sup>110</sup>

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<sup>103</sup> P.L. 2015, c. 465, § C-1.

<sup>104</sup> P.L. 2017, c. 445.

<sup>105</sup> *An Act To Exempt from Taxation Sales to Certain Nonprofit Organizations Supporting Veterans: Hearing on L.D. 1882 Before the J. Standing Comm. On Taxation*, 128th Legis. 3 (2017) (testimony of Adria Horn, Director of the Bureau of Veterans’ Services).

<sup>106</sup> P.L. 1957, c. 354.

<sup>107</sup> P.L. 1971, c. 604.

<sup>108</sup> P.L. 1985, c. 737, Pt. A, § 97.

<sup>109</sup> P.L. 1997, c. 723.

<sup>110</sup> 1 Legis. Rec. S-976 (1st Spec. Sess. 1997).

The statute has been further amended over the last 15 years, again in response to changing circumstances. The existing statute was broadened in 2007 to exempt sales to “air ambulance services that are limited liability companies all of whose members are nonprofit organizations and sales of tangible personal property leased to air ambulance services that are limited liability companies all of whose members are nonprofit organizations.”<sup>111</sup> Next, in response to the purchase of a new ferry by the nonprofit ferry service that serves Chebeague Island, the Legislature in 2019 added an exemption for the sale of watercraft “to an incorporated nonprofit transportation company that has a written understanding with a municipality that the watercraft will be available at all times to transport an emergency medical services patient from an island to a licensed ambulance service on the mainland.”<sup>112</sup> As with many of the new exemptions over the years, the 2019 change came about because an existing nonprofit did not fit into one of the preexisting categories of exemption in the statute.<sup>113</sup>

## Current Law and Administration

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### Overview of Current Nonprofit Sales Tax Exemptions

There are 56 separate provisions in Maine’s sales tax law exempting different types of entities from the sales and use tax.<sup>114</sup> More than  $\frac{3}{4}$  of those provisions require the applicant to be a “nonprofit” to qualify for exemption. Maine’s sales tax law defines “nonprofit” as any organization which has been determined by the IRS to be exempt from taxation under section 501(c) of the I.R.C.<sup>115</sup> As discussed earlier in the Federal Law section, I.R.C. § 501(c) includes a broad range of different types of organizations. Maine’s existing sales tax entity exemptions similarly cover a wide variety of different organizations.

The broad groups of exempt entities, in line with how the applications are categorized on the MRS website, includes:<sup>116</sup>

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<sup>111</sup> P.L. 2007, c. 419.

<sup>112</sup> P.L. 2019, c. 343, Pt. YYYY, § 1.

<sup>113</sup> As noted in the testimony before the Committee, the organization attempted to gain exemption under the existing ambulance services exemption but was denied because it did not qualify under the statute. *An Act To Exempt from Sales Tax Certain Watercraft Purchased by an Incorporated Nonprofit Transportation Company That Provides Transportation of Emergency Medical Services Patients from an Island to the Mainland: Hearing on L.D. 124 Before the J. Standing Comm. On Taxation*, 129th Legis. 3 (2019) (testimony of John Rent, President of the Chebeague Transportation Company).

<sup>114</sup> 36 M.R.S. § 1760. This figure includes entity exemptions for businesses, tribal individuals, etc. The service provider tax has 48 corresponding entity exemptions. 36 M.R.S. § 2557.

<sup>115</sup> 36 M.R.S. § 1752(7-C).

<sup>116</sup> MRS, *Maine Sales Tax Exempt Organizations*, [www.maine.gov/revenue/taxes/sales-use-service-provider-tax/tax-exempt-organizations](http://www.maine.gov/revenue/taxes/sales-use-service-provider-tax/tax-exempt-organizations) (last visited Aug. 18, 2023). Some applications are duplicated under multiple organization types in the chart above. This figure does not include Pine Tree Development Zone or tribal exemption applications.



Organization Type	Number of Separate Applications
Medical - Healthcare	18
Educational	12
Governmental	4
Religiously Affiliated Exempt Organizations	3
Child-Related Exemptions	11
Other Nonprofit Incorporated Agencies	17

## Administration of the Exemptions

Applications for exemption require the organizations to provide varying types of documentation. Most require copies of articles of incorporation, bylaws, and other documents demonstrating the exempt purpose. In addition, all “nonprofit” exemptions require that applicants submit a copy of their IRS-issued 501(c) determination letter.

Once an applicant files its application with the articles of incorporation, bylaws, and 501(c) determination letter, additional supporting documentation is often needed. An organization applying for the “memorial foundation” exemption, for example, would need to show evidence that the “primary” organizational purpose is to “provide cultural programs free to the public”;<sup>117</sup> perhaps by providing copies of pamphlets or other event materials demonstrating that purpose. The exemption for certain “residential youth camps,” on the other hand, would require different proof, i.e., that the applicant: (1) receives funding from the Department of Education; and (2) “provide[s] educational programs specifically designed for teaching young people how to make decisions about drugs, alcohol and interpersonal relationships at a residential youth camp setting.”<sup>118</sup>

The patchwork of exemptions creates substantial “gray area” in some parts of the tax code, posing challenges for taxpayers and for MRS. The memorial foundation exemption, for example, does not define “cultural program”—a term which is ambiguous and can be interpreted in a myriad of ways. This creates uncertainty for organizations, who may not know if they are covered by the exemption and if they should therefore apply, and MRS, who must administer the law and determine which organizations do qualify in line with the intent of the Legislature. Along with the previously discussed requirement that tax exemptions be construed narrowly, these gray areas result in a fair amount of confusion for organizations, who may apply when they don’t qualify, or fail to apply when they do qualify. In addition, MRS must dedicate time and resources on education, customer assistance, and administration to ensure that the law is carried out as intended.

<sup>117</sup> 36 M.R.S. § 1760(42).

<sup>118</sup> 36 M.R.S. § 1760(59).



The number of applications for sales tax exemptions in the last four fiscal years is shown in the table below.<sup>119</sup> That number has fluctuated from a high of 184 in fiscal year 2021-2022, to a low of 106 in fiscal year 2022-2023. Note that the 859 applications in fiscal year 2020-2021 is not a true representation of the number of applications that year. Active exemption certificates are reviewed periodically by MRS, which contacts exempt organizations to ensure that they still exist and operate for their listed purpose. Responses from current exempt organizations are reflected in the data as “Approved,” so the numbers below for fiscal year 2020-2021 reflect that significantly higher than normal activity.

<b>Applications</b>	<b>FY19-20</b>	<b>FY20-21</b>	<b>FY21-22</b>	<b>FY22-23</b>	<b>Total</b>
Approved	93	808	141	81	1,123
Denied	41	33	31	18	123
Withdrawn	9	18	12	7	46
<b>Total</b>	<b>143</b>	<b>859</b>	<b>184</b>	<b>106</b>	<b>1,292</b>

## Other Benefits for Nonprofit Organizations in Maine

Organizations with section 501(c)(3) certification already receive certain income and property tax benefits in Maine. Organizations are not subject to Maine corporate income tax if they have been determined to be tax-exempt under section 501(c)(3).<sup>120</sup> In addition, many nonprofit organizations may be eligible for a property tax exemption under 36 M.R.S. § 652. Section 652 provides an exemption from property tax for real and personal property owned and occupied or used solely for their own purposes by incorporated benevolent and charitable institutions. While not all nonprofit organizations qualify for the section 652 exemption,<sup>121</sup> many would be eligible for a property tax exemption in addition to the income tax exemption.

## Sales Tax Exemptions in Other States

### Nonprofit Exemptions Nationally

Many states across the country have some form of sales tax exemption for nonprofit organizations. Of the 47 states with sales taxes,<sup>122</sup> 30 offer some form of “blanket” exemption for nonprofit or charitable organizations. Maine is in the minority of states

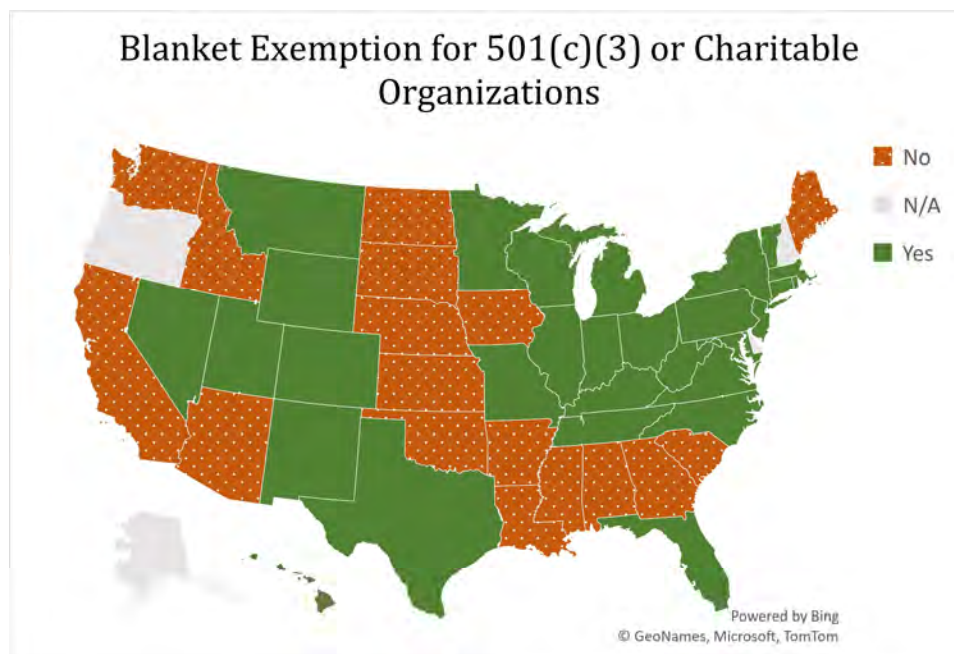
<sup>119</sup> This chart combines new and renewal applications.

<sup>120</sup> See 36 M.R.S. §§ 5102(6), 5200(1-A). As at the federal level, an otherwise exempt organization may still be liable for Maine income tax on its unrelated business income, i.e., income from a trade or business that is regularly carried on and not substantially related to the organization’s charitable purpose.

<sup>121</sup> See, e.g., *Credit Counseling Ctrs. v. City of S. Portland*, 2003 ME 2, 814 A.2d 458.

<sup>122</sup> Including Montana and, for the purposes of this report, D.C. Montana has no state sales tax but has a state exemption for its county-level sales tax. Alaska, Delaware, New Hampshire, and Oregon are excluded.

nationally that does not offer a blanket exemption for nonprofit organizations. Maine is also the only state in the Northeast<sup>123</sup> that does not have such an exemption.



Nationally, there are two basic approaches to determining eligibility.<sup>124</sup> Some states issue sales tax exemption certificates to any applicant who submits a valid IRS section 501(c) determination letter—generally under “(c)(3).” Other states independently determine eligibility based on their own state definition of “charitable” purposes. States independently defining “charitable” purposes mostly still recommend (and many require) that applicants submit IRS section 501(c) documentation, if applicable.

## Criteria for Blanket Exemptions Compared

### *Eligibility Based on Section 501(c)(3) Exemption Alone*

Twelve states base eligibility for sales tax exemption solely on whether the organization has been recognized by the IRS as tax-exempt under section 501(c)(3).<sup>125</sup> Some of these states also exempt other 501(c) organizations.<sup>126</sup> Every state imposes restrictions on how

<sup>123</sup> See Appendix, Chart 2 for a description of the other Northeast states.

<sup>124</sup> There is considerable variation between states, and the described categories overlap and differ in several ways. The descriptions in this report of other states are intended to provide a limited, high-level overview of eligibility criteria for blanket exemptions across the country.

<sup>125</sup> Connecticut, Florida, Hawaii, Kentucky, Massachusetts, Michigan, New Jersey, New Mexico, Tennessee, Utah, Vermont, and Wisconsin.

<sup>126</sup> For example, Florida exempts 501(c)(3), (4), (12); Hawaii exempts 501(c)(3), (4), (6), (8), (12); and Connecticut exempts 501(c)(3), (13). This list of states is not all-inclusive.

the certificates may be used. For example, all states require that purchased property be used only for the exempt organizational purpose (and not personal use). Some states further limit the exemption's applicability by requiring the organization to pay tax on specific items or services, such as building materials or electricity.<sup>127</sup>

### *Additional State Requirements*

Fifteen states have independent or additional eligibility requirements beyond an IRS determination.<sup>128</sup> These states often exempt “charitable” organizations or similarly broad categories.<sup>129</sup> Very often, these independent state definitions of exempt “charitable” purposes overlap with the “charitable” purposes in section 501(c)(3). These states mostly recommend (although many require) that applicants prove their tax-exempt status under section 501(c)(3). Three of these states exempt only 501(c)(3)s, but also restrict eligibility further.<sup>130</sup>

For example, Virginia only exempts 501(c)(3) organizations with annual administrative costs  $\leq$ 40% of annual gross revenue, among other requirements.<sup>131</sup> West Virginia, on the other hand, only exempts 501(c)(3) organizations that either: (1) annually receive more than half of their support from gifts, grants, charitable contributions, or membership fees; or (2) have no paid employees and donate income from fundraisers to organizations exempt under sections 501(c)(3) or 501(c)(4).<sup>132 133</sup>

Some states defer to the IRS section 501(c) determinations in many cases, but still retain ultimate discretion to determine eligibility. New York, for example, allows section 501(c)(3) organizations to submit IRS determination letters in lieu of other normally required documents, such as articles of incorporation, bylaws, statements of activities, receipts, expenditures, assets, and liabilities.<sup>134</sup> But New York reserves the right to request those documents if it determines that they are “necessary for a proper determination of

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<sup>127</sup> In New Mexico, construction material and metalliferous mineral ore are taxable. N.M.S.A. 1978 § 7-9-60. In Pennsylvania, building materials, supplies, and equipment used in the construction, reconstruction, remodeling, repair or maintenance of a nonprofit entity's real estate are taxable; however, routine maintenance and repair, and supplies for routine repair, are exempt. Pa. Stat. Ann. 72 § 7204(10). In North Carolina, electricity, telecommunications services, ancillary services, piped natural gas, video programming, and prepaid meal plans are taxable. N.C. Gen. Stat. § 105-164.14(b).

<sup>128</sup> Colorado, D.C., Illinois, Indiana, Maryland, Minnesota, Missouri, Montana, New York, Nevada, North Carolina, Pennsylvania, Rhode Island, Virginia, West Virginia.

<sup>129</sup> See, e.g., Illinois. I.L.C.S. c. 35, § 120/2-5(11).

<sup>130</sup> North Carolina exempts 501(c)(3)s “other than (i) community improvement and capacity building; (ii) public and societal benefit; or (iii) mutual and membership benefit orgs.” N.C. Gen. Stat. § 105-164.14(b).

<sup>131</sup> Va. Code § 58.1-609.11.

<sup>132</sup> Section 501(c)(4) provides an exemption for social welfare organizations and local associations of employees.

<sup>133</sup> W. Va. Code § 11-15-9(a)(6).

<sup>134</sup> N.Y.C.R.R. 20 § 529.7(f)(2).

whether the applicant qualifies for exempt status under New York law,” and to deny applicants that do not meet the state’s definition of “charitable” purpose.<sup>135</sup>

Imposing additional requirements beyond the IRS determination may allow the respective state legislatures to target the benefits of a sales tax exemption more narrowly, similar to how Maine’s current exemption structure functions. However, this narrower approach comes at the expense of simplicity for the tax filer and imposes additional, often heavy administrative burdens on taxpayers and tax agencies, as well as the legislatures themselves who must constantly revisit and expand the sales tax exemption law as new and deserving organizations come forward.

### *Hybrid Eligibility*

The remaining three states have some form of hybrid statute.<sup>136</sup> These types of statutes allow organizations to qualify for exemption by either documenting that the organization has been determined to be tax-exempt by the IRS under section 501(c)(3) *or* by documenting that the organization is “charitable” as defined in the applicable state law.

### Northeastern States

Of the seven Northeastern states, four determine eligibility based on section 501(c)(3) status alone, while three determine “charitable” purposes independently. Connecticut, Massachusetts, New Jersey, and Vermont exempt all section 501(c)(3) organizations from sales tax.<sup>137</sup> New York, Pennsylvania, and Rhode Island have blanket exemptions for “charitable” organizations, as defined in each state’s law.

As noted above, New York streamlines its application process for section 501(c)(3) organizations by allowing them to submit IRS determination letters in lieu of other normally required documents, while reserving the right to independently determine whether the organization qualifies as “charitable” under New York law. Rhode Island exempts organizations that are “operated exclusively for religious or charitable purposes.”<sup>138</sup> Although the state does not reference section 501(c) in statute or regulations, the relevant form requires that an IRS 501(c) determination letter be included in all “charitable” exemption applications.<sup>139</sup>

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<sup>135</sup> *Id.*

<sup>136</sup> Ohio, Texas, and Wyoming.

<sup>137</sup> See Appendix, Chart 2.

<sup>138</sup> R.I. Gen. Laws § 44-18-30(5)(i).

<sup>139</sup> R.I. Div. Taxation, *Sales & Use Exemption for an Exempt Organization*, Form EXO-SUE, [tax.ri.gov/sites/g/files/xkgbur541/files/2022-05/EXO-SUE\\_Final\\_w.pdf](http://tax.ri.gov/sites/g/files/xkgbur541/files/2022-05/EXO-SUE_Final_w.pdf) (May 2022) (last visited Oct. 26, 2023).



Pennsylvania, on the other hand, has more complex requirements. The state exempts from sales tax a “purely public charity,” defined as an organization that advances a “charitable” purpose.<sup>140</sup> The organization must also: operate entirely free from private profit motive; donate or render gratuitously a substantial portion of its services; benefit a substantial and indefinite class of persons who are legitimate subjects of charity; and relieve the government of some of its burden.”<sup>141</sup>

## Nonprofit Organizations in Maine & Effects of a Blanket 501(c)(3) Exemption

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### Overview

According to the Maine Association of Nonprofits (“MANP”), there are approximately 7,172 nonprofit organizations<sup>142</sup> operating in the state of Maine who are registered with the IRS and exempt under section 501(c)(3) as of 2018, including 6,659 public charities and 513 private foundations. Most of these organizations are small nonprofit organizations—approximately 75% of them have annual expenditures of less than \$100,000.<sup>143</sup>

In comparison, there are 7,618 active nonprofit-related sales tax exemption certificates in circulation. Approximately 84% of those certificates are held by organizations who are also exempt under section 501(c), with nearly all that subset of organizations (~98%) being exempt under section 501(c)(3). Thus, Maine’s existing sales tax exemptions already cover the large majority, but not all, of the nonprofit organizations operating in the state.

Moving to a blanket exemption that allows organizations to qualify for a sales tax exemption if they are tax-exempt under section 501(c)(3) would result in an expansion in the number of qualifying organizations and a corresponding reduction in sales tax revenue. However, such a blanket exemption would also be a significant step toward simplification of the existing system for exemption in the sales and use tax statute, both for MRS and for taxpayers. The process for applying for exemption would be streamlined, as the only documentation needed from the applicant would be a copy of their IRS determination letter.

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<sup>140</sup> 10 Pa. Stat. Ann. § 375. “Charitable” purposes include: (a) the relief of poverty, (b) the advancement or provision of education, (c) advancement of religion, (d) prevention or treatment of disease or injury (including mental retardation and mental disorders), (e) government purposes, or (f) the accomplishment of a purpose recognized as important and beneficial to the public and that advances social, moral or physical objectives. *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Maine Nonprofits at Work*, 2021 Edition, Maine Association of Nonprofits. The MANP numbers do not include churches and religious organizations that are not required to register with the IRS, as discussed in the Federal Law section earlier in the report.

<sup>143</sup> *Id.*

The requests for additional documentation, evidence of exempt purpose, copies of bylaws, etc. would all be eliminated, making the exemption process simpler for both the applicants and MRS.

### Impacts of a Blanket 501(c)(3) Exemption

MRS estimates that an additional 5,278 section 501(c)(3) organizations that do not currently have a sales tax exemption would be eligible under a blanket section 501(c)(3) exemption.<sup>144</sup> IRS data contains National Taxonomy of Exempt Entities (“NTEE”) codes for many of those organizations, shown in Appendix, Chart 5. The additional qualifying nonprofit organizations include organizations promoting the arts, culture and humanities; education; human services; philanthropy, voluntarism and grantmaking; environmental quality, protection and beautification; and more.<sup>145</sup>

The below table details the fiscal impact of a blanket section 501(c)(3) sales tax exemption:

<b>Fiscal year</b>	<b>Fiscal Impact of Blanket 501(c)(3) Exemption<sup>146</sup></b>
2025	\$3,998,000
2026	\$9,821,000
2027	\$10,119,000
2028	\$10,407,000

While the enactment of a blanket section 501(c)(3) sales tax exemption would result in significant simplification, it could not fully replace the existing statutory structure without affecting the status of some organizations that are currently exempt. More specifically, there are a number of current entity exemptions that do not explicitly require nonprofit status for eligibility. Those exemptions would need to be retained in addition to the blanket exemption if the goal is ensuring no currently exempt organizations lose their status.

### Current Non-501(c) Sales Tax Exemptions

Fifteen entity exemptions do not require the organization be a “nonprofit,” currently defined in Maine law as tax-exempt under section 501(c), as shown in Appendix, Chart

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<sup>144</sup> This is based on the total number of section 501(c)(3) organizations that may be eligible. However, 3,381 of those organizations did not report any income to the IRS in the most recent filing period, which is often the case for small nonprofits. This may not reflect a complete list, as some organizations registered with out-of-state addresses could have exempt activity in Maine.

<sup>145</sup> For a full list of the categories of nonprofits that would become exempt under the blanket exemption, see Chart 5.

<sup>146</sup> This includes and assumes a blanket exemption for both sales and use tax and service provider tax.



3.<sup>147</sup> Most of these organizations exist to provide some public benefit, like a nonprofit. However, many of the sales tax exemptions that do not explicitly require section 501(c) exemption in Maine law may only be available to entities that are already exempt from federal income tax under 501(c). The Maine sales tax exemption for state-chartered credit unions, for example, does not require “nonprofit” 501(c) status in Maine law, but the eligible organizations are nonprofit organizations exempt from federal income tax under 501(c)(14), which exempts state-chartered credit unions. However, because there may be organizations that are exempt under the current statutory language, these exemptions should be retained to avoid removing the benefit of a sales tax exemption from an existing organization.

## Exemptions That Could Be Repealed

The exemptions in Appendix, Chart 4 are currently used exclusively by organizations with a section 501(c)(3) determination and could be repealed and replaced by a blanket section 501(c)(3) exemption without impacting organizations that are currently exempt. Note, however, that potential applicants that are eligible under these current provisions would only be eligible for the section 501(c)(3) blanket exemption if they maintained a current federal income tax exemption under section 501(c)(3).

## Conclusion

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Nonprofit organizations play a vital role in Maine’s economy, employing more than 100,000 people and contributing more than \$14 billion to the economy according to the Maine Association of Nonprofits.<sup>148</sup> The Legislature has recognized the important role of nonprofit organizations and the value that an exemption from sales tax can play in allowing these organizations to better serve the public, by enacting more than 50 separate sales tax exemptions for nonprofit organizations over the years. While these exemptions are valuable to the organizations that qualify, Maine’s current combination of narrowly crafted exemptions results in substantial “gray area” in parts of the tax code, creating inequities between similar organizations and confusion for taxpayers.

The current patchwork of exemptions leaves some nearly identical organizations with different statuses, resulting in inequities and, as evidenced by the legislative history, the excluded groups coming to the Legislature to broaden eligibility or create a new exemption. Efforts to expand or create new exemptions come with opportunity costs. The Legislature

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<sup>147</sup> Two of these exempt nonprofits as well as their non-501(c) “affiliates,” and “[LLCs], all of whose members are nonprofit organizations.” 36 M.R.S. § 1760(16)(L), (26) (relating respectively to literacy/clinical assistance for dyslexic children and air ambulance services).

<sup>148</sup> *Maine Nonprofits at Work*, 2021 Edition, Maine Association of Nonprofits.

spends considerable time deliberating on proposals to change exemption provisions, often in relation to new and deserving nonprofit organizations. A blanket exemption would dramatically reduce many of these requests, giving lawmakers more time to consider other policy issues.

Tax law should be simple and accessible. Even when exemptions exist, the number and complexity mean many taxpayers may lack the resources to take advantage of the available tax benefits. Most nonprofit organizations are small, staffed by volunteers and without dedicated tax advisors, and may not have the time or background to assess eligibility for each of the dozens of separate sales tax exemptions. Many eligible organizations may not even be aware that they are eligible for exemption, while other nonprofit organizations may incorrectly assume they are exempt already because of their federal exemption status. Creating a clear, recognizable standard would reduce confusion and time for taxpayers, MRS, and the Legislature.

To that end, MRS and OTP recommend that the structure be simplified by creating a blanket exemption to allow all organizations who have been granted tax-exempt status by the IRS under section 501(c)(3) to be eligible for a sales tax exemption. A blanket exemption would put us largely in line with neighboring states in the Northeast<sup>149</sup> and tying eligibility directly to an organization's section 501(c)(3) status will dramatically simplify the process for taxpayers while ensuring the benefit goes to deserving charitable organizations. Similarly situated organizations should receive similar tax benefits, and a blanket exemption for section 501(c)(3) organizations would be a significant step towards that goal of creating a fairer, simpler sales tax.

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<sup>149</sup> While all Northeastern states have a blanket nonprofit exemption, some impose additional requirements. However, as noted in the report, imposing additional requirements beyond the IRS determination dramatically reduces the simplicity and other benefits of a blanket exemption.

## Appendix

Chart 1: Types of organizations exempt under Section 501(c)

Section of 1986 Code	Description of organization	General nature of activities
501(c)(1)	Corporations Organized under Act of Congress (including Federal Credit Unions)	Instrumentalities of the United States
501(c)(2)	Title Holding Corporation For Exempt Organization	Holding title to property of an exempt organization and distributing net income to it
501(c)(3)	Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations	Activities of nature implied by description of class of organization
501(c)(4)	Civic Leagues, Social Welfare Organizations; and Local Associations of Employees	Promotion of community welfare; charitable, educational, or recreational
501(c)(5)	Labor, Agricultural, and Horticultural Organizations	Educational or instructive, the purpose being to improve conditions of work, and to improve products and/or efficiency
501(c)(6)	Business Leagues, Chambers of Commerce, Real Estate Boards, etc.	Improvement of business conditions of one or more lines of business
501(c)(7)	Social and Recreational Clubs	Pleasure, recreation, social activities
501(c)(8)	Fraternal Beneficiary Societies and Associations	Providing for payment of life, sickness, accident or other benefits to members within a lodge system
501(c)(9)	Voluntary Employees Beneficiary Associations	Employee association providing for payment of life, sickness, accident, or other benefits to members
501(c)(10)	Domestic Fraternal Societies and Associations	Earnings devoted to charitable, fraternal, and other specified purposes within a domestic lodge system. No benefits to members
501(c)(11)	Teachers' Retirement Fund Associations	Teachers' association for payment of retirement benefits
501(c)(12)	Benevolent Life Insurance Associations, Mutual Ditch or Irrigation Companies, Mutual or Cooperative Telephone Companies, and Like Organizations	Activities of a mutual or cooperative nature

Chart 1: Types of organizations exempt under Section 501(c) [continued]

	<b>Description of organization</b>	<b>General nature of activities</b>
501(c)(13)	Cemetery Companies	Burials and incidental activities
501(c)(14)	State-Chartered Credit Unions, Mutual Reserve Funds	Loans to members
501(c)(15)	Mutual Insurance Companies or Associations	Providing insurance to members substantially at cost
501(c)(16)	Cooperative Organizations to Finance Crop Operations	Financing crop operations in conjunction with activities of a marketing or purchasing association
501(c)(17)	Supplemental Unemployment Benefit Trusts	Provides for payment of supplemental unemployment compensation benefits
501(c)(18)	Employee Funded Pension Trust (created before June 25, 1959)	Payment of benefits under a pension plan funded by employees
501(c)(19)	Post or Organization of Past or Present Members of the Armed Forces	Activities implied by nature of organization
501(c)(21)	Black Lung Benefit Trusts	Funded by coal mine operators to satisfy their liability for disability or death due to black lung diseases
501(c)(22)	Withdrawal Liability Payment Fund	To provide funds to meet the liability of employers withdrawing from a multi-employer pension fund
501(c)(23)	Veterans' Organization (created before 1880)	To provide insurance and other benefits to veterans
501(c)(25)	Title Holding Corporations or Trusts with Multiple Parent Corporations	Holding title and paying over income from real property to 35 or fewer parents or beneficiaries
501(c)(26)	State-Sponsored Organization Providing Health Coverage for High-Risk Individuals	Provides health care coverage to high-risk individuals
501(c)(27)	State-Sponsored Workers' Compensation Reinsurance Organization	Reimburses members for losses under workers' compensation acts
501(c)(28)	National Railroad Retirement Investment Trust	Manages and invests the assets of the Railroad Retirement Account
501(c)(29)	CO-OP health insurance issuers	A qualified health insurance issuer which has received a loan or grant under the CO-OP program



Chart 2: Nonprofit sales tax exemptions in the Northeast

State	Blanket Exemption Type
CT	<b>Eligibility based on 501(c) status.</b> The organization must prove it is an IRS recognized 501(c)(3) or (c)(13). Conn. Gen. Stat. §12-412(8).
MA	<b>Eligibility based on 501(c) status.</b> The organization must prove it is an IRS recognized 501(c)(3). Mass. Gen. L. Chapter 64H § 6(e).
ME	<b>No blanket exemption.</b>
NJ	<b>Eligibility based on 501(c) status.</b> The organization must prove it is an IRS recognized 501(c)(3). N.J. Rev. Stat. § 54:32B-9(b)(1); N.J. Admin. Code §18:24-8.4(c)(5).
NY	<b>State determination.</b> The organization must prove that it is both organized and operated exclusively for one or more exempt purposes: religious, charitable, scientific, testing for public safety, educational, literary, prevention of cruelty to children or animals, or fostering national or international amateur sports competition. Applicants that are IRS recognized 501(c)(3)s have streamlined application requirements. N.Y.C.R.R. 20 § 529.7(a)(2), (f)(2).
PA	<b>State determination.</b> The organization must prove it is a “purely public charity.” (Defined, footnote 20). Pa. Stat. Ann. 72 § 7204(10).
RI	<b>State determination.</b> The organization must prove it is “operated exclusively for religious or charitable purposes.” R.I. Gen. Laws § 44-18-30(5)(i).
VT	<b>Eligibility based on 501(c) status.</b> The organization must prove it is an IRS recognized 501(c)(3) or, in certain cases, (c)(5). Vt. Stat. Ann. 32 § 9743(3)(A).

Chart 3: Current Maine entity exemptions that do not require nonprofit status

Subsection	Entity Exemptions that <u>do not</u> Require “Nonprofit” 501(c) Status	Total # Orgs	# Orgs Exempt under 501(c)
(2)	Certain governmental entities	1206	7%
(16)(A)	Incorporated Hospitals	57	67%
(16)(K)	Schools	756	48%
(16)(L)	[Affiliates of] incorporated nonprofit organizations . . . whose purpose is to provide literacy assistance or free clinical assistance to children with dyslexia	4	100%
(16)(M)	Regularly organized churches or houses of religious worship.	2303	30% <sup>150</sup>
(26)	[A]ir ambulance services that are limited liability companies[,] all of whose members are nonprofit organizations . . . .	40	73%
(28)	Community mental health facilities, community adult developmental services facilities and community substance use disorder facilities	16	63%
(37)	Regional planning commissions and councils of government	1	100%
(49)(B)	Child advocacy organizations that are members of the Medicaid Advisory Committee	2	100%
(49)(C)	Community action agencies	11	91%
(71)	State-chartered credit unions	14	14%
(84)	Centers for innovation	2	50%
(87)	Qualified development zone businesses	0	N/A
(100)	Certain veterans' service organizations	111	81%
(108)	Area agencies on ageing	65	98%

<sup>150</sup> This figure includes churches, which are not required to register with the IRS for tax exemption in many cases.

Chart 4: Entity exemptions that could be replaced by a blanket exemption for 501(c)(3) nonprofits

Subsection	Requires 501(c)?	Description	# of Orgs.
1760(42)	Yes	Historical societies, museums and certain memorial foundations	9
1760(62)	Yes	Charitable suppliers of medical equipment	3
1760(16)(G)	Yes	Inc. nonprofit dental health centers	11
1760(49)(B)	No	Statewide organizations that advocate for children and that are members of the Medicaid Advisory Committee	2
1760(16)(L)	Split	Inc. nonprofit orgs. or their affiliates whose purpose is to provide free clinical assistance to children with dyslexia	4
1760(51)	Yes	Veterans' Memorial Cemetery Associations	3
1760(77)	Yes	Eye banks	1
1760(37)	No	Regional planning commissions and councils of government	1
1760(16)(F)	Yes	Inc. nonprofit federally qualified health centers	2
1760(103)	Yes	Certain support organizations for combat injured veterans	2
1760(104)	Yes	Nonprofit youth camps	11
1760(105)	Yes	Pet food assistance organizations	2
1760(110)	Yes	Certain educational collaboratives	1



Chart 5: Categories of new organizations exempt under a blanket exemption for 501(c)(3) nonprofits

<b>Description<sup>151</sup></b>	<b>Count</b>	<b>Average Income</b>
Arts, Culture and Humanities	606	\$859,593
Education	657	\$1,380,861
Environmental Quality, Protection and Beautification	356	\$1,256,756
Animal-Related	145	\$369,679
Health - General and Rehabilitative	149	\$20,460,380
Mental Health, Crisis Intervention	78	\$703,579
Diseases, Disorders, Medical Disciplines	64	\$109,731
Medical Research	15	\$668,080
Crime, Legal-Related	42	\$2,139,744
Employment, Job-Related	25	\$1,196,256
Food, Agriculture and Nutrition	67	\$1,338,146
Housing, Shelter	102	\$1,609,733
Public Safety, Disaster Preparedness and Relief	73	\$216,904
Recreation, Sports, Leisure, Athletics	370	\$482,574
Youth Development	114	\$459,460
Human Services - Multipurpose and Other	406	\$588,542
International, Foreign Affairs and National Security	84	\$665,893
Civil Rights, Social Action, Advocacy	23	\$406,232
Community Improvement, Capacity Building	171	\$704,988
Philanthropy, Voluntarism and Grantmaking Foundations	381	\$4,108,273
Science and Technology Research Institutes, Services	24	\$419,274
Social Science Research Institutes, Services	7	\$1,147,122
Public, Society Benefit - Multipurpose and Other	105	\$2,829,062
Religion-Related, Spiritual Development	192	\$1,041,323
Mutual/Membership Benefit Organizations, Other	7	\$42,690
Unknown	36	\$7,511,592
Classification not available	979	
<b>Total</b>	<b>5,278</b>	<b>\$2,554,102</b>

<sup>151</sup> Categories listed in Chart 5 represent the National Taxonomy of Exempt Entities codes for organizations as provided in data from the IRS.