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Kentucky Supreme Court Limits Charitable Tax Exemption to Property Taxes Only.

Delving deeply into the history of the charitable exemption from taxes under Section 170 of the Kentucky Constitution as well as the use tax, the Kentucky Supreme Court recently held that the exemption applies only to property taxes. *Dep't of Revenue v. Interstate Gas Supply, Inc.*, 2016-SC000281-DG (March 22, 2018). Section 170 exempts from taxation all institutions of "purely public charity."

Interstate Gas Supply, Inc. ("IGS") applied for a refund of certain use taxes it collected and remitted on behalf of Tri-State Healthcare Laundry, Inc. ("Tri-State"), an entity which serves the laundry needs of three charitable hospitals. Tri-State is not a 501(c)(3) tax exempt organization, so it does not qualify for the charitable exemption from sales and use taxes afforded to those entities under KRS 139.495. Tri-State is, however, recognized by the Kentucky Department of Revenue ("Department") as an institution of purely public charity, entitled to the Section 170 exemption.

Tri-State purchased natural gas from IGS during the relevant periods. IGS requested a refund of Kentucky use tax, arguing that Tri-State's status as a purely public charity exempted it from all revenue-raising taxes pursuant to Section 170 and that as stated in *Commonwealth ex. rel. Luckett v. City of Elizabethtown*, 435 S.W.2d 78 (Ky. 1968) the use tax was in effect a property tax, thus bringing it within the scope of Section 170, even if that section was deemed to apply only to property tax. The Kentucky Board of Tax Appeals and the Franklin Circuit Court both found that Section 170 applied only to property taxes, but the Court of Appeals agreed with IGS and the City of Elizabethtown decision and held that the use tax operated like a property tax so that Section 170 applied to its imposition as well. The Department appealed to the Kentucky Supreme Court, which granted discretionary review.

The Kentucky Supreme Court first analyzed the scope of Section 170 and held that the exemption was intended only to apply to Kentucky property tax. Undertaking a review of both the plain language of Section 170 and its many references to property as well as a number of cases that had taken up the issue, the Court held that the Section 170 exemption for institutions of purely public charity applied only to ad valorem taxation.

As to IGS's argument that the use tax operated so similarly to a property tax that it should fall within the scope of Section 170, the Court analyzed *City of Elizabethtown* as well as a number of other cases, and also undertook a review of the sales and use tax regime in Kentucky. While noting some similarities between the use tax's imposition of tax on the storage and use of items within Kentucky, the Court ultimately held that the use tax was intended as a complement to the sales tax and arose out of a transaction, not the ownership or valuation of such property. The Court also noted the criticism *City of Elizabethtown* had drawn over the years. The Court stated that nowhere else in the country had a use tax been treated as akin to a property tax, and in the Court's words, such a conclusion "is simply wrong." Accordingly, the Court overturned *City of Elizabethtown* and declined to extend the scope of Section 170 beyond property taxes.

This decision, combined with House Bill 487, which implanted a number of new tax policies in Kentucky, has resulted in a perfect storm of uncertainty in the nonprofit world as to whether these organizations must register for and/or collect and remit certain taxes. Without the assurances in City of Elizabethtown and the new policies found in H.B. 487, many nonprofits may be responsible for collecting and remitting sales tax on items such as admissions to special fundraising events, silent auction items, and certain types of memberships or programs (for example, summer camps or little league memberships). The Department has promised to issue more guidance and is working with organizations such as the Kentucky Nonprofit Network to disseminate information in an efficient and effective manner given the number of nonprofits that may not be aware of the changes. So, it's often best to consult with a tax professional who can provide your organization with advice tailored to your specific circumstances.

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