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ATTORNEY GENERAL OPINION NO. 87- 141

The Honorable Ben E. Vidricksen
State Senator, Twenty-Fourth District
713 N. 11th Street
Salina, Kansas 67401

Re: Taxation--Kansas Retailers' Sales Tax--Exempt Sales
Taxation--Income Tax--Taxable Income

Synopsis: A non-profit hospital operating a telephone answering service exclusively for hospital purposes is exempt from payment of sales tax on the telephone services it purchases for such operation. K.S.A. 1986 Supp. 79-3606(b), as amended. A telephone answering service is not itself taxable under the Kansas retailers' sales tax act, but the rental of beepers or other such equipment by the hospital to physicians is taxable. K.S.A. 1986 Supp. 79-3603(h), as amended.

A non-profit hospital which meets the requirements of 26 U.S.C. §501 and 26 C.F.R. §1.501 is exempt from federal income taxation pursuant to 26 U.S.C. §501(a), and thus from state income taxation pursuant to K.S.A. 79-32,113, except to the extent it receives "unrelated business income." The receipt of a service free of charge from an employer as partial compensation for services rendered would fall within the scope of the broadly interpreted term "gross income," and therefore would be taxable income to the employee unless specifically exempted. Cited herein: K.S.A. 1986 Supp. 79-201b First; K.S.A. 79-32,113, 79-32,117;

K.S.A. 1986 Supp. 79-3603, as amended by L. 1987, ch. 182, §108; 79-3606, as amended by L. 1987, ch. 64, §1 and L. 1987, ch. 292, §32; K.A.R. 92-19-19; 26 U.S.C. §§61, 62, 501; 26 C.F.R. §1.501.

* * *

Dear Senator Vidricksen:

As State Senator for the Twenty-Fourth District, you request our opinion regarding the tax exempt status of a non-profit hospital operating a telephone answering service. You inform us that though the hospital was granted a property tax exemption in 1985, the county appraiser has since seen fit to place the answering service equipment on the tax rolls. You question whether the hospital should also be responsible for payment of sales and income taxes, and whether services provided to physicians at no cost should be treated as income to those physicians.

K.S.A. 1986 Supp. 79-201b First provides:

"The following described property, to the extent herein specified, shall be and is hereby exempt from all property or ad valorem taxes levied under the laws of the state of Kansas:

"First. All real property, and tangible personal property, actually and regularly used exclusively for hospital purposes by a hospital as the same is defined by K.S.A. 65-425, and amendments thereto, or a psychiatric hospital as the same is defined by K.S.A. 59-2902, and amendments thereto, which hospital or psychiatric hospital is operated by a corporation organized not for profit under the laws of the state of Kansas or by a corporation organized not for profit under the laws of another state and duly admitted to engage in business in this state as a foreign, not for profit corporation; and all intangible property including moneys, notes and other evidences of debt, and the income therefrom, belonging exclusively to such a

corporation and used exclusively for hospital or psychiatric hospital purposes." (Emphasis added.)

Based on this provision, the Board of Tax Appeals of the State of Kansas (Board) granted an exemption from ad valorem taxation to the hospital in question for its answering service equipment. Docket No. 3162-85-TX, Jan. 2, 1986. As you have indicated, the county appraiser has since placed this personal property on the tax rolls. However, the hospital has again applied for an exemption and such application is still pending before the Board. Thus, there was a finding in 1986 that this equipment was being used exclusively for hospital purposes by a not for profit hospital and as yet there has been no contrary factual determination by the Board.

K.S.A. 1986 Supp. 79-3603, as amended by L. 1987, ch. 182, §108, provides in part as follows:

"For the privilege of engaging in the business of selling tangible personal property at retail in this state or rendering or furnishing any of the services taxable under this act, there is hereby levied and there shall be collected and paid a tax as follows:

. . . .

"(b) a tax at the rate of 4% upon the gross receipts from intrastate telephone or telegraph services, which sale is not otherwise exempt from taxation under the provisions of this act;

. . . .

"(h) a tax at the rate of 4% upon the gross receipts from the service of renting or leasing of tangible personal property. . . ."

K.S.A. 1986 Supp. 79-3606, as amended by L. 1987, ch. 292, §32 and L. 1987, ch. 64, §1, provides for the following exemptions from sales tax:

"The following shall be exempt from the tax imposed by this act:

. . . .

"(b) all sales of tangible personal property or service, including the renting and leasing of tangible personal property, purchased directly by the state of Kansas, a political subdivision thereof, other than a school or educational institution, or purchased by a public or private nonprofit hospital or nonprofit blood, tissue or organ bank and used exclusively for state, political subdivision, hospital or nonprofit blood, tissue or organ bank purposes, except when: (1) Such state or hospital is engaged or proposes to engage in any business specifically taxable under the provisions of this act and such items of tangible personal property or service are used or proposed to be used in such business. . . .

. . . .

"(z) all sales of intrastate telephone and telegraph services for noncommercial use except noncommercial intrastate long distance telephone service. . . ."
(Emphasis added.)

Finally, K.A.R. 92-19-19 provides that the company furnishing telephone services is required to pass the tax on to the consumers thereof, and must secure exemption certificates from all persons and institutions claiming exemption from the tax pursuant to the statutory provision quoted above.

A telephone answering service is not taxable under the provisions of K.S.A. 1986 Supp. 79-3603, as amended. Thus, regardless whether a business is for profit, it is not required to collect sales tax upon providing this service. However, the rental of beepers or other such equipment would be subject to sales tax pursuant to K.S.A. 1986 Supp. 79-3603(h), unless an exemption applies. Similarly, the telephone services purchased by the hospital would be taxable pursuant to K.S.A. 1986 Supp. 79-3603(b) unless otherwise exempt.

In our opinion, the rental of beepers or other such equipment by the hospital to the physicians would be subject to sales tax. There appears to be no exemption applicable to such a transaction. The purchase of telephone services by the hospital, however, may be exempt pursuant to K.S.A. 1986 Supp. 79-3606(b), as amended. Since a telephone answering service is not a "business specifically taxable under the provisions of the [the Kansas retailers' sales tax act]," the exception to the exemption found at K.S.A. 1986 Supp. 79-3606(b)(1), as amended, does not apply to this situation. Therefore, as long as the telephone services are purchased by the nonprofit hospital and used exclusively for hospital purposes, the services would be tax exempt. This office has been provided conflicting information regarding whether the services in question are used exclusively for hospital purposes, and thus we are unable to comment upon the hospital's eligibility for this tax exempt status.

Your second question is whether this not-for-profit hospital is responsible for the payment of income taxes for money collected from physicians using the answering service. The Kansas income tax act provides at K.S.A. 79-32,113:

"(a) A person or organization exempt from federal income taxation under the provisions of the internal revenue code shall also be exempt from the tax imposed by this act in each year in which such person or organization satisfies the requirements of the internal revenue code for exemption from federal income taxation. If the exemption applicable to any person or organization under the provisions of the internal revenue code is limited or qualified in any manner, the exemption from taxes imposed by this article shall be limited or qualified in a similar manner.

"(b) Notwithstanding the provisions of subsection (a) of this section, the unrelated business taxable income, as computed under the provisions of the internal revenue code, of any person or organization otherwise exempt from the tax imposed by this act and subject to the tax imposed on unrelated business income by the internal revenue code shall be subject

to the tax which would have been imposed by this act but for the provisions of subsection (a) of this section.

"(c) In addition to the persons or organizations exempt from federal income taxation under the provision of the internal revenue code, there shall also be exempt from the tax imposed by this act, express companies, insurance companies, banks, trust companies, savings and loan associations, credit unions and any other organizations, entities or persons specifically exempt from Kansas income taxation under the laws of the state of Kansas."

The internal revenue code lists exemptions from federal income taxation at 26 U.S.C. §501(c). One such exemption is for corporations organized and operated exclusively for charitable purposes, no part of the earnings of which inures to the benefit of any private shareholder or individual. 26 U.S.C. §501(c)(3). A non-profit hospital may be deemed charitable by a showing that its purpose and activity is to provide hospital care for members of the community and it is thereby promoting health. To meet this test, hospital facilities must be provided exclusively for the benefit of the public rather than for any private benefit. Rev. Rul. 69-545, CB 1969-2 p. 117, amplified by Rev. Rul. 83-151. See Lugo v. Simon, 453 F.Supp. 677 (D.C. Ohio 1978); Eastern Kentucky Welfare Rights Organization v. Shultz, 506 F.2d 1278 (U.S. App. D.C. 1974). Thus, a hospital which meets the requirements of 26 U.S.C. §501(c)(3) and 26 C.F.R. §1.501(c)(3)-1 et seq. would be entitled to an exemption from federal income tax pursuant to 26 U.S.C. §501(a). See Lovitch, Legal Framework Governing the Kansas Non-Profit Corporation-Part II, 48 J.B.A.K. 343 (1979). If the non-profit hospital in question qualifies for the federal exemption, it would also be entitled to an exemption from state income taxation pursuant to K.S.A. 79-32,113. We should note, however, that even if the hospital is exempt under 26 U.S.C. §501(a), any "unrelated business income," as defined in 26 U.S.C. §512, will be taxable. Due to the conflicting factual information before us, whether income derived from a telephone answering service is in this case unrelated business income is a factual determination we are unable to make.

Your final question is whether physicians receiving the benefit of this answering service free of charge are required to declare the cost of the service as income. K.S.A. 1986 Supp. 79-32,117 provides that the Kansas adjusted gross income of an individual means such individual's federal adjusted gross income with certain specified modifications not applicable here. The Internal Revenue Code defines federal adjusted gross income as, "in the case of an individual, gross income minus [certain] deductions." 26 U.S.C. §62. Gross income is defined as "all income from whatever source derived. . . ." 26 U.S.C. §61(a).

"Broadly, it may be said that the courts have expanded, or at least articulated, the broad concept of income embraced in section 61(a) rather than restricted its meaning." Chommie, Federal Income Taxation 25 (2d ed. 1973).

Indeed, the Supreme Court of the United States has held:

"Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature. And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted." Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 429, 430, 75 S.Ct. 473, 99 L.Ed. 483, 489 (1955).

Based on this authority, it is our opinion that the receipt of a service free of charge from an employer as partial compensation for services rendered would fall within the broad scope of the term "gross income," and would therefore, unless specifically exempted, be taxable.

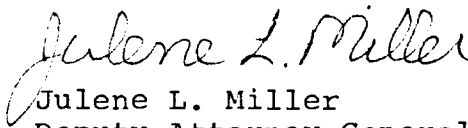
In conclusion, a non-profit hospital operating a telephone answering service exclusively for hospital purposes is exempt from payment of state sales tax for the telephone services it purchases for such operation. K.S.A. 1986 Supp. 79-3606(b), as amended. A telephone answering service is not itself taxable under the Kansas retailers' sales tax act, but the rental of beepers or other such equipment by the hospital to physicians is taxable. K.S.A. 1986 Supp. 79-3603(h), as amended. Non-profit hospitals which meet the requirements of 26 U.S.C. §501 and 26 C.F.R. §1.501 are exempt from federal

income taxation pursuant to 26 U.S.C. §501(a), and thus from state income taxation pursuant to K.S.A. 79-32,113, except to the extent of any "unrelated business income." Finally, the receipt of a service free of charge from an employer as partial compensation for services rendered would fall within the scope of the broadly interpreted term "gross income," and therefore would be taxable income to the employee unless specifically exempted.

Very truly yours,



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