

Cite as Det. No. 92-150, 12 WTD 183 (1993).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Correction of Assessment of)	
)	No. 92-150
)	
. . .)	Registration No. . . .
)	. . ./Audit No. . . .
)	

[1] RULE 169: B&O TAX -- EXEMPTION -- SHELTERED WORKSHOPS. The definition of "handicapped" under RCW 82.04.385 includes recovering substance abusers who have completed rehabilitation programs. A nonprofit organization operating a sheltered workshop which also includes among its clients "vocationally-disadvantaged" persons who do not qualify as handicapped will not lose entitlement to the exemption if it otherwise meets the statutory requirements, including proving its "primary purpose" is to provide training and employment to clients who qualify as "handicapped" under the statute.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

NATURE OF ACTION:

Taxpayer petitions for correction of assessment of B&O tax on its sheltered-workshop income where its B&O tax deductions were denied after Department concluded its clients were not "handicapped" as required by RCW 82.04.385.

FACTS:

Adler, A.L.J. -- Taxpayer is organized as a nonprofit for federal tax purposes under IRC Section 501(c)(3). It operates programs, including

- a) an involuntary-commitment facility for substance (drug and alcohol) abusers;
- b) a program providing employment for work-release participants;
- c) programs to provide training and work experience to its clients.

To accomplish the goal of providing training to its clients, taxpayer operates several enterprises, including

- a) a foodservice program to provide meals to its clients and to facilities with which it contracts;
- b) a cooperative food-buying service to supply its members' food needs at lower prices; and
- c) a light-manufacturing business.

The intent of the enterprise operations, according to taxpayer's annual report, is to make operation of the nonprofit and its programs as self-sufficient as possible, in order to avoid the impact of unpredictable government financing.

The enterprise activities are staffed mostly by taxpayer's clients. They include graduates of the involuntary-commitment facility and recovering substance abusers from taxpayer's and others' programs. The clients also include persons termed by the taxpayer as being "at risk." They are unskilled and hard-to-place persons, including work-release participants, all of whom are attempting to learn a skill and create a "transferable work record," according to the annual report.

In an effort to assist the clients, the light-manufacturing business offers classroom instruction in both work and life skills, including math, blueprint reading, check-writing and food buying, in addition to the on-the-job training and equipment-operation instruction. The other businesses provide similar educational and vocational opportunities.

An audit conducted by the Department's Taxpayer Account Administration (TAA) resulted in a denial of the taxpayer's regular deductions of income for amounts received from its sheltered workshop activities. The examiner concluded none of the clients, including the recovering substance abusers, were "handicapped" under the statute. The above-captioned assessment was issued, covering the period from January 1, 1987, through August 31, 1991.

ISSUES:

Does the definition of "handicapped" include recovering drug and alcohol abusers and can a sheltered workshop employ a mix of disadvantaged persons and retain the B&O tax exemption?

DISCUSSION:

A. DEFINITIONS OF "HANDICAPPED" AND "SHELTERED WORKSHOP" UNDER RCW 82.04.385

[1] Unlike federal law, Washington's Revenue Act contains no general exemption from taxation for nonprofit organizations. The Washington legislature has included nonprofits within the definition of "persons" under RCW 82.04.030. Additionally, in Det. No. 88-173, 5 WTD 273 (1988), a sheltered-workshop case, the Department commented that a federal-agency interpretation of a federal statute, which results in the federal government calling a workshop "sheltered," doesn't control for state tax purposes. As such, taxpayer's qualification as a nonprofit and as a sheltered workshop for federal tax purposes does not control whether it has met the state-law requirements for a business and occupation tax exemption.

In this case, the examiner based his decision to disallow the deductions on two factors. First, he concluded that the types of clients staffing taxpayer's businesses, including recovering substance abusers, are not "handicapped" under RCW 82.04.385. Second, even if the substance abusers qualify, the presence of non-qualifying clients causes taxpayer to lose entitlement to the exemption. RCW 82.04.385 does not define the term "handicapped" or state what the client base of a sheltered workshop must be.

We note that, under RCW 43.19.525, the statutes enabling the Department of General Administration to purchase goods and services from sheltered workshops use the definition of "sheltered workshops" contained in RCW 82.04.385. Those granting real and personal property tax exemptions to nonprofits operating sheltered workshops were enacted at the same time the B&O tax exemption was added, and the same definition of "sheltered workshop" was originally used for both types of taxes. RCW 84.36.353, RCW 82.04.385. For the purposes of applying property tax exemptions under Chapter 84.36 RCW:

"Sheltered workshop" means rehabilitation facility, or that part of a rehabilitation facility operated by a nonprofit corporation, where any manufacture or handiwork is carried on and which is operated for the primary purpose of (1) providing gainful employment or rehabilitation services to the handicapped as an

interim step in the rehabilitation process for those who cannot be readily absorbed in the competitive labor market or during such time as employment opportunities for them in the competitive labor market do not exist; or (2) providing evaluation and work adjustment services for handicapped individuals.

In 1988, the definition of "sheltered workshop" in RCW 82.04.385 was changed slightly to provide that B&O tax would not apply to income from

the business activities of nonprofit organizations from the operation of sheltered workshops. For the purposes of this section, "the operation of sheltered workshops" means performance of business activities of any kind on or off the premises of such nonprofit organizations which are performed for the primary purpose of (1) providing gainful employment or rehabilitation services to the handicapped as an interim step in the rehabilitation process for those who cannot be readily absorbed in the competitive labor market or during such time as employment opportunities for them in the competitive labor market do not exist; or (2) providing evaluation and work adjustment services for handicapped individuals.

No changes were made to clarify the term "handicapped" or to alter the definition of "sheltered workshops" at that time.

To assist in defining "handicapped" under the statute, the examiner relied on Webster's Dictionary (2nd College Edition), which defines as "handicapped" those who are physically disabled or mentally retarded. The taxpayer's client base included work-release and other unemployable persons, often called "vocationally-disadvantaged" persons. Believing these persons were not "handicapped," he denied the deduction to the business as a whole.

We disagree with this result for two reasons.

First, the full definition in Webster's 2nd College Edition states a "handicap" is

something which hampers a person; disadvantage; hindrance...[causes the person] to be at a disadvantage...

(Brackets supplied.)

We find persuasive the federal case law interpreting the Rehabilitation Act of 1973 and medical opinion developed since its enactment, which treat drug and alcohol addiction as a disease and a disability. Additionally, the comprehensive Americans with Disabilities Act (ADA) specifically includes substance abusers who have completed a supervised rehabilitation program in the class of qualified individuals "with a disability." 42 U.S.C. §12101 et seq. (1990). The ADA replaced the statutory term "handicapped" with "disability" in deference to the semantic preference of such persons.

While these interpretations or enactments are not controlling for state tax purposes, we find they are in accord with the full dictionary definition of "handicapped."

The examiner correctly concluded the term "handicapped" is "commonly understood to apply to persons with physical or mental disabilities." As a result, the exemption does not apply to "socially" or "vocationally" disadvantaged persons, such as those who find it difficult to obtain employment due to their criminal records or lack of marketable skills. To broaden the exemption this far would require an action by the legislature.

Despite the fact that some of taxpayer's clients qualify under the statute as construed above, the examiner properly followed case law, which has held that "exemptions to a tax are narrowly construed; taxation is the rule and exemption is the exception." Budget Rent-a-Car v. Department of Rev., 81 Wn.2d 171, 174 (1972). This led him to conclude that employment of nonhandicapped clients caused the taxpayer to lose entitlement to the exemption.

We disagree and find the exemption cannot be denied to the taxpayer solely because a portion of its client base includes persons outside the category of "handicapped" persons. This is because administrative rules cannot exceed or conflict with the scope of the statutes they interpret. Duncan Crane v. Department of Rev., 44 Wn.App.684 (1986); Tacoma v. Smith, 50 Wn.App. 717 (1988), review denied 110 Wn.2d 1032 (1989). In Deaconess Medical Center, et al., v. Department of Rev., Docket No. 87-2-2055-7 (Thurston Co. Sup. Ct. 1990), the court disallowed the Department's denial of a sales and use tax exemption for prosthetic devices, where its

definition, in so far as it requires the replacement [to] be permanent, broadens the sales and use tax imposed by the statute. This results in this regulation being invalid to this extent...

(Brackets supplied.)

As worded, RCW 82.04.385 requires:

- a) the organization must be a nonprofit
- b) operating a sheltered workshop, which
- c) performs business activities of any kind on or off its premises
- d) for the primary purpose of (1) providing gainful employment or rehabilitation services to the handicapped as an interim step in the rehabilitation process for those who cannot be readily absorbed in the competitive labor market or during such time as employment opportunities for them in the competitive labor market do not exist; or (2) providing evaluation and work adjustment services for handicapped individuals.

(Emphasis supplied.)

The application of the B&O tax has been statutorily limited by RCW 82.04.385 to exempt income of nonprofit organizations operating sheltered workshops for the primary purpose or purposes listed above. Nowhere in the statute or rule is there a requirement that one hundred percent of the clients employed by such a nonprofit organization's sheltered workshop be handicapped under the statute. As a result, we find that the exemption cannot be denied solely on the basis that the taxpayer includes in its client base other persons who are not handicapped. Where a taxpayer can show that it meets the statutory requirements, including proving that the sheltered workshop is operated for the required primary purpose, the B&O tax exemption applies.

B. "BUSINESS ACTIVITIES OF ANY KIND" UNDER RCW 82.04.385

Taxpayer also operates two other enterprises:

a food-buying service, which is a joint venture with [another nonprofit] and sells food which is provided to [taxpayer's] clients and "more than 300 food banks, low-income food-buying cooperatives, and agencies;" and

a food-preparation service, an institutional commissary which provides cooked meals for all [taxpayer's] work-release residents, as well as competing for contracts to provide meals to outside customers. It delivers 200,000 meals per year.

Taxpayer's Annual Report (brackets supplied).

Like the light-manufacturing business, both of these ventures are used to provide employment and training to taxpayer's clients.

A review of the taxpayer's file indicated its president, on behalf of the taxpayer and the other nonprofit, wrote the Department in 1984 asking whether the sheltered workshop exemption applied to these two then-new ventures. The Department's response letter stated the ventures did not qualify, because the food-buying and food-preparation activities were not "manufacturing or handiwork," as was then required by the statute, which also provided that the activities had to be conducted on the premises of the workshop. Since that time, however, the 1988 amendment to RCW 82.04.385 made two important changes to the statute, both of which affect the finding in the 1984 letter: it broadened the language to include "business activities of any kind" and permitted them to occur "on or off the premises."

As a result, where these other two enterprises are staffed by appropriate clients, and assuming the other requirements of the statute are met, both enterprises are engaged in business activities which now qualify as sheltered workshops under the current statute.

DECISION AND DISPOSITION:

Taxpayer has confirmed that it meets the requirement of RCW 82.04.385 that the workshops' "primary purpose" is providing gainful employment or rehabilitation services to persons meeting the definition of "handicapped" for the audit period in question, and its petition is granted. The assessment will be cancelled. For future periods, taxpayer will be required to demonstrate its continued compliance with the statutory requirements in order to retain entitlement to the exemption.

DATED this 19th June 1992.