



Nonprofits and Taxes: What You Need to Know



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KENTUCKY NONPROFITS – WHAT YOU NEED TO KNOW ABOUT TAXES

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As Kentucky attorneys, it is almost certain you will encounter questions regarding nonprofits in some capacity, whether as volunteer, board member, or advisor. Nonprofit practice can be a surprisingly complex area of the law. There are numerous areas of the law that nonprofits must consider, but surprisingly, tax implications of nonprofit status are often overlooked. While most people understand, at a high level, that nonprofits are exempt from federal income tax, the reality is more complicated. Furthermore, the state and local tax treatment of nonprofits is varied and often complex.

This material will discuss some of the tax issues a nonprofit needs to be aware of on both the federal and state levels. Importantly, this is merely an overview. Not every nonprofit model is covered, nor is every potentially applicable tax. Thus, a nonprofit should consult a tax advisor to determine what its obligations may be.

I. FEDERAL TAX-EXEMPT STATUS

When an organization is described as “nonprofit” or “tax exempt,” this typically refers to a federal income tax classification. This federal classification forms the basis of entity classification for state tax purposes as well, although as you will see, there are sometimes important differences. But what exactly does this mean?

Generally speaking, there are two common ways for an entity to be classified as tax exempt on the federal level. The first way is to be classified as one of the entities listed in the Internal Revenue Code (“IRC”) under [Section 115](#). This section provides an exemption for state governments and any political subdivision thereof. The most common way in which an organization becomes classified as tax-exempt on the federal level, however, is to meet the criteria of [IRC §501](#).

There are numerous entities that qualify as tax-exempt under [IRC §501](#), ranging from hospitals to recreational clubs. Some of the most common are [§501\(c\)\(3\)](#) organizations, social welfare organizations exempt under [IRC §501\(c\)\(4\)](#), business leagues, chambers of commerce, real estate boards and boards of trade exempt under [IRC §501\(c\)\(6\)](#), and social and recreational clubs exempt under [IRC §501\(c\)\(7\)](#). By far, the most common exemptions are found under [IRC §501\(c\)\(3\)](#).

A [§501\(c\)\(3\)](#) organization includes organizations 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

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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), 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.

This code section provides a number of requirements that must be met for tax exemption. While a review of these requirements is beyond the scope of these materials, the IRS provides useful guidance on these requirements, and an attorney with nonprofit experience can be an invaluable resource.

Most organizations claiming exemption under [§501\(c\)\(3\)](#) must apply for an exemption. This often occurs using a [Form 1023-EZ](#) (online only), [Form 1023](#), [Form 1024-A](#) or [Form 1024](#), depending on the exact exemption being claimed and on the anticipated gross receipts and assets of the organization. However, many organizations, including churches and their integrated auxiliaries, and small organizations that bring in less than \$5,000 per year, are not required to file for an exemption. Other organizations must simply notify the IRS of the intent to operate in an exempt manner.

II. FEDERAL INCOME TAXES

An entity exempt from taxation under [IRC §501](#) is generally exempt from federal income tax on its income. However, it is important to note that this is not absolute.

First, a nonprofit, even one operating appropriately, is required to file information returns on one of the [Form 990 series](#).² Failure to file these returns for three consecutive years results in automatic revocation of exempt status. If the organization does not obtain a reinstatement from the IRS, its income becomes subject to the then current corporate tax rate.³ Depending on the exact circumstances, the IRS may deny the reinstatement or may grant it retroactively or prospectively.

Second, an otherwise exempt organization may have unrelated business income, which is taxable. [IRC §511](#). Unrelated business taxable income (“UBTI”) is gross income from an organization's unrelated trades or businesses, less deductions for business expenses, losses, depreciation, and similar items “directly connected with the carrying on of such trade or business.” [IRC §512\(a\)\(1\)](#). This can include certain income from investments or programs operated by nonprofits. The tax rate depends on the type of legal organization the nonprofit is classified as.

² Note that religious institutions and their integrated auxiliaries which do not hold an independent [§501\(c\)\(3\)](#) designation are not required to file information returns (or [Form 990](#)) with the IRS. Other entities may petition the IRS for filing exemptions, but the availability of such exemptions is limited.

³ This tax rate being the flat 21% at the corporate level enacted by the Tax Cuts and Jobs Act (“TJCA”) and extended through the enactment of the One Big Beautiful Bill Act (“OBBA”) in 2025.

The presence of UBTI alone does not jeopardize an organization's exempt status, although the organization must file a separate tax return and remit the appropriate tax. However, if the majority of an organization's income consists of UBTI, the IRS may view the organization as one operated for profit and may revoke the organization's exemption.

It is also important to note that UBTI has a number of exceptions, and exceptions to those exceptions. For example, while most investment income is considered unrelated business income, specific code sections exempt most of this income from tax. The same is true for rental and lease income in many situations. However, these items that are ordinarily not taxed can become taxable if the property or income is subject to certain financing. For example, if stock that generates dividends is purchased using financing, the normally exempt dividends will become at least partially taxable. Thus, it is important to do an in-depth analysis of the tax consequences of income generating activities.

III. FEDERAL EXCISE TAXES

While many organizations are aware, to some extent, of potential income taxes that may apply to their organization despite its exempt status, few consider the potential impact of federal excise taxes.

Before discussing the most common excise taxes, it is important to note that with respect to [§501\(c\)\(3\)](#) organizations, the IRS uses two broad categories to classify organizations. These categories are public charities and private foundations.⁴ While there are subcategories of each, each with its own set of rules and regulations, in general, federal excise taxes are more likely to apply to private foundations than to public charities.

Two common excise taxes potentially apply to both private foundations and public charities. These include the tax on excess benefits found in [IRC §4958](#) and the tax on excess tax-exempt organization executive compensation found in [IRC §4960](#).

The excise tax on excess benefits is designed to penalize individuals, not organizations themselves, who receive more benefit from an exempt organization than they should receive based on services rendered. This excise tax is commonly applied in the case of compensation, for example when an officer is paid significantly in excess of the value of their services, or when the organization purchases property or enters into a transaction that is particularly lopsided in favor of the other party. In the event a person meets the definition of

⁴ The IRS automatically classifies organizations under [§501\(c\)\(3\)](#) as private foundations unless an organization can demonstrate that it is a public charity. Generally speaking, private foundations receive their funding from a small number of donors, although they may still conduct fundraising from the general public. Public charities, however, often receive the majority of their funding from the general public, other nonprofits, or government agencies, or actively solicit donations from these groups on a regular basis. Public charities are also limited in the amount of investment income they may receive, while private foundations traditionally rely heavily on investment income.

“disqualified person,”⁵ and that person engages in an excess benefit transaction,⁶ the disqualified person is subject to an excise tax of 25% of the excess benefit. [IRC §4958\(a\)\(1\)](#). If not returned to the organization within the taxable period identified in the statute, the tax balloons to 200% of the excess benefit. [IRC § 4958\(b\)](#). Additionally, if the management of the organization agrees to the transaction while knowing it is an excess benefit transaction, the management is subject to a 10% excise tax. [IRC §4958\(a\)\(2\)](#).

The excise tax on excess executive compensation, unlike the excess benefit transaction tax, does apply to the organizations themselves. This tax was added to the IRC as part of the major tax reform efforts of late 2017. The tax provides that the corporate tax rate will apply to the amount of remuneration, as defined by the statute, paid by an applicable tax-exempt organization to any covered employee in excess of \$1 million. [IRC §4960](#). While few organizations will ever be large enough for this tax to potentially apply, it should be noted that the tax does apply to governmental organizations in addition to traditional nonprofits.

Other excise taxes typically apply only to private foundations. These include an excise tax based on investment income, which applies to most foundations that generate investment income, equal to 1.39% of the net investment income for the taxable year. [IRC §4940](#).

In the event a private foundation engages in a self-dealing transaction, the self-dealer (disqualified person) is subject to a tax equal to 10% of the amount involved in the transaction, which increases to 200% if not returned within the taxable period. [IRC §4941](#). Foundation managers who knowingly agree to such a transaction are also subject to a 5% excise tax, which increases to 50% if the manager refuses to agree to part or all of the correction of the transaction. *Id.*

Foundations can also be subject to a tax equal to 30% of their undistributed income, if such income is not distributed within a set period of time. This tax increases to 100% of the undistributed income if the income is not distributed within the taxable period set by statute.

⁵ “The term ‘disqualified person’ means, with respect to any transaction, (A) any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, (B) a member of the family of an individual described in subparagraph (A), (C) a 35-percent controlled entity, (D) any person who is described in subparagraph (A), (B), or (C) with respect to an organization described in [section 509\(a\)\(3\)](#) and organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of the applicable tax-exempt organization, (E) which involves a donor advised fund (as defined in [section 4966\(d\)\(2\)](#)), any person who is described in paragraph (7) with respect to such donor advised fund (as so defined), and (F) which involves a sponsoring organization (as defined in [section 4966\(d\)\(1\)](#)), any person who is described in paragraph (8) with respect to such sponsoring organization (as so defined).” [IRC §4958\(f\)\(1\)](#).

⁶ “The term ‘excess benefit transaction’ means any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. For purposes of the preceding sentence, an economic benefit shall not be treated as consideration for the performance of services unless such organization clearly indicated its intent to so treat such benefit.” [IRC §4958\(c\)\(1\)](#).

[IRC §4942](#). While public charities are not subject to an equivalent tax, it should be noted that failure to spend a sufficient amount on exempt activities can lead to a revocation of status.

Foundations must also avoid excess business holdings.⁷ In the event a foundation has excess business holdings, the foundation must pay an excise tax equal to 10% of the excess holdings. [IRC §4943](#). This tax increases to 200% if the holdings are not divested within the statutory time period. *Id.*

The IRS views some private foundation investments as those that may jeopardize the organization's charitable purpose. These are generally considered to be risky or non-diverse investments, with the risk determined as of the time the investment is made. In the event such an investment is made, the private foundation is subject to an excise tax equal to 10% of the amount so invested for each year of the taxable period, which increases to 25% if not corrected. [IRC §4944](#). There is also a 10% tax on management that knowingly participates in such an investment. An additional 5% tax will be imposed in the event management does not support correction. *Id.*

Foundations are also not allowed to make certain expenditures, including certain expenditures to influence legislation or elections, certain types of travel grants, and grants to most other foundations. In the event these prohibited expenditures are made, the foundation is subject to an excise tax of 20% of the amount of the expenditure, which increases to 100% if the transaction is not corrected. [IRC §4945](#). There is also a 5% tax on the foundation's management if the management knowingly agrees to such expenditure. This tax rises to 50% if the management refuses to correct the transaction. *Id.*

IV. FEDERAL EMPLOYMENT TAXES

While nonprofit organizations are generally exempt from paying income taxes, these organizations are not exempt from collecting and remitting employment taxes. If the organization has employees, the organization must collect federal income tax withholding from the employee and must also ensure FICA taxes (Social Security and Medicare) are collected and paid. In this sense, exempt organizations are no different than for-profit employers.

Some exempt organizations are also required to pay federal unemployment taxes. Generally speaking, [§501\(c\)\(3\)](#) organizations are exempt from federal unemployment taxes, but exempt organizations under other sections of the IRC are not.

Special considerations apply to exempt governmental employers. Such entities may, depending on the circumstances, only need to withhold federal income taxes and Medicare, while some long-term employees may not need to have Medicare withheld at all.

⁷ "The term 'excess business holdings' means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings." [IRC §4943\(c\)](#).

For all exempt organizations, it is important that those performing services for the organization, which are compensated for those services, are properly classified as either an employee or an independent contractor. The IRS uses many factors to determine an individual's correct classification, based significantly on the amount of control exerted by the organization. It is particularly important that the organization not treat two individuals performing substantially similar services differently for employment tax purposes, unless there is clear justification, as doing so may make it harder for the organization to avoid penalties in the event the IRS reclassifies a worker.

V. CHARITABLE GIVING CHANGES UNDER THE ONE BIG BEAUTIFUL BILL ACT (“OBBBA”)

The passing of the OBBBA last year implemented changes for charitable giving that are already impacting nonprofits in 2026. These changes affect how taxpayers who donate to nonprofit organizations may claim their donation deductions on their tax return. While the OBBBA temporarily increased the standard deduction to \$15,750 for single filers and \$31,500 for joint filers (inflation-adjusted thereafter), the OBBBA created a permanent above-the-line deduction for charitable donations of \$1,000 per filer who takes the standard deduction beginning in 2026.

In addition to the \$1,000 charitable deduction limit for taxpayers who take the standard deduction, the OBBBA imposes a new floor on the deduction for charitable contributions. If an individual taxpayer's charitable donations fall below 0.5% of their respective adjusted gross income (“AGI”), or 1% for corporations, then the charitable donations will not be deductible.⁸

Along with these changes, the OBBBA makes the cash charitable donation deduction limit of 60% permanent. However, the non-cash contribution deduction limit is 50%. Therefore, there are considerable changes to charitable giving that taxpayers should be aware of in order to claim the necessary deductions.

While these changes are, on the surface, an issue for donors, it is important that nonprofits understand the impact on their operations. The above-the-line deduction incentivizes small donations, but the floor disincentivizes donations by higher-income donors. Thus, it is possible that savvy donors will restructure their giving in the future.

VI. KENTUCKY TAX EXEMPT STATUS

The discussion thus far has involved some potentially applicable taxes on the federal level. While some of the general principles apply at the state level, it is important to note that Kentucky does not automatically exempt nonprofits from tax. Part of this complexity is due to the fact that Kentucky has multiple taxes that are simply not in place at the federal level. However, some of this complexity also comes from the fact that Kentucky utilizes additional

⁸ To illustrate, for an individual taxpayer who has \$300,000 AGI and has charitable donations of \$10,000, the first \$1,500 of the taxpayer's charitable donations would not be deductible (\$300,000 multiplied by 0.5%). The remaining \$8,500 of charitable contributions would be deductible.

criteria for exempt organizations that are similar, but not identical, to the federal exemption standards.

Because Kentucky has multiple taxes, each with its own standards for exemption, each tax will be discussed separately. However, there are several common variations that are utilized.

The first of these standards comes from the Kentucky Constitution. [Section 170](#) of the Kentucky Constitution provides a number of categories of property that are exempt from Kentucky property taxes. The types of generally exempt organizations based upon this list include public entities (*i.e.*, governmental entities), nonprofit cemeteries, institutions of religion, institutions of purely public charity, institutions of education not used or employed for gain by any person or corporation, and the income of which is solely devoted to the cause of education, and public libraries.

This list clearly encompasses many of the organizations that are eligible for exemption from federal taxes. However, “institutions of purely public charity” is not as broad as is the exemption in [§501\(c\)\(3\)](#).

Another standard utilized in Kentucky taxes is an exemption for “corporations or other entities exempt under [Section 501](#) of the Internal Revenue Code.”⁹ This is a broad exemption that is consistent with federal law, and would capture all exempt organizations under [§501](#), including entities such as chambers of commerce and recreational clubs.

Another common standard utilized in Kentucky is an exemption for “religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit.”¹⁰ This exemption is even broader than that listed above, as it would include organizations that may not, for whatever reason, be organized under [§501](#), or that would be but that have not yet had an application for exemption approved. It could also potentially cover organizations that had been exempt under [§501](#), but that lost the exemption for failure to file proper information returns.

Regardless, it is important that an organization evaluates its liability for taxes based on the specific taxes at issue, rather than assume that federal exempt status conveys a Kentucky exemption as well.

VII. KENTUCKY CORPORATE INCOME TAXES AND THE LIMITED LIABILITY ENTITY TAX

Most nonprofits, if formally organized, are organized as corporations or limited liability companies. As a result, these organizations will be subject to Kentucky’s corporate income tax and limited liability entity tax (“LLET”) unless an exemption applies.

[KRS 141.040](#) provides the exemptions from the corporate income tax. Currently, the relevant exemptions are for:

⁹ See [KRS 141.040\(1\)\(a\)\(6\)](#).

¹⁰ See [KRS 141.040\(1\)\(a\)\(7\)](#).

6. Corporations or other entities exempt under [Section 501](#) of the Internal Revenue Code;

7. Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit.

[KRS 141.040\(1\)\(a\)\(6\)-\(7\)](#).

Thus, the corporate income tax utilizes two of the standards discussed above and would encompass both organizations that have received an exemption under [§501](#) from the IRS and those organizations performing similar functions that do not have a determination letter from the IRS.¹¹ These exemptions would also cover municipal corporations. In recent years, the exemptions statute has been amended. However, the exemptions for nonprofit entities have remained the same.

Kentucky's LLET is provided for in [KRS 141.0401](#). This statute provides for a tax on every corporation and limited liability pass-through entity doing business in Kentucky on all Kentucky gross receipts or Kentucky gross profits unless an exception applies. The LLET statute utilizes the same exemptions for nonprofits as the corporate income tax, providing an exemption for:

6. Corporations or other entities exempt under [Section 501](#) of the Internal Revenue Code;

7. Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit.

[KRS 141.0401\(6\)\(a\)](#).

Generally speaking, an organization does not need to file a form or an exemption application akin to the [Form 1023](#) to claim the above exemptions, particularly if the organization is organized as a nonprofit with the appropriate Secretary of State. However, when the organization files its [Form 990](#) each year, it must submit a copy to the Kentucky Attorney General. Likewise, organizations that register with the Kentucky Secretary of State are generally prompted to file a tax registration form with the Department of Revenue, which asks general questions about activities and exempt status. If exempt, the Department issues a letter saying two tax accounts are required.

However, if an organization has UBTI, that income may be taxable for Kentucky purposes as well unless another exemption can be found. However, Kentucky has not specifically addressed this issue.

¹¹ It is important to note, however, that if an organization is not listed with the Kentucky Secretary of State as a non-profit entity, the Kentucky Department of Revenue is likely to assume no exemption applies. As a result, it is important to properly register new nonprofit organizations.

VIII. KENTUCKY SALES AND USE TAX

Kentucky sales and use tax issues can be particularly confusing for nonprofits, in part because there are two areas that generally must be examined. First, an organization that purchases tangible personal property must consider whether it is exempt from such tax and be able to provide appropriate exemption certificates. Additionally, an organization that makes sales must assess its requirement to register for a sales tax permit and to collect and remit Kentucky sales tax.

[KRS 139.495\(1\)](#) specifically provides that the sales and use tax statutes apply to [§501\(c\)\(3\)](#) organizations, as well as resident single member limited liability companies that are wholly owned and controlled by a resident [§501\(c\)\(3\)](#) organization and disregarded under federal income tax law. Thus, unless an exception applies, nonprofits must pay, collect and remit such taxes as the situation dictates.

For organizations making purchases of tangible property rather than selling, [KRS 139.495\(2\)](#) provides a number of transactions which would not incur sales tax. With respect to purchases by organizations, [KRS 139.495\(2\)\(a\)\(1\)](#) provides that nonprofits and their disregarded single member limited liability companies are not subject to sales tax when the taxable product or service is used solely in Kentucky for educational, charitable or religious purposes. Foreign exempt entities may also be eligible for an exemption on purchases. [KRS 139.470\(8\)](#).

In order to claim this purchase exemption, which requires either a [§501\(c\)\(3\)](#) determination letter or being a disregarded subsidiary of such an organization, a nonprofit should file [Form 51A125](#) – Application for Purchase Exemption Sales and Use Tax with the Department of Revenue. This form notes that the Department views numerous entities as eligible for a sales tax exemption, including governmental entities, historical sites, charitable, educational and religious organizations, and cemeteries. Specific attachments are required for each entity type. For charitable, educational and religious institutions, a copy of the Articles of Incorporation and a detailed schedule of receipts and disbursements must be attached to the application, as well as the IRS determination letter. Once the Department approves the application, the organization can issue an exemption certificate to vendors. Importantly, if the organization makes any purchases that are not exempt under statute, it is still responsible for sales tax.

[KRS 139.495\(2\)](#) also addresses situations in which a [§501\(c\)\(3\)](#) organization and its disregarded subsidiaries are not required to collect sales tax from its customers. Specifically, the statute provides:

(2) (a) Tax does not apply to:

...

2. Sales of food to students in school cafeterias or lunchrooms;

3. Sales by school bookstores of textbooks, workbooks, and other course materials;

4. Sales by nonprofit, school sponsored clubs and organizations, provided such sales do not include tickets for athletic events;

5. Sales of admissions, including the sales of admissions to a golf course when the admission is the result of a fundraising event, by nonprofit educational, charitable, or religious institutions described in subsection (1) of this section. All other sales of admissions to a golf course by these institutions are not exempt from tax under this section; or

6. a. Fundraising event sales made by nonprofit educational, charitable, or religious institutions and limited liability companies described in subsection (1) of this section.

b. For the purposes of this subparagraph, “fundraising event sales” does not include sales related to the operation of a retail business, including but not limited to thrift stores, bookstores, surplus property auctions, recycle and reuse stores, or any ongoing operations in competition with for-profit retailers.

(b) The exemptions provided in subparagraphs 5. and 6. of paragraph (a) of this subsection shall not apply to sales generated by or arising at a tourism development project approved under [KRS 148.851 to 148.860](#).

[KRS 139.495\(2\)](#).

Additional sales by nonprofits are also exempt. These include:

(1) Sales by elementary or secondary schools or nonprofit elementary or secondary school-sponsored clubs and organizations or any nonprofit, elementary, or secondary school-affiliated groups such as parent-teacher organizations and booster clubs, whose membership may be composed of individuals other than students, provided the net proceeds from the sales are used solely for the benefit of the elementary or secondary school or its students. Nontaxable sales shall include sales resulting from agreements or contracts entered into with resident or nonresident organizations to participate in fund-raising campaigns for a percentage of the gross receipts where students act as agents or salesmen for the organizations by selling or taking orders for the sale of tangible personal property, and no one shall be required to pay sales or use taxes on such sales;

(2) Sales made by nonprofit educational youth programs affiliated with a land grant university cooperative extension service, if the net proceeds from the sales are used solely for the benefit of the affiliated programs; or

(3) (a) Sales of tangible personal property made by a federally chartered corporation¹² at the corporation's annual national convention held in the Commonwealth.

[KRS 139.497](#).

As a result of these statutes, many sales by small organizations are exempt. However, any sale not covered by this exemption is subject to sales tax collection requirements, and an organization must register for a sales tax permit in the event the organization has three or more sales in a 12-month period. Once registered, an organization generally must submit monthly sales and use tax returns. However, a nonprofit organization can petition for the ability to file quarterly instead. [KRS 139.590](#).

For organizations that sell donated goods, the organization is eligible for a refund of 25% of the tax collected on the sale of the donated goods, provided that the refund is used exclusively as reimbursement for capital construction costs of additional retail locations in Kentucky. The institution must meet several requirements in order to qualify for the refund. [KRS 139.495\(3\)](#).

In Kentucky, use tax typically applies when a purchase is not subject to sales tax, and is paid directly by the buyer. The same exemptions for sales tax apply to use tax. However, for many years there was no imposition of the use tax on purchases by a number of organizations. However, in *Commonwealth v. Interstate Gas Supply, Inc.*, 554 S.W.3d 831 (Ky. 2018), the Kentucky Supreme Court held that [Section 170](#) of the Kentucky Constitution exempting taxation of organizations of “purely public charity” applies only to property taxes. This overruled *Commonwealth ex. rel. Luckett v. Elizabethtown*, 435 S.W.2d 78 (Ky. 1968), which held the use tax was in effect a property tax and thus exempted nonprofits from use tax under the state Constitution.

The *Interstate Gas* case became particularly important to nonprofits in 2018, when two tax reform bills were introduced. Due to the lack of explicit exemptions for nonprofits, the Department relied on *Interstate Gas* to interpret the new statutory language as requiring all nonprofits to collect sales tax on admissions beginning in July 2018. This resulted in sales tax being owed on entry into children’s athletic events and fundraising galas, among others. The Department recognized that this was problematic and encouraged the General Assembly to clarify this position. In March 2019, [KRS 139.495\(2\)](#) was amended to explicitly exempt sales of admissions by certain nonprofits. Additionally, [KRS 139.498](#) was added to further clarify the exemption. These amendments were effective on March 26, 2019. However, nonprofits technically remain liable for sales taxes on admissions from July 2018 until March 2019.

The exemptions discussed in this section are not all inclusive, and an organization may qualify for a number of other exemptions. It is particularly important that an organization that

¹² “As used in this subsection, ‘federally chartered corporation’ means a corporation federally chartered under [Title 36](#) of the United States Code and whose stated purpose is to serve students and former students of vocational agriculture in middle and secondary schools to develop character, train for useful citizenship, and foster patriotism.” [KRS 139.497\(3\)\(b\)](#).

is making sales verify the taxability of those sales, as failure to remit sales tax in Kentucky can lead to personal liability for the organization’s officers. [KRS 139.185](#).

IX. KENTUCKY PROPERTY TAX

Many nonprofits do not consider the property taxes they may owe, particularly if they do not own real property. However, many nonprofits are subject to some form of property tax.

[Section 170](#) of the Kentucky Constitution is a major source of exemptions for nonprofits with respect to property tax. It provides in relevant part:

There shall be exempt from taxation public property used for public purposes; places of burial not held for private or corporate profit; real property owned and occupied by, and personal property both tangible and intangible owned by, institutions of religion; institutions of purely public charity, and institutions of education not used or employed for gain by any person or corporation, and the income of which is devoted solely to the cause of education, public libraries, their endowments, and the income of such property as is used exclusively for their maintenance...

[Ky. Const. §170](#).

The language and punctuation of this section can be somewhat confusing. Broken down, this section provides an exemption for:

1. Public property used for public purposes. This generally exempts government property which is open to the public or otherwise serves the public.
2. Nonprofit cemeteries.
3. Real property owned and occupied by religious institutions.¹³

¹³ While the “owned and occupied” language appears initially to apply only to institutions of religion, case law suggests this might not be the case. The Kentucky Supreme Court has interpreted the “owned and occupied by” provision of [Section 170](#), finding that the exemption extends only to real property that is both owned and occupied, not simply owned, by an exempt organization. *Freeman v. St. Andrew Orthodox Church, Inc.*, 294 S.W.3d 425 (Ky. 2009). While that case involved a religious institution, the Court went on to state that, with respect to the phrase “owned and occupied,” and the term “occupied” specifically, “our ruling here today in defining this term is restricted to ‘institutions of religion’ and other entities qualifying for tax exemption under [Section 170](#) of our state Constitution.” *Id.* at 429 (emphasis added). Recently, the Kentucky Court of Appeals examined a situation involving non-religious exempt organizations and third parties and held that “the purely public charity must both own and occupy the real property to be entitled to the tax exemption afforded under the [Section 170](#).” *Grand Lodge of Kentucky Free and Accepted Masons v. City of Taylor Mill*, No. 2015-CA-001617-MR, 2017 WL 541077 (Ky. App. Feb. 10, 2017) (unpublished). Thus, a court may determine that an eligible organization must both own and occupy the property to claim the exemption, even if the organization is not religious in nature.

4. Personal property, both tangible and intangible, of religious institutions.¹⁴
5. Property of purely public charities.¹⁵
6. Property of institutions of education not used or employed for profit, the income of which is devoted solely to the cause of education, public libraries, and endowments, provided the income from which is used exclusively for the institution's maintenance.

An organization that believes some or all of its property is exempt must apply for an exemption with the property valuation administrator ("PVA") in the county where the property is located. The form ([Revenue Form 62A023](#)) and all supporting documentation must be submitted for property the organization owned on January 1 of the taxable year. The application form will ask various questions regarding the name and contact information of the exempt organization, the purpose and major activity of the organization, the owner of the property (if other than the applicant), and the property itself. Several attachments are required, including a copy of the deed and the property record card (if available), interior and exterior pictures of the property and buildings, the organization's IRS determination letter, compensation statements for a number of individuals associated with the organization, lists of employees, detailed financial statements, and organizational documents. This form is fairly detailed and will take some time to complete.

In many cases, the PVA may be comfortable making the determination regarding the applicability of the tax exemption, in which case the final determination will be handled at the county level. However, if the PVA is unsure if the applicant qualifies for an exemption, the application will be forwarded to the Kentucky Department of Revenue for review. The Department may request additional information from the applicant as part of its review. Once the Department makes a determination, the Department will notify the PVA, and the PVA will send a final determination letter to the applicant.

¹⁴ This constitutional provision has been the subject of *Dunn v. Solomon Foundation*, 723 S.W.3d 711 (Ky. 2025), wherein the Solomon Foundation owned real property in Kentucky and leased it to a church. On appeal, the Kentucky Supreme Court ruled in favor of the tax authority denying the property tax exemption. The Supreme Court found that while the Foundation promotes religion, it itself is not a church, religious sect, society, or denomination. However, the Supreme Court declined to address whether the phrase "owned and occupied by ... institutions of religion" requires unity of ownership and occupation. This will likely continue to be the subject of ongoing litigation as many churches are encountering this issue.

¹⁵ "Public charity" is not currently defined in Kentucky statutes, although that was not always the case. In the early 1990s, KRS 132.011 provided, "Every organization which has qualified for exemption under [Section 501\(c\)\(3\)](#) of the Internal Revenue Code of 1986, as amended, and whose charitable activities constitute more than an incidental part of the organization's overall activities, shall be, for Kentucky tax purposes, an institution of purely public charity and its property shall be exempt from all state, county, district, city and school taxes." This statute was ultimately repealed.

The Jefferson County PVA's website provides some illustrations of these rules in action:

In order to qualify for the current tax year, the applicant must own the property as of January 1 of the year in which application is made.

All organizations seeking exemption must meet the required qualifications in order to receive exemption. For example, real property must be owned and occupied or used by the organization seeking exemption. Examples of real property both owned and occupied by religious organizations are:

- Minister Occupied Parsonages
- Land & Improvements (buildings) used for Church Camps
- Church Meeting Halls or Social Centers used by its Members
- Outdoor Recreation Areas Held for Use by its Members

Personal property such as motor vehicles, office equipment, furniture, etc. owned and used by nonprofit organizations also qualify as exempt, once qualifications are met. However, a vacant church building, unoccupied educational facility, or an unoccupied facility under renovation owned but not currently in use by a nonprofit group does not qualify for exemption. Exemption cannot be granted based on the future use of a property. However, some exceptions apply such as an unoccupied public property facility (or government property) under renovation which is automatically exempt. Any such property would become taxable should ownership transfer to a private ownership.

Nonprofit organizations seeking exemption must submit an application to PVA. PVA will notify the applicant once the application is processed. If an organization holds an approved exemption on property and an additional property is acquired, an addendum application may be all that is required to be filed with PVA. All applications for exemption must list the current property use. Once exemption is approved, should the property use change, the property owner must notify PVA. If PVA is not notified, the property owner may be subject to delinquent taxes on any years the property was not legally qualified to receive exemption.

Jefferson County PVA, *Nonprofit & Religious Organization Exemptions*.¹⁶

It is important to note that otherwise exempt property can become taxable if certain transactions are undertaken. In particular, when otherwise exempt property is transferred to an individual or other entity for for-profit use, even though the title to the property remains

¹⁶ Available at <https://jeffersonpva.ky.gov/property-assessment/exemptions/nonprofit-religious-organization-exemptions/> (last visited Apr. 3, 2026).

with the exempt organization, the possessory interest in the property becomes subject to property tax. [KRS 132.195](#). Thus, the lessee or person in possession becomes responsible for the tax. There are several exceptions to this rule, but these exceptions are fairly specific and would not apply to most exempt organizations.

The terms of a lease can also have other impacts on the taxation of property. Under [Section 170](#) of the Constitution, if property is leased for an initial term in excess of 98 years, the lessee is considered to be the equitable owner of the property, and the taxability of the property is determined accordingly. Thus, if an exempt organization enters into a long-term lease with a non-exempt entity, the property can lose its exempt status, even without the operation of [KRS 132.195](#). Conversely, if a for-profit entity enters into a long-term lease with a nonprofit entity that would otherwise be exempt, the nonprofit will be considered the equitable owner.

X. KENTUCKY TRANSFER TAX

[KRS 142.050](#) provides that a tax must be paid upon the recording of a deed or other transfer document for transfers of Kentucky real property. Unlike most Kentucky taxes, there is no generally applicable exemption for transactions with nonprofits, unless those transactions meet other exemptions. However, when one of the parties is a governmental entity, an exemption may apply. In particular, there is an exemption for transfers of title “[t]o, in the event of a deed of gift or deed with nominal consideration, or from the United States of America, this state, any city or county within this state, or any instrumentality, agency, or subdivision hereof.” Thus, if a nonprofit transfers property to a governmental entity, the tax will still apply upon recordation if the transfer is for more than a nominal consideration.

XI. KENTUCKY EMPLOYMENT TAXES

Much like federal employment taxes, there is no exemption for nonprofits with respect to withholding Kentucky income taxes from employee wages. [KRS 141.310](#). Thus, withholding must occur unless the employee presents a proper exemption certificate to the nonprofit employer.

Whether a nonprofit is liable for Kentucky unemployment taxes depends on the type of organization and the number of employees the organization has, as well as the time worked by those employees.

A detailed listing of the liability for unemployment taxes can be found in Kentucky Career Center’s *Unemployment Insurance Employer Guide*.¹⁷ A [§501\(c\)\(3\)](#) organization will be liable for unemployment insurance taxes if it has at least four workers in the United States in any part of 20 weeks out of a calendar year. They do not have to be the same four workers in each week, and the weeks do not have to be consecutive. Church employees are exempt, but independent businesses conducted on church property, such as daycare centers, may be covered unless they are also part of the church ministry. State and local government

¹⁷ Available at https://kewes.ky.gov/Documents/EMPLOYER_GUIDE.pdf (last visited Apr. 3, 2026).

employers are liable for unemployment taxes for any employment except for elected officials and certain other exclusions.

XII. LOCAL KENTUCKY OCCUPATIONAL TAXES

Kentucky's occupational license taxes have two components – an employee portion paid through withholding, and an employer portion paid on the employer's income or net profit. In cities that impose an occupational license tax, nonprofits are generally required to withhold from employee's wages and remit them appropriately. However, many localities exempt nonprofits from the employer portion of the tax. For example, the Lexington-Fayette Urban County Government provides via regulation:

No net profits license fee is imposed on and no filing is required of the usual activities of boards of trade, chambers of commerce, trade associations or unions, community chest funds or foundations; corporations or associations organized and operated exclusively for religious, charitable, scientific, literary, educational, or civic purposes, or for the prevention of cruelty to children or animals; or clubs or fraternal organizations operated exclusively for social, literary, educational, or fraternal purposes where no part of the income or receipts of such units, groups, or associations inures to the benefit of any private shareholder or individual. To qualify for this exemption, the organization must submit satisfactory proof of their exempt status for federal income tax purposes.

LFUCG Regulation 13.4, Section 3.4(D).¹⁸

A nonprofit should review the requirements of its home locality or any location where it makes sales to determine if it has an occupational license requirement.

XIII. CONCLUSION

Numerous situations exist in which a nonprofit organization may have a filing requirement, a payment requirement, or a collection requirement. Federal tax-exempt status alone does not mean that state and local taxes will not apply to an organization. An organization should consult a tax advisor with any questions regarding potential compliance issues.

¹⁸ Available at [License%20Fee%20Regulations.pdf](#) (last visited April 3, 2026).