

ARIZONA TRANSACTION PRIVILEGE TAX PROCEDURE
TPP 99-5

Procedure for Recognition of Exempt Status
of

I. A Qualifying Hospital

or

II. A Qualifying Health Care Organization

or

III. A Qualifying Community Health Center

or

IV. Rehabilitation Programs for Mentally or Physically Handicapped Persons

(This procedure supersedes Arizona Transaction Privilege Tax Procedure TPP 93-3)

This procedure gives information concerning the exemptions available from the transaction privilege tax and use tax for organizations recognized annually by the department as exempt from tax under certain specific business activities.

I. A QUALIFYING HOSPITAL

- Applicable Law:

Arizona Revised Statutes (A.R.S.) § 42-5001(11) defines a qualifying hospital as:

- a. A licensed hospital which is organized and operated exclusively for charitable purposes, no part of the net earning of which inures to the benefit of any private shareholder or individual.
- b. A licensed nursing care institution or a licensed residential care institution or a residential care facility operated in conjunction with a licensed nursing care institution or a licensed kidney dialysis center, which provides medical services, nursing services or health related services and is not used or held for profit.
- c. A hospital, nursing care institution or residential care institution which is operated by the federal government, this state or a political subdivision of this state.

The exemptions from the transaction privilege tax and use tax are provided by:

A.R.S. § 42-5061(A)(25)(a) *Retail classification*

A.R.S. § 42-5063(C)(3)(a) *Utilities classification*

A.R.S. § 42-5065(B)(2)(a) *Publication classification*

A.R.S. § 42-5066(B)(3)(a) *Job printing classification*

A.R.S. § 42-5071(B)(2)(a) *Personal property rental classification*

A.R.S. § 42-5074(B)(7) *Restaurant classification*

A.R.S. § 42-5159(A)(13)(a), (b), (c) *Use Tax*

- Application for Exemption:

Organizations must apply to the Department of Revenue for an annual exemption letter to take advantage of the statutory exemptions. Exemption letter requests should be submitted at least (30) thirty days prior to the beginning of the calendar or fiscal year for which the organization is requesting exemption.

The request must:

1. Be in writing.
2. Include a copy of the organization's current hospital license as issued by the Arizona Department of Health Services. (Out-of-state hospitals requesting exemption may include a copy of its state's license.)
3. Include a copy of the organization's I.R.C. § 501(c) determination letter *if the organization is qualifying as a licensed hospital which is organized and operated exclusively for charitable purposes, no part of the net earning of which inures to the benefit of any private shareholder or individual*. The IRS issues a § 501(c) determination letter as of a specific date. The entity does not qualify as a § 501(c) organization prior to that date. The name on the IRS letter should match the name of the organization seeking the exemption. The department may waive the letter requirement if the department already has a copy of the organization's determination letter on file.
4. Include verification satisfactory to the department that the organization is not used or held for profit *if the organization is seeking qualification as a licensed nursing care institution, a residential care facility operated in conjunction with a licensed nursing care institution or a licensed kidney dialysis center, which provides medical services, nursing services or health related services*. If the organization has been recognized as a § 501 (c) organization, a copy of the organization's I.R.C. § 501(c) determination letter is considered satisfactory verification. The name on the IRS letter should match the name of the organization seeking the exemption.

(NOTE: A residential care facility operated in conjunction with a licensed nursing care institution must provide additional information when applying for exempt status. See Arizona

Transaction Privilege Tax Ruling TPR 99-8.)

II. A QUALIFYING HEALTH CARE ORGANIZATION

- Applicable Law:

A.R.S. § 42-5001(10) defines a qualifying health care organization as:

[A]n entity that is recognized as nonprofit under § 501(c) of the United States internal revenue code and that uses at least eighty per cent of all monies that it receives from all sources each year only for health and medical related educational and charitable services, as documented by annual financial audits prepared by an independent certified public accountant, performed according to generally accepted accounting standards and filed annually with the department. (Emphasis added)

The exemptions from the transaction privilege tax and use tax are provided by:

A.R.S. § 42-5061(A)(25)(b), (c) *Retail classification*

A.R.S. § 42-5063(C)(3)(b) *Utilities classification*

A.R.S. § 42-5065(B)(2)(b) *Publication classification*

A.R.S. § 42-5066(B)(3)(b) *Job printing classification*

A.R.S. § 42-5071(B)(2)(a) *Personal property rental classification*

A.R.S. § 42-5074(B)(8) *Restaurant classification*

A.R.S. § 42-5159(A)(13)(d), (e) *Use Tax*

- Application for Exemption:

Organizations must apply to the Department of Revenue for an annual exemption letter to take advantage of the statutory exemptions. Exemption letter requests should be submitted at least (30) thirty days prior to the beginning of the calendar or fiscal year for which the organization is requesting exemption.

The request must:

1. Be in writing.
2. Include a copy of the organization's I.R.C. § 501(c) determination letter. The name on the IRS letter should match the name of the organization seeking the exemption. The department may waive this requirement if the department already has a copy of the organization's determination letter on file.
3. Include an annual financial audit for the year(s) previous to the specific period (s) that the exemption is sought. The audit must be prepared by an independent certified public accountant and should substantiate that 80 percent of all monies collected from all sources are used for health and medical related educational and charitable services. (NOTE: A start-up organization may explain the unavailability of this information to the department in its request.)

- Discussion:

- A. It is important to note that under the various classifications providing an exemption for sales to qualifying health organizations, with the exceptions of A.R.S. §§ 42-5061(A)(25) (c) and 42-5159(A)(13)(e), the tangible personal property must be used solely to provide health and medical related educational and charitable services.
 - B. There are no exceptions to the statutory requirements. The § 501(c) determination letter must be on file with the department and the financial audit must be submitted with the annual request. (Note: The IRS issues a § 501(c) determination letter as of a specific date. The entity does not qualify as a § 501(c) organization prior to that date. The name on the IRS letter should match the name of the organization seeking the exemption.)
 - C. Under these statutory requirements it is generally acknowledged that the following types of organizations are health and medical related:
 1. Organizations related to the maintenance of health.
 2. Medical research organizations.
 3. Support organizations which may not necessarily treat the patient directly, but which support other exempt organizations which do.
 4. Mental and physical health organizations, e.g., a school for emotionally disturbed children.
 5. Organizations related to and for the treatment of alcoholism, drug abuse, physical abuse.
 6. Organizations specializing in testing and evaluation for mental, physical and other health related maladies.
 7. Support group organizations.
 8. Organizations related to education of the public.
 9. Organizations publishing health related publications.
 10. Organizations conducting and organizing health fairs.
 11. Organizations for the maintenance of conditions conducive to health.
- A. The annual financial audit must be performed by an independent

certified public accountant, according to generally accepted accounting principles. The department will rely on the financial audit for determination of the statutory requirement regarding eighty (80) percent usage of all funds only for health and medical related educational and charitable services.

Eighty (80) percent usage may be determined in three ways.

1. Positive certification by the independent certified public accountant as to the usage of all funds only for health and medical related educational and charitable services. This will be in the form of a separate letter in which the accountant attests to eighty (80) percent usage or by actual reference in the opinion issued as part of the audit. Negative confirmation letters or *general purpose* statements are not sufficient to meet this requirement.
2. If there is no certification with the audit the department will compute the ratio of program services to total income.
3. If the result in item (2) is not at least eighty (80) percent, the department will review the breakdown of support expenses and re-calculate the ratio based upon the available information submitted with the request.

The department recognizes that organizations must pay rent, utilities, wages, travel, etc. as part of the expenses of the organization. *Each case is a facts and circumstances situation.* Therefore it is beneficial to the organization to provide as much information as necessary to reflect its specific situation.

The department will look to answer such questions as the following. *What is the general use of income in relation to the exempt purpose of the organization? Has the entity really spent the resources received? Has it spent them for health and medical related educational and charitable services? Is there an accumulation of income? How much income does the organization have left? Are there unusual expenses? Are the categories of expenses valid?*

- Qualifying health care organizations ***dedicated to providing educational, therapeutic, rehabilitative and family medical education training for blind, visually impaired and multi-handicapped children from the time of birth to age 21***

A.R.S. §§ 42-5061(A)(25)(c) and 42-5159(A)(13)(e) respectively, provide exemptions from transaction privilege tax and use tax for retail sales to a qualifying health care organization dedicated to providing educational, therapeutic, rehabilitative and family medical education training for blind, visually impaired and multi-handicapped children from the time of birth to age 21.

The exemptions *are not limited* to tangible personal property which is used by the organization solely to provide health and medical related educational and charitable services.

To qualify as a health care organization for blind, visually impaired and multi-handicapped children (from birth to age 21), the organization must satisfy the requirements of a qualifying health care organization. In addition, it must provide documentation showing that the organization is dedicated to providing educational, therapeutic, rehabilitative and family medical education training for blind, visually impaired and multi-handicapped children from the time of birth to age 21.

III. A QUALIFYING COMMUNITY HEALTH CENTER

- Applicable Law:

A.R.S. § 42-5001(9) defines a *qualifying community health center* as:

An entity that is recognized as nonprofit under 501(c)(3) of the United States internal revenue code that is a community-based, primary care clinic that has a community-based board of directors and that is either:

- a. The sole provider of primary care in the community.
- b. A nonhospital affiliated clinic that is located in a federally designated medically underserved area in this state.

The exemptions from the transaction privilege tax and use tax are provided by:

A.R.S. § 42-5061(A)(25)(d) *Retail classification*

A.R.S. § 42-5071(B)(2)(a) *Personal property rental classification*

A.R.S. § 42-5159(A)(13)(i) *Use Tax*

- Application for Exemption:

Organizations must apply to the Department of Revenue for an annual exemption letter to take advantage of the statutory exemptions. Exemption letter requests should be submitted at least (30) thirty days prior to the beginning of the calendar or fiscal year for which the organization is requesting exemption.

The request must:

1. Be in writing.
 2. Include a copy of the organization's I.R.C. § 501(c)(3) determination letter. The IRS issues a § 501(c)(3) determination letter as of a specific date. The entity does not qualify as a § 501(c)(3) organization prior to that date. The name on the IRS letter should match the name of the organization seeking the exemption. The department may waive the letter requirement if the department already has a copy of the organization's determination letter on file.
 3. Include documentation showing that the organization meets the statutory definition of a qualifying community health center.
- Discussion:

Generally a community may be anything from a town/city to a group of people with a common bond or unifying trait. A community is not limited to any particular geographical area. It may be part of a larger town/city or it may extend beyond the boundaries of a town/city. A community-based facility would generally be that which is indigenous to the area in which it is located and that was created to serve that community of individuals.

The organization should include with its request a description of the services provided at the clinic.

A primary care clinic is a facility that delivers the first level of care to patients through the employment of physicians, professional nurses, physician's assistants or other health care technical and professional personnel. A clinic may range in size from one individual to a group of individuals. Primary care encompasses any one or any combination of the following four areas of medicine: internal medicine, gynecology, family practice or pediatrics. The type of services such a clinic provides include preventive, diagnostic, treatment, consultation, referral, routine associated laboratory, diagnostic radiological, and emergency health. The fact that a clinic also provides specialized medical care in addition to primary care does not prevent the clinic from qualifying as a primary care clinic.

The organization should provide documentation with its request that the clinic has a community-based board of directors consisting of names, addresses, and occupations of board members; by-laws; or other internal governing documents. Documentation should include information regarding the targeted users of the clinic.

A majority of the board members of the clinic should be individuals who, as a group, are representative of the population using the center within the community in which the facility is located or the group that the facility was formed to serve.

If the organization is seeking qualification as the sole provider of primary care in the community, it should include in its request documentation showing that it is the sole provider of

primary care in the community. Examples of acceptable documentation include a letter from the board of directors certifying that it is the sole provider of primary care in the community and a description of the area to which the clinic provides services.

If the organization is seeking qualification as a *nonhospital* affiliated clinic that is located in a federally designated medically *underserved* area in this state, the organization should include in its request verification that the clinic is not affiliated with a hospital. Examples include a letter from the board of directors certifying that it is not affiliated with any hospital and if applicable, a copy of its medical facility license issued by the Arizona Department of Health Services.

IV. REHABILITATION PROGRAMS FOR MENTALLY OR PHYSICALLY HANDICAPPED PERSONS

- Applicable Law:

A.R.S. §§ 42-5061(A)(29) and 42-5159(A)(13)(f) provide for exemption from the transaction privilege tax and the use tax, respectively, for tangible personal property *purchased or leased* in this state by a nonprofit charitable organization which has qualified under § 501(c)(3) of the United States Internal Revenue Code.

In order to qualify for the exemption:

1. The organization must operate programs for mentally or physically handicapped persons;
2. The programs must be in the areas of training, job placement, rehabilitation or testing; and,
3. The tangible personal property purchased or leased by the organization must be used exclusively for the purposes listed in items 1 and 2.

- Application for Exemption:

The annual request must:

1. Be in writing.
2. Include a copy of the organization's I.R.C. § 501(c)(3) determination letter. The IRS issues a § 501(c)(3) determination letter as of a specific date. The entity does not qualify as a § 501(c)(3) organization prior to that date. The name on the IRS letter should match the name of the organization seeking the exemption. The department may waive the letter requirement if the department already has a copy of the organization's determination letter on file.
3. Include documentation attesting that the items purchased or leased will be used exclusively for training, job placement or rehabilitation programs or testing for mentally or physically handicapped persons.

V. GENERAL INFORMATION APPLICABLE TO ALL ORGANIZATIONS

If an organization seeking qualification does not submit the required documents, the department may send a letter requesting further information and allowing thirty (30) days within which to respond. If there is no response or if the information is not sufficient, a denial will be issued. The decision of the department based upon information sent with an application for exemption is final.

An exemption letter is valid for a period of 12 months from the first day of the month following the issue date of the exemption letter unless the organization's tax exempt status changes prior to the end of the 12-month period, or the organization misrepresented or omitted material information in its exemption request.

- Prior Year Applications

An organization requesting exempt status under any of these statutory provisions is required to submit an annual request for an exemption letter. Generally a request must be submitted at least thirty (30) days prior to the beginning of the year for which the exemption is requested. However, the department will honor a request for a prior year(s). An exemption letter for a previous year may be granted if the organization submits all required documentation.

Required Documentation:

1. The effective date of the I.R.C. § 501(c) or § 501(c)(3) determination letter must be dated/issued on or before the time period for which the department's exemption letter is granted.
2. Required licenses must be applicable to the time periods at issue.
3. The annual financial audit, as required for qualifying health care organizations, must be for the year in question or for the last preceding fiscal year end prior to that year. The requesting entity is not allowed to use an audit for more than one year.

All organizations are subject to the statutory provisions in A.R.S. § 42-1106 *Time limitations for credit and refund claims* and § 42-1108 *Audit; deficiency assessments*.

- Appeal of Agency's Decision

A.R.S. § 41-1092 defines "appealable agency action" as an action that determines the legal rights, duties or privileges of a party and that is not preceded by an opportunity for an administrative hearing. A denial of qualification by the department is an appealable agency action.

A party may obtain a hearing on an appealable agency action by filing a petition or notice of appeal with the agency within forty-five (45) days after receiving a denial of exemption. See Arizona Administrative Code (A.A.C.) R15-10-105(C) for further instruction on filing a petition. Generally hearings for appealable agency actions are held within sixty (60) days after the notice of appeal is filed. (See A.R.S. § 41-1092.05.)

If requested by the appellant of an appealable agency action, the department will hold an informal settlement conference within fifteen (15) days after receiving the written request. Procedures for informal settlement conferences are covered by A.R.S. § 41-1092.06.

Mark W. Killian, Director

Explanatory Notice

The purpose of a tax procedure is to provide procedural guidance to the general public and to department personnel. A tax procedure is a written statement issued by the department to assist in the implementation of tax laws, administrative rules, and tax rulings by delineating procedures to be followed in order to achieve compliance with the law. Relevant statute, case law, or administrative rules, as well as a subsequent procedure, may modify or negate any or all of the provisions of any tax procedure. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.