DEPARTMENT OF TAXATION
2004 Fiscal Impact Statement

1. Patron Linda T. Puller

2. Bill Number SB 84

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

3. Committee House Finance

4. Title Retail Sales and Use Tax: Provides an exemption for nonprofit organization organized for the purpose of rehabilitating prisoners incarcerated in the Commonwealth.

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

5. Summary/Purpose:

This bill would provide a retail sales and use tax exemption for tangible personal property purchased for use or consumption by nonprofit organizations exempt from federal taxation under § 501(c)(3) organized to improve the condition of prisoners and families affected by crime; reduce crime by promoting programs and policies directed at the rehabilitation of errants; and promote family and community ties during a prisoners incarceration.

This bill would be effective from July 1, 2004 to July 1, 2008.

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

7. Budget amendment necessary: No.

8. Fiscal implications:

This bill would result in minimal forms revisions and taxpayer education expenses for the Department.

This bill would have a minimal negative impact on General Fund, Transportation Trust Fund, and local revenues. Based on information provided by the requesting organization, it is estimated that this bill would have a minimum negative impact on state and local revenues of $365 in FY 2005, $372 in FY 2006, $380 in FY 2007, $388 in FY 2008, $395 in FY 2009, and $402 in FY 2010.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Va. Code § 30-19.05 governs the current process for nonprofit organizations that request an existing or a new sales and use tax exemption. Nonprofit organizations may qualify for an existing exemption in the law or they may seek legislation from the General Assembly for a new exemption. To qualify for legislative consideration of an exemption, organizations must meet certain criteria.

Exemption Criteria

In order to qualify for an existing or new exemption, a nonprofit entity must meet all of the applicable criteria:

- The entity is exempt from federal income taxation under IRC § 501(c)(3) or under IRC § 501 (c) (4).
- The entity is in compliance with all applicable state solicitation laws, and where applicable, provides appropriate verification of such compliance.
- The entity's annual general administrative costs, including salaries and fundraising, relative to its annual gross revenue, under generally accepted accounting principles, is not greater than 40 percent.
- If the entity's gross annual revenue was $250,000 or greater in the previous year, the entity must provide a financial audit performed by an independent certified public accountant.

This organization does not meet one or more of the criteria above and is not eligible for legislative consideration of a new exemption.

New Process

Legislation enacted in the 2003 Virginia General Assembly (Chapters 757 and 758) significantly alters the process by which nonprofit organizations obtain Virginia retail sales and use tax exemptions. This legislation eliminates the need for nonprofit organizations to seek new sales tax exemptions through the legislature. Effective July 1, 2004, all Internal Revenue Code (IRC) § 501(c)(3) and charitable § 501(c)(4) organizations can qualify for a sales tax exemption provided the criteria established by this legislation are met. The Department of Taxation will administer this process.

Exemption Criteria

The new legislation provides that in order to qualify for an exemption under the new process, a nonprofit entity must meet all of the applicable criteria:

- The entity is exempt from federal income taxation under IRC § 501(c)(3) or, if organized for a charitable purpose, exemption under IRC § 501 (c) (4). Alternatively, the entity has annual gross receipts of less than $5,000 and is organized for at least one of the purposes set forth in IRC § 501(c)(3) or (4).

- The entity is in compliance with all applicable state solicitation laws, and where applicable, provides appropriate verification of such compliance.

- The entity's annual general administrative costs, including salaries and fundraising, relative to its annual gross revenue, under generally accepted accounting principles, is not greater than 40 percent.

- If the entity's gross annual revenue was $250,000 or greater in the previous year, the entity must provide a financial audit performed by an independent certified public accountant.

- If the entity filed an IRS Form 990 or 990 EZ, it must provide a copy of such form to the Department. If the entity did not file an IRS Form 990 or 990 EZ, the entity must provide a list of the Board of Directors or other responsible agents of the entity, composed of at least two individuals and the location where the financial records of the entity are available for public inspection.

Under the new process, many nonprofit organizations will be eligible to apply for a sales and use tax exemption and most will likely qualify for exemption based on the criteria listed above. The Department of Taxation will accept applications for exemption prior to the effective date of the new process. The Department of Taxation will issue exemption certificates to qualifying organizations for a duration of 5 to 7 years. Organizations will renew their exemptions by submitting updated information to the Department of Taxation showing that they continue to meet the standard criteria. While this organization does not meet the criteria at this time, it may be eligible for exemption in the future, if it meets the applicable criteria under the new administrative process.

The legislation that created the nonprofit sales and use tax exemption process was 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. One of the goals of establishing the administrative process for granting sales and use tax exemptions was to eliminate the need for organizations to seek individual exemptions through the General Assembly.

cc: Secretary of Finance