

DEPARTMENT OF TAXATION

2004 Fiscal Impact Statement

1. **Patron** Jeffrey M. Frederick

3. **Committee** House Finance

4. **Title** Retail Sales and Use Tax:
Exempts Tangible Personal Property and
Services Sold Via the Internet

2. **Bill Number** HB 1188

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would provide a sales and use tax exemption for all tangible personal property and services sold via the Internet. This bill would exempt Virginia individual consumers and businesses from paying sales and use tax on all tangible personal property and services sold via the Internet.

The effective date of this bill is not specified.

6. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

7. **Budget amendment necessary:** No.

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation would incur no administrative costs as a result of this bill.

Revenue Impact

The fiscal impact is unknown because there is a lack of consistent data regarding the dollar volume of electronic commerce nationally and, specifically, in Virginia. Many of the estimates do not take into account those sales, which qualify for any of the current sales and use tax exemptions (e.g., sales of nonprescription and prescription drugs). It also appears that this bill would exempt taxable services, such as hotel accommodations, if the service is sold over the Internet. As drafted, this bill would exempt property or services **acquired** by use of the Internet. Many vendors operating "brick and mortar" locations in Virginia allow customers to order goods over the Internet and pay for them at their store locations in Virginia. Currently these sales are subject to sales tax. In addition to goods **purchased** over the Internet, this bill would exempt these sales as the sale of goods **acquired** by use of the Internet.

Currently, only those Internet vendors that have a physical presence in Virginia are required to charge and collect Virginia sales tax on sales to Virginia customers. Internet vendors having no physical presence in the state cannot be required to collect the tax on sales to their Virginia customers. While the Department cannot require out-of-state Internet vendors to collect sales tax on sales to Virginia customers, Virginia customers are required to remit use tax on such purchases. However, compliance with this requirement by individual taxpayers is extremely low and use tax reported on such purchases does not produce significant revenues. Compliance by businesses is significantly higher.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

In order to clarify that only sales made over the Internet would qualify for the exemption under this bill, the following technical amendment is suggested:

Page: 2, Line: 89 After: service
Strike: acquired
Insert: purchased

11. Other comments:

Current Law and Policy

Collection of the sales tax: Virginia Internet vendors are required to collect and remit the sales tax on sales of tangible personal property to their Virginia customers. Similarly, out-of-state Internet vendors who have a physical connection with Virginia, as defined in *Virginia Code* § 58.1-612, are also required to collect and remit the tax on sales to their Virginia customers. This bill would allow these Internet vendors to sell tangible personal property to their Virginia individual and business customers exempt of the tax.

Payment of the use tax: The consumer use tax was enacted in 1966 as the other half of the sales tax and generally is owed on purchases upon which no Virginia sales tax was paid. The consumer use tax applies, for example, on items purchased from out-of-state vendors who are not required to collect the Virginia sales tax. The primary purpose of the use tax, as determined by the Virginia Supreme Court in Commonwealth v. Miller-Morton, 220 Va. 852, 263 S.E. 2d 413 (1980), is to prevent the sales tax from placing Virginia retailers at a competitive disadvantage with retailers located outside of Virginia.

While Virginia dealers and some out-state dealers collect and remit the sales tax on their sales to Virginia customers, most out-state retailers have no physical connection with the state and refuse to collect the tax. Virginia, like other states, is prohibited by the U.S. Supreme Court's decision in Quill Corp. v. North Dakota from requiring the collection of the sales tax from these out-of-state dealers. Thus, Virginia seeks collection of the use tax from purchasers. To this end, the Department of Taxation employs a number of compliance strategies.

- Virginia Individual Income Tax packages were expanded in 1992 to include the Consumer Use Tax Form CU-7, instructions, and information on the use tax. Form CU-7 was developed by the Department to facilitate the filing of the use tax by individuals and is due at the same time as the income tax returns.
- For tax years 1993 and after, the individual income tax return allows taxpayers to pay their consumer use tax liability, thus avoiding the need to file Form CU-7.
- Unlike individual taxpayers, the consumer use tax liability of businesses is enforced through periodic sales and use tax audits which generally cover a three-year audit period. Accordingly, the consumer use tax paid by businesses more accurately reflects actual liability.

This bill would allow Virginia individual consumers and businesses to purchase tangible personal property and services over the Internet without reporting and paying the consumer use tax.

Services: This bill exempts tangible personal property and services sold via the Internet. Virginia does not generally impose sales and use tax on services. The only exceptions are: (i) services made in connection with taxable sales of tangible personal property, and (ii) certain taxable services such as the provision of transient accommodations (e.g., hotel/motel accommodations). Under this bill, services made in connection with sales of tangible personal property purchased over the Internet would not be taxable. This is because the underlying property itself would be exempt.

However, it is currently unclear how this bill would affect the sale of taxable services. It may be that under this bill the provision of hotel accommodations would be exempt from the sales and use tax if the hotel room is reserved and paid for via the Internet.

Other remote sellers: The exemption provided in this bill would not affect the sales and use tax as it applies to mail order vendors, home shopping programs, and other non-Internet transactions.

Streamline Sales and Use Tax Agreement: Virginia is participating in the national Streamlined Sales Tax Project. One of the goals of the project is to conform state sales and use tax laws to a point that Congress will require out-of-state vendors (including Internet vendors) to collect tax in states where they do not have a physical presence.

HB 788 and SB 514 would conform Virginia's sales tax laws to allow Virginia to join the Streamlined Sales Tax states which may benefit from any future congressionally mandated filing by out-of-state vendors.

Similar Legislation

Senate Bill 632 would clarify the sales and use tax exemption for services and exempt software, data, content and other information services via the Internet.

cc: Secretary of Finance

Date: 2/3/2004/vhm