DEPARTMENT OF TAXATION
2002 Fiscal Impact Statement

1.Patron: Miller, K.G.

2. Bill No. SB 16

House of Origin:
X Introduced
_____ Substitute
_____ Engrossed

3.Committee: Senate Finance

4.Title: Retail Sales and Use Tax : Provides a Refund Program for All Nonprofit Organizations Exempt From Federal Income Tax under §§ 501(c)(3) or (c)(4) of the Internal Revenue Code.

Second House:

_____ In Committee
_____ Substitute
_____ Enrolled

5. Summary/Purpose:

This bill would:

- Establish a refund program for all nonprofit organizations exempt from federal income taxation under §§ 501(c)(3) or (c)(4) of the Internal Revenue Code. Nonprofit organizations may apply for a refund of the taxes paid on their purchases of tangible personal property and taxable services made on or after January 1, 2003.

  Organizations must apply for the refund within three years from the last day of the calendar year in which the purchases are made. Eligible organizations may apply quarterly for refunds. If a refund request is at least $5,000 in a calendar year, including any amount already refunded in such year, the organization may apply for the refund at any time during the calendar year.

  The bill provides that the amount refunded would be equal to 100% of the tax paid. Interest would accrue and be paid on any refund not paid within 59 days after an application for a refund is filed with the department. Such interest shall begin to accrue from a date sixty days after the Tax Commission has received a properly completed application for refund and shall end on a date determined by the Tax Commissioner preceding the date of the refund check by no more than five days. Interest shall be paid at a rate equal to the rate of interest established pursuant to § 58.1-15.

- Exclude from the refund program certain nonprofit organizations currently exempt from retail sales and use tax. These organizations, including schools, churches and area agencies on aging, would continue to make purchases exempt of the sales and use tax pursuant to exemptions under current law.

6. Fiscal Impact Estimates are: Tentative. (See Line 8).

6a. Expenditure Impact:

Fiscal Year	***Dollars***	***Fund***
2002-03	$663,100	GF
2003-04	$148,800	GF
2004-05	$140,100	GF

6b. Revenue Impact:

Fiscal Year	***Dollars***	***Fund***
2002-03	$8.1 million	GF
2002-03	$1.4 million	TTF
2002-03	$2.8 million	Local
2003-04	($4.7 million)	GF
2003-04	($0.8 million)	TTF
2003-04	($1.6 million)	Local

7. Budget amendment necessary: Yes.
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8. Fiscal implications:

Administrative costs:

There are costs associated with modifying the system to implement this legislation. TAX is currently in the process of replacing its automated systems as part of a partnership with AMS. As a result, TAX will be maintaining two systems-the current STARS system and the new IRMS system-for a period of time as a contingency. The contract with AMS generally provides for the cost of implementing routine legislation. However, changes attributable to major legislation are not within the scope of the contract.

Because the scope of this legislation is significant, systems changes will not be paid through the AMS contract. Based on the number of nonprofit organizations that would be eligible to file refund request, it is estimated that the TAX would incur systems costs of $503,100 in FY2003 and $8,700 in FY2004. TAX would incur other administrative costs of $160,000 for FY2003 and $140,100 for FY 2004. These amounts include 4 full-time positions to review and process refund requests, equipment and forms costs. These costs assume TAX's role would be limited to an office review of the refund application and supporting documentation, and TAX would not be required to implement an enforcement program or audit the refund requests.

Revenue

Under current law, nonprofit organizations that qualify for an exemption in Code of Virginia do not pay the sales and use tax on purchases of tangible personal property and in some instances taxable services. Under this bill, all §501(c)(3) and (c)(4) organizations not excluded from the refund program would pay the tax on purchases of tangible personal property and taxable services effective January 1, 2003. As a result, this bill would generate additional revenues for the General Fund (GF), the Transportation Trust Fund (TTF) and the localities totaling $12.3 million (state: $9.5 million; local: $2.8 million) in FY2003. The estimates are based on the tax paid for the period January through May 2003. These revenues would result from the repeal of current exemptions effective January 1, 2003.

There would be a revenue loss for the GF, the TTF and the localities totaling $7.1 million (state: $5.5 million; local: $1.6 million) in FY2004. Losses of similar magnitude are anticipated for years beyond FY2004. TAX has registered 1,570 nonprofit organizations exempt from the sales and use tax under current law. There are currently 22,000 §§ 501(c)(3) or (c)(4) located in Virginia. Under this bill, the number of refund requests would significantly increase due to the increase in nonprofit organizations eligible for a refund.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current law provides exemptions from the retail sales and use tax for certain nonprofit organizations. The organizations qualifying for these exemptions are entitled to make purchases of tangible personal property, and in some instances taxable services, exempt of the retail sales and use tax at the time of purchase. The Department has registered approximately 1,570 nonprofit organizations exempt from the retail sales and use tax. Currently, there are approximately 22,000

§§ 5011(c)(3) and (c)(4) nonprofit organizations located in Virginia. Under this bill, these organizations would be eligible to apply for a refund on their purchases of tangible personal property and taxable services made on or after January 1, 2003.

Impact on Nonprofit Organizations

Under this bill, nonprofit organizations would be required to: (1) pay the tax at the point of purchase, (2) retain all purchase invoices or other receipts associated with such purchases, and (3) file a refund application with the purchase documentation.

Impact on Dealers

Effective January 1, 2003, dealers would no longer be responsible for requesting a copy of a nonprofit organization's exemption certificate in order to make tax-exempt sales. Dealers would be required to collect and remit the tax as with any other customer. However, there are notable exceptions to this rule. Churches, schools and area agencies on aging would continue to make purchases exempt of the tax, as they are not subject to the refund procedure. Therefore, dealers would need to be aware of the organizations that would continue to make tax exempt purchases and those that would be required to pay the tax at the point of purchase.

Dealer's Discount

The bill would not adjust the amount of the refunds to account for the dealer's discount allowed under Code of Virginia § 58.1-622. Dealers are compensated by the Commonwealth for accounting for and remitting the sales and use tax. This compensation is taken in the form of a discount on the sales and use tax return. Thus, the amount of refunds claimed under this proposal would exceed the actual amount of sales and use taxes remitted to the department by the dealers that collected the sales tax at the time sales were made to nonprofit organizations.

Statute of Limitations

Eligible organizations would be permitted to apply for a refund of taxes paid within three years from the last day of the calendar year in which purchases are made. This exceeds the time period allowed for refund requests under current law, which is three years from the date the tax is due and payable. Code of Virginia § 58.1-634.

Local Tax Distribution

The Department of Taxation devotes a significant amount of resources to improve the distribution to the localities of state sales tax education revenue funds. These funds are a substantial revenue source for many localities, and they are closely attuned to revenue fluctuations. The refund procedure under this bill is likely to result in an imprecise allocation of local taxes. Refunds may be deducted from localities where the original tax was not paid.

North Carolina Refund Program

North Carolina adopted a refund program, which requires certain nonprofit organizations pay the sales tax at the point of purchase and then apply semi-annually directly to the Department of Revenue for a refund of the tax.

Organizations must file refund claims for the tax paid for the period January 1 through June 30 by October 15. Refunds claims for tax paid for the period July 1, through December 31 must be filed by April 15. As originally enacted, the North Carolina law contained provisions which applied penalties for late filing of refund claims. The penalty provisions were first reduced and then repealed. As a result, North Carolina now processes refunds on a year-round basis.

Organizations applying for a refund must be certified as a nonprofit organization by the Department of Revenue. Refund claims are filed to include the tax paid, and local tax paid must be separately identified. North Carolina does not allow a dealer’s discount. Therefore, there is no compensating adjustment for the dealer’s discount.

North Carolina originally provided sales tax exemptions to nonprofit organizations by statute, similar to Virginia. The system was abolished in the early 1960’s and replaced with the current refund program. North Carolina employs six staff full-time to handle the nonprofit refund program. The six staff persons work year round on the refund program exclusively.

North Carolina does not have an enforcement program in place for its refund procedure. Generally, processing of the refund claims is limited to office review of total sales and use taxes paid. There is no structured audit program in place to verify the refund claims.

cc: Secretary of Finance

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