DEPARTMENT OF TAXATION
2003 Fiscal Impact Statement

1. Patron Orrock

2. Bill Number HB 2525

House of Origin:
_____ **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
X **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. Committee Senate Finance

4. Title Retail Sales and Use Tax: Converts the Legislative Process for Granting Sales and Use Tax Exemptions to Nonprofit Organizations to an Administrative Process

5. Summary/Purpose:

This bill would create an administrative process for granting sales and use tax exemptions to nonprofit organizations. The bill would establish standard criteria that would be used to qualify nonprofit organizations for sales and use tax exemptions. The Department of Taxation would administer the new process.

Currently, *new* sales and use tax exemptions are granted to nonprofit organizations by the General Assembly. This bill would eliminate the need for nonprofit organizations to seek new sales and use tax exemptions through the legislative process.

This bill would grandfather current exemptions under the terms and conditions of the exemptions as they exist as of June 30, 2003. Nonprofit organizations that already hold a valid exemption certificate issued by the Department of Taxation or hold a valid self-issued exemption certificate would continue to enjoy the same exemption. However, the bill would establish a filing schedule for grandfathered organizations to file the same information required of organizations applying for an exemption under the new process. The grandfather clause would preserve the exemption for nonprofit organizations that may not have a federal income tax exemption under Internal Revenue Code § 501(c)(3) or 501(c)(4). The clause would also preserve exemptions on sales of tangible personal property or purchases of taxable services held by some nonprofit organizations.

This bill would allow the sharing of confidential taxpayer information related to exempt nonprofit entities when requested by the General Assembly or a duly constituted committee of the General Assembly.

The Department of Taxation would be required to file an annual report with the Chairmen of the House Finance Committee, the House Appropriations Committee, and the Senate Finance Committee by December 1 of each year beginning in 2004.

The Department of Taxation, in consultation with the Virginia Coalition of Nonprofits and other interested parties, would be required to develop rules and regulations needed to carry out the provisions of this bill by July 1, 2004.

The effective date of this bill would be July 1, 2004.

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

6a. Expenditure Impact:

Fiscal Year	*Dollars*	*Positions*	*Fund*
2002-03	$49,800	0	GF
2003-04	$270,700	3	GF
2004-05	$130,400	3	GF

6b. Revenue Impact:

Fiscal Year	*Dollars*	*Positions*	*Fund*
2004-05	($5.1 million)	0	GF
2004-05	($0.9 million)	0	TTF
2004-05	($1.7 million)	0	Local

7. Budget amendment necessary: Yes.
Items 283 and 285, Department of Taxation

8. Fiscal implications:

Administrative

Total administrative costs to implement this bill would be $49,800 in Fiscal Year 2003, $270,700 in Fiscal Year 2004, and $130,400 in Fiscal Year 2005. Annual administrative costs of $130,000 would be incurred in fiscal years beyond Fiscal Year 2005.

The Department of Taxation estimates that systems costs to implement this bill would be $49,800 in Fiscal Year 2003, $125,000 in Fiscal Year 2004 and $4,000 annually in Fiscal Year 2005 and beyond. Additional personnel would be needed to administer the provisions of this bill. The Department of Taxation would need three full time employees to administer the new process. Personnel related costs are estimated to be $145,000 in Fiscal Year 2004 and $115,000 annually in Fiscal Year 2005 and beyond. Some minimal processing costs related to forms, postage, and data capture would be incurred beginning in Fiscal Year 2005 and continuing on an annual basis.

Revenue

This bill would have a negative impact on General Fund, Transportation Trust Fund, and local revenues. It is estimated that this bill would have a negative impact on state and local revenues of $7.7 million (state: $6.0 million; local: $1.7 million) for Fiscal Year 2005. There would be no revenue impact in Fiscal Year 2004 due to the delayed effective date of the bill.

Methodology

The methodology for computing the revenue impact is based in part on data obtained from the National Center for Charitable Statistics ("the Center"). The Center maintains a database of financial information on 501(c)(3) nonprofit organizations culled from Form 990s filed by the nonprofits with the Internal Revenue Service. Information from fiscal year 1999 for Virginia nonprofit organizations was used to determine the revenue impact of a general sales tax exemption. Totals of Form 990 expenses such as supplies, equipment rental, and maintenance were used to determine the revenue impact associated with an expanded exemption for all 501(c)(3) nonprofit organizations in Virginia.

The revenue impact was then increased by less than 1 percent to account for a much smaller population of 501(c)(4) nonprofits that would qualify for exemption. An adjustment was made to reflect purchases made by nonprofit organizations with less than $25,000 in gross receipts. These organizations are not required to file Form 990 with the Internal Revenue Service and their purchases would not be included in the data obtained from the Center. Data for the Form 990 "other expenses" account does not contain a breakdown showing purchases of tangible personal property that would be subject to sales and use tax. It was assumed that 20 percent of the total for other expenses would be taxable and the revenue impact was increased on this basis.

The resulting total revenue impact was then adjusted to remove the value of current exemptions for nonprofit organizations. Information from the Department of Taxation's database of nonprofit organizations with exemptions was used to determine the value of current exemptions. The value of current exemptions was deducted from the total revenue impact to arrive at the net revenue impact of expanding the nonprofit exemption.

Revenue Estimate

The revenue impact calculated by the Department of Taxation is tentative for several reasons. The data from the National Center for Charitable Statistics appears to be highly variable from year to year. The data used to determine the revenue impact of this bill comes from 1999 Form 990 returns. This revenue impact only uses data for Virginia nonprofit organizations. The bill would allow the exemption for all qualifying nonprofit organizations, which may include out-of-state organizations that make purchases in Virginia. However, the number of nonprofit organizations that choose to go through the filing process with the Department of Taxation to obtain an exemption may be limited in number. This could decrease the revenue impact.

Churches are not included in the revenue impact calculation. Churches currently enjoy an exemption from Virginia sales and use tax although it is narrower than the exemption provided by this bill. However, the impact of expanding the current exemption for churches is considered minimal.

The Department of Taxation's nonprofit database contains purchases data provided by nonprofit organizations. The purchase data supplied by nonprofit organizations in the database may not be accurate. There are nonprofit organizations missing from the database, and some organizations provide purchase data for varying periods ranging from 6 months to three years. Purchase totals that are provided to the Department are not verified to determine if they may include purchases that are not subject to sales and use tax.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: None.

11. Other comments:

New Process

The administrative process created by this bill would establish standard criteria to be used to qualify nonprofit organizations for a general sales and use tax exemption. The criteria include many of those currently considered by the General Assembly when considering new exemptions such as: 1) an exemption from federal income taxes under IRC § 501(c)(3) or 501(c)(4); 2) annual general administrative costs are 40% or less of annual gross receipts; and 3) if applicable, the organization is in compliance with Chapter 5 of Title 57 (state solicitations). The current process, like the new one, requires the provision of an estimate of total taxable purchases.

Under the new process, nonprofit organizations would have to file a copy of their Form 990 with the Department of Taxation, if a copy was filed with the Internal Revenue Service. If an organization does not file a Form 990, then the organization would be required to provide a list of the Board of Directors or other responsible agents of the organization and the location of the organization's financial records. Nonprofit organizations would be required to file a copy of a financial audit if gross annual revenues are $250,000 or greater.

Other Highlights

1) The Department of Taxation would issue exemption certificates for a duration of 5 to 7 years. Exemptions would be renewed based on the criteria established by this bill.

2) The bill would allow the Department of Taxation and the Department of Agriculture and Consumer Affairs to share information.

3) Beginning in 2004, the Department of Taxation would be required to file an annual report December 1 of every year with the chairmen of the House Finance, Senate Finance, and House Appropriations Committees that gives the annual fiscal impact of the sales and use tax exemption for nonprofit entities.

4) The bill contains a grandfather clause that excludes nonprofit organizations and churches that already hold valid exemptions from the new process and grants these organizations a permanent exemption under the terms that currently exist for their exemption. These organizations would be required to file updated information with the Department of Taxation based on a filing schedule set up by exemption category. This schedule mirrors the schedule now in use for the current exemption process.

5) The Department of Taxation would be required to promulgate rules and regulations to carry out the provisions of this bill in consultation with the Virginia Coalition for Nonprofits and other interested parties.

The Department of Taxation estimates that 22,000 501(c)(3) and 501(c)(4) nonprofit organizations in Virginia may benefit from the provisions of this bill. In addition, the Department of Taxation estimates that 7,700 churches in Virginia may benefit from the provisions of this bill. There are currently 1702 nonprofit organizations that have exemptions issued by the Department of Taxation. The inclusion of churches in the new process would be a departure from the current process, which excludes churches.

This bill is a result of recommendations made by the House Special Study Committee Studying Sales and Use Tax Exemptions. The Committee's recommendations were made through the Joint Subcommittee to Study and Revise Virginia's State Tax Code.

Other Legislation

The exemption process for nonprofit organizations established by this bill is similar to the process in SB 743. There are two key differences in the bills:

- SB 743 provides that the exemption process would expire July 1, 2006. HB 2525 does not include an expiration date for the same process.

- HB 2525 establishes a filing schedule for grandfathered organizations to file the same information required of organizations applying for an exemption under the new process. SB 743 does not include this requirement.

cc : Secretary of Finance

Date: 02/04/03/GRM

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