

**REDACTED DECISION – DK# 12-199 CU-C, 12-200 U-C
BY – MATTHEW R. IRBY¹, ADMINISTRATIVE LAW JUDGE
SUBMITTED FOR DECISION on DECEMBER 9, 2012
DECISION ISSUED ON MAY 7, 2013**

SYNOPSIS

TAX ADMINISTRATION -- DUTIES OF TAX COMMISSIONER -- It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. §11-1-2 (West 2010).

TAXATION -- PROCEDURE AND ADMINISTRATION -- “The Tax Commissioner shall collect the taxes, additions to tax, penalties and interest imposed by this article or any of the other articles of this chapter to which this article is applicable.” W. Va. Code Ann. §11-10-11(a) (West 2010).

TAXATION -- USE TAX -- IMPOSITION -- “An excise tax is hereby levied and imposed on the use in this state of tangible personal property, custom software or taxable services, to be collected and paid as provided in this article or article fifteen-b of this chapter, at the rate of six percent of the purchase price of the property or taxable services, except as otherwise provided in this article.” W. Va. Code Ann. §11-15A-2(a) (West 2010).

TAXATION -- USE TAX -- EXEMPTIONS -- “The use in this state of the following tangible personal property, custom software and services is hereby specifically exempted from the tax imposed by this article to the extent specified: (2) Tangible personal property, custom software or services, the gross receipts from the sale of which are exempt from the sales tax by the terms of article fifteen, chapter eleven of the code of West Virginia, one thousand nine hundred thirty-one, as amended, and the property or services are being used for the purpose for which it was exempted.” W. Va. Code Ann §11-15A-3(a)(2) (West 2013).

TAXATION -- CONSUMERS SALES AND SERVICE TAX -- EXEMPTIONS -- West Virginia Code Section 11-15-9(a)(6) provides an exemption from the consumers sales and service tax for: “Sales of tangible personal property or services to a corporation or organization which has a current registration certificate issued under article twelve of this chapter, which is exempt from federal income taxes under Section 501(c)(3) or (c)(4) of the Internal Revenue Code of 1986, as amended, and which is: (A) A church or a convention or association of churches as defined in Section 170 of the Internal Revenue Code of 1986, as amended.” W. Va. Code Ann. §11-15-9(a)(6)(A) (West 2010).

TAXATION -- CONSUMERS SALES AND SERVICE TAX -- LIMITATIONS ON EXEMPTIONS -- “The exemption allowed by this subdivision does not apply to . . . sales of

¹ After the evidentiary hearing in this matter, Judge Irby left the Office of Tax Appeals. This decision was written by Chief Administrative Law Judge A.M. “Fenway” Pollack.

tangible personal property or services to be used or consumed in the generation of unrelated business income as defined in Section 513 of the Internal Revenue Code of 1986, as amended. The exemption granted in this subdivision applies only to services, equipment, supplies and materials used or consumed in the activities for which the organizations qualify as tax-exempt organizations under the Internal Revenue Code” W. Va. Code Ann. §11-15-9(a)(6)(G) (West 2010).

INTERNAL REVENUE CODE – DEFINITION -- UNRELATED TRADE OR BUSINESS – Section 513 of the Internal Revenue Code defines unrelated trade or business as: “any trade or business the conduct of which is not substantially related . . . to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501” I.R.C. §513(a) (West 2013).

INTERNAL REVENUE SERVICE, TREASURY -- UNRELATED TRADE OR BUSINESS -- “The primary objective of adoption of the unrelated business income tax was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the nonexempt business endeavors with which they compete.” 26 CFR §1.513-1(b) (West 2013).

WEST VIRGINIA OFFICE OF TAX APPEALS -- BURDEN OF PROOF -- In proceedings before the West Virginia Office of Tax Appeals the burden of proof is upon the Petitioner. *See* W. Va. Code Ann. §11-10A-10(e) (West 2010).

TAXATION -- EXEMPTIONS CONSTRUCTIVELY CONSTRUED -- “Where a person claims an exemption from a law imposing a license or tax, such law is strictly construed against the person claiming the exemption” *See* Syl. Pt. 5 Davis Memorial Hosp. v. West Virginia State Tax Com'r, 222 W.Va. 677, 671 S.E.2d 682 (2008); Syl. Pt. 1 RGIS Inventory Specialists v. Palmer, 209 W.Va. 152, 544 S.E.2d 79 (2001); Syl. Pt. 4 Shawnee Bank, Inc. v. Paige, 200 W.Va. 20, 488 S.E.2d 20 (1997).

WEST VIRGINIA OFFICE OF TAX APPEALS -- CONCLUSION OF LAW -- Conducting the business of a day care center is not substantially related to the performance by the Petitioner of its 501(c)(3) purpose, which is as a religious organization operating a church.

WEST VIRGINIA OFFICE OF TAX APPEALS -- CONCLUSION OF LAW -- The Petitioner is not entitled to an exemption from use taxes under West Virginia law and has not met its burden of showing that the assessment issued against it was erroneous, unlawful, void or otherwise invalid.

FINAL DECISION

On March 22, 2012, the Auditing Division of the West Virginia State Tax Commissioner’s Office (the Tax Department or the Respondent) issued two Audit Notices of Assessment against the Petitioner. These assessments were issued pursuant to the authority of

the State Tax Commissioner, granted to him by the provisions of Chapter 11, Article 10 *et seq*, of the West Virginia Code. The first assessment was for use tax for the period January 1, 2007, through June 30, 2008, for tax in the amount of \$____, and interest in the amount of \$____, for a total assessed tax liability of \$____. The second assessment was for combined sales and service and use tax for the period July 1, 2008, through December 31, 2011, for tax in the amount of \$____, and interest in the amount of \$____, for a total assessed tax liability of \$____. These two assessments represent a combined total tax liability of \$____. Written notice of these assessments was served on the Petitioner as required by law.

Thereafter, on May 22, 2012, the Petitioner timely filed with this Tribunal, the West Virginia Office of Tax Appeals, two petitions for reassessment. *See* W. Va. Code Ann. §§11-10A-8(1); 11-10A-9 (West 2010).

Subsequently, notice of a hearing on the petitions was sent to the Petitioner, and a hearing was held in accordance with the provisions of West Virginia Code Section 11-10A-10, after which the parties filed legal briefs. The matter became ripe for a decision at the conclusion of the briefing schedule.

FINDINGS OF FACT

1. The Petitioner operates a church and day care center (hereinafter "the Center") in a West Virginia city, in a county in West Virginia.
2. The record is not clear as to when the church began operating. However, in February of 1987, the church was granted a 501(c)(3) exemption from federal income taxes by the Internal Revenue Service. The Center began operation at some unidentified time after 1987.
3. The Center operates in identical fashion to any other day care center, in that it, for a fee, provides care for children during weekdays while their parents are otherwise engaged. At

various times in its history, the Center has allowed some children to attend free of charge, due to the financial difficulties of the parents. The children do receive some bible lessons during the course of the day, along with a traditional pre-k curriculum. At the time of the evidentiary hearing in this matter, none of the members of the church's congregation had children enrolled in the day care.

4. In April of 2011, an auditor from the West Virginia State Tax Department conducted an audit of the Center.

5. The Petitioner's records were complete enough to allow the auditor to do a detailed audit.

6. During this audit it was discovered that the Petitioner was not remitting use tax on its purchases of tangible personal property and services for the Center.

7. This discovery led to the assessments that form the basis of this matter. Specifically, the auditor reviewed the purchases of tangible personal property and services utilized by the Center and assessed the appropriate amount of use tax that was due but unremitted. In consultation with the director of the center, the auditor pro-rated purchases that were used by both the church and the Center.²

DISCUSSION

The relevant facts in this matter are not in dispute. The parties seem to agree regarding the operation of the day care center and what transpired during the audit. The parties also agree that the Petitioner is exempt from federal income taxes pursuant to Section 501(c)(3) of the Internal Revenue Code. The Petitioner does not argue that the auditor conducted the audit incorrectly or that it did not purchase the property and services, which generated the sales and

² Regarding the Center's food purchases, the auditor testified that she prorated some of these purchases to correspond with the reduction in the sales tax on food that occurred during the audit period.

use tax assessment. The Petitioner simply argues that its purchases are exempt from West Virginia use tax because of its 501(c)(3) designation. The Tax Commissioner argues that the 501(c)(3) designation, alone, does not provide the requested exemption.

Generally, if a business in West Virginia were to buy a case of glass cleaner from ABC Cleaning Supplies in Anytown, U.S.A., one of two things would happen. Either ABC would charge the business West Virginia sales tax or the business would later remit use tax to the Tax Commissioner pursuant to West Virginia Code Section 11-15A-2, which states:

An excise tax is hereby levied and imposed on the use in this state of tangible personal property, custom software or taxable services, to be collected and paid as provided in this article or article fifteen-b of this chapter, at the rate of six percent of the purchase price of the property or taxable services, except as otherwise provided in this article.

W. Va. Code Ann. §11-15A-2(a) (West 2010). However, there are exemptions from the use tax, and one of those exemptions is if the property or service is exempt from sales tax, pursuant to Article 15 of Chapter 11. *See* W. Va. Code Ann. § 11-15A-3 (West 2013). Section 9 of Article 15, Chapter 11 contains the sales tax exemptions and subsection (a)(6) of Section 9 provides an exemption for:

Sales of tangible personal property or services to a corporation or organization which has a current registration certificate issued under article twelve of this chapter, which is exempt from federal income taxes under Section 501(c)(3) or (c)(4) of the Internal Revenue Code of 1986, as amended, and which is: (A) A church or a convention or association of churches as defined in Section 170 of the Internal Revenue Code of 1986, as amended.

W. Va. Code Ann. §11-15-9(a)(6)(A) (West 2010). If one keeps reading just a few subparagraphs beyond (a)(6)(A) they would discover that the Legislature has put limitations on the exemptions for 501(c)(3) organizations.

The exemption allowed by this subdivision does not apply to . . . sales of tangible personal property or services to be used or consumed in the generation of unrelated business income as defined in Section 513 of the Internal Revenue Code of 1986, as amended. The exemption granted in this subdivision applies only

to services, equipment, supplies and materials used or consumed in the activities for which the organizations qualify as tax-exempt organizations under the Internal Revenue Code

Id., at (a)(6)(G). Section 513 defines unrelated trade or business as:

The term “unrelated trade or business” means, . . . any trade or business the conduct of which is not substantially related . . . to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501

I.R.C. § 513(a) (West 2013). The Tax Commissioner argues that it is axiomatic that a day care center would naturally generate business income that would be unrelated to the purpose of a Church.

The Petitioner in this matter, like all Petitioners before the Office of Tax Appeals, has the burden of proof. *See* W. Va. Code Ann. §11-10A-10(e) (West 2010). Additionally, “[w]here a person claims an exemption from a law imposing a license or tax, such law is strictly construed against the person claiming the exemption.” *See* Syl. Pt. 5 Davis Memorial Hosp. v. West Virginia State Tax Com'r, 222 W.Va. 677, 671 S.E.2d 682 (2008); Syl. Pt. 1 RGIS Inventory Specialists v. Palmer, 209 W.Va. 152, 544 S.E.2d 79 (2001); Syl. Pt. 4 Shawnee Bank, Inc. v. Paige, 200 W.Va. 20, 488 S.E.2d 20 (1997).

It is hard to tell what the Petitioner’s arguments actually are. At the evidentiary hearing, it suggested, by the tenor of its testimony, that it believes that the purpose of the church and the purpose of the Center are substantially related. In its post hearing brief it never even mentions West Virginia Code Section 11-15-9(a)(6), which contains the exemption that it supposedly seeks, let alone any discussion of why the limitation on the exemption in (a)(6)(G) does not apply to it. Rather, the Petitioner spends much of its brief discussing how the church is a charitable organization. The question of whether or not the church is a charitable organization is

not determinative of the issue before this Tribunal. Section 9, the sales tax exemptions, makes it clear that the 501(c)(3) exemption is not absolute, whether you are a church, charitable organization or the Boy Scouts; the exemption does not apply to unrelated business income. Therefore, the question before us is, has the Petitioner met its burden of showing that its operation of the Center is substantially related to the purpose for which the Internal Revenue Service granted it 501(c)(3) status? We rule that the Petitioner has not met its burden in this regard.

The Petitioner in this matter has two difficult hurdles to overcome. First, is the well-established rule of statutory construction which requires us to strictly construe the language in West Virginia Code Section 11-15-9(a)(6)(G) against the Petitioner. Second, is the use of the phrase "substantially related" in Section 513(a) of the Internal Revenue Code. Construing that phrase strictly against the Petitioner can only lead to upholding the assessment. Our decision would be the same even if we did not use a strict construction. The Tax Commissioner is correct; it is axiomatic that the purpose of a church is not substantially related to the purpose of a day care center. A church has many purposes, but generally it is to promote a specific religion and to bring people's hearts and minds closer to that religion. The purpose of a day care center is to care for children while their parents are otherwise engaged. It certainly could be argued (and was by the Petitioner) that there is a relationship between the church and the Center. The problem for the Petitioner is that the relationship has to involve the purpose of the two endeavors and has to be substantial, and in this matter the Petitioner has not made such a showing.

Our ruling is bolstered by a review of the Internal Revenue Service regulations that accompany Section 513. This review reveals that an important consideration for the Internal Revenue Service (and by implication for the West Virginia Legislature) was unfair competition

between exempt and non-exempt organizations. “The primary objective of adoption of the unrelated business income tax was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the nonexempt business endeavors with which they compete.” 26 CFR § 1.513-1(b) (2013). This regulatory language raises another obvious fact; all of the other day care centers in and around a city in West Virginia are in competition with each other and with the Petitioner. Therefore, the Petitioner would have an unfair advantage by obtaining a tax break that is unavailable to similarly situated day care centers. Apparently, according to the language in the regulation, avoiding this outcome was one of the primary purposes in the adoption of the unrelated business income tax. When the West Virginia Legislature coupled the limitations on 11-15-9(a)(6) exemptions with Internal Revenue Service Section 513, it too must have had the same concerns.

Based upon the foregoing, we rule that the Petitioner has not met its burden of showing entitlement to the requested exemption.

CONCLUSIONS OF LAW

1. It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. §11-1-2 (West 2010).

2. “The Tax Commissioner shall collect the taxes, additions to tax, penalties and interest imposed by this article or any of the other articles of this chapter to which this article is applicable.” W. Va. Code Ann. §11-10-11(a) (West 2010).

3. “An excise tax is hereby levied and imposed on the use in this state of tangible personal property, custom software or taxable services, to be collected and paid as provided in this article or article fifteen-b of this chapter, at the rate of six percent of the purchase price of the

property or taxable services, except as otherwise provided in this article.” W. Va. Code Ann. §11-15A-2(a) (West 2010).

4. “The use in this state of the following tangible personal property, custom software and services is hereby specifically exempted from the tax imposed by this article to the extent specified: (2) Tangible personal property, custom software or services, the gross receipts from the sale of which are exempt from the sales tax by the terms of article fifteen, chapter eleven of the code of West Virginia, one thousand nine hundred thirty-one, as amended, and the property or services are being used for the purpose for which it was exempted.” W. Va. Code Ann. §11-15A-3(a)(2) (West 2013).

5. West Virginia Code Section 11-15-9(a)(6) provides an exemption from the consumers sales and service tax for: “Sales of tangible personal property or services to a corporation or organization which has a current registration certificate issued under article twelve of this chapter, which is exempt from federal income taxes under Section 501(c)(3) or (c)(4) of the Internal Revenue Code of 1986, as amended, and which is: (A) A church or a convention or association of churches as defined in Section 170 of the Internal Revenue Code of 1986, as amended.” W. Va. Code Ann. §11-15-9(a)(6)(A) (West 2010).

6. “The exemption allowed by this subdivision does not apply to . . . sales of tangible personal property or services to be used or consumed in the generation of unrelated business income as defined in Section 513 of the Internal Revenue Code of 1986, as amended. The exemption granted in this subdivision applies only to services, equipment, supplies and materials used or consumed in the activities for which the organizations qualify as tax-exempt organizations under the Internal Revenue Code” W. Va. Code Ann. §11-15-9(a)(6)(G) (West 2010).

7. Section 513 of the Internal Revenue Code defines unrelated trade or business as “any trade or business the conduct of which is not substantially related . . . to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501” I.R.C. §513(a) (West 2013).

8. “The primary objective of adoption of the unrelated business income tax was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the nonexempt business endeavors with which they compete.” 26 CFR §1.513-1(b) (West 2013).

9. In proceedings before the West Virginia Office of Tax Appeals the burden of proof is upon the Petitioner. *See* W. Va. Code Ann. §11-10A-10(e) (West 2010).

10. “Where a person claims an exemption from a law imposing a license or tax, such law is strictly construed against the person claiming the exemption” *See* Syl. Pt. 5 Davis Memorial Hosp. v. West Virginia State Tax Com'r, 222 W.Va. 677, 671 S.E.2d 682 (2008); Syl. Pt. 1 RGIS Inventory Specialists v. Palmer, 209 W.Va. 152, 544 S.E.2d 79 (2001); Syl. Pt. 4 Shawnee Bank, Inc. v. Paige, 200 W.Va. 20, 488 S.E.2d 20 (1997).

11. Conducting the business of a day care center is not substantially related to the performance by the Petitioner of its 501(c)(3) purpose, which is as a religious organization operating a church.

12. The Petitioner is not entitled to an exemption from use taxes under West Virginia law and has not met its burden of showing that the assessment issued against it was erroneous, unlawful, void or otherwise invalid.

DISPOSITION

WHEREFORE, it is the final decision of the West Virginia Office of Tax Appeals that the two assessments issued against the Petitioner on March 22, 2012, for use tax and for combined sales and service and use tax, respectively, for a combined total tax liability of \$____, should be and hereby are **AFFIRMED**.

Pursuant to West Virginia Law, interest accrues on the assessments until the liabilities are fully paid. *See* W. Va. Code Ann. §11-10-17(a) (West 2010).

WEST VIRGINIA OFFICE OF TAX APPEALS

By: _____
A. M. "Fenway" Pollack
Chief Administrative Law Judge

Date Entered