DEPARTMENT OF TAXATION
2004 Fiscal Impact Statement

1. **Patron** Harry R. Purkey

2. **Bill Number** HB 311
   House of Origin:
   X **Introduced**
   ____ **Substitute**
   ____ **Engrossed**

   Second House:
   ____ **In Committee**
   ____ **Substitute**
   ____ **Enrolled**

3. **Committee** House Finance

4. **Title** Sales and Use Tax; Exemptions for Nonprofits

5. **Summary/Purpose:**

   This bill would add to the criteria for a nonprofit entity to qualify for a sales tax exemption certificate the requirement that it donate or use at least 60 percent of its annual gross revenues for charitable purposes. Additionally, this bill would clarify that the entity's administrative costs, which may not exceed 40 percent of annual gross revenues, include travel and office expenses.

   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:**

   Legislation in the 2003 General Assembly Session charged the Department with the responsibility for granting sales tax exemption certificates to nonprofit entities who meet statutory criteria. This bill would increase the supporting documentation that must be submitted and reviewed by the Department in its review of sales tax exemption applications. The cost of implementing this bill is expected to be minimal.

   By requiring entities to donate or use at least 60% of their annual gross revenue for charitable purposes, many fraternal or social IRC § 501(c)(4) organizations may lose their exemptions. It is unknown how may entities would fail to meet the additional requirements imposed by this bill. To the extent that nonprofit entities are denied sales tax exemption certificates because they do not meet these criteria, the Commonwealth and its localities would experience an increase in sales tax revenues.

9. **Specific agency or political subdivisions affected:**

   Department of Taxation

10. Technical amendment necessary: Yes.

If the intent of this bill is to provide an expenditure criteria that would not bar nonprofit entities organized for religious, educational and other purposes that are not technically "charitable" from qualifying for a sales and use tax exemption, the following amendment is suggested:

Page 1, Line 42, After: for
Strike: charitable purposes
Insert: charitable or other purposes set forth in § 501 (c) (3) of the Internal Revenue Code

11. Other comments:

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.

The legislation provides that any nonprofit organization that held a valid exemption certificate issued by the Department, or any nonprofit church that held a valid self issued certificate on June 30, 2003 will remain exempt from the collection or payment of such taxes. These grandfathered exemptions will expire and organizations will need to apply for a new exemption under the new process based on the following filing schedule:

Exemption Group	Deadline
Civic and community service (first half) (58.1-609.8)	July 1, 2004
Civic and community service (second half) (58.1-609.8)	July 1, 2005
Cultural and Miscellaneous (58.1-609.9, 58.1-609.10)	July 1, 2006
Educational (58.1-609.4)	July 1, 2007
Medical-Related (58.1-609.7)	July 1, 2008

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.

Organizations Exempt Under IRC § 501(c)(3) or (4)

Nonprofit organizations exempt from federal income taxes under IRC § 501(c)(3) are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

Nonprofit organizations exempt from federal income taxes under IRC § 501(c)(4) are operated exclusively for the promotion of social welfare, or local associations of employees, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Proposal

This bill would add to the criteria for a nonprofit entity to qualify for a sales tax exemption certificate the requirement that it donate or use at least 60 percent of its annual gross revenues for charitable purposes. Additionally, this bill would clarify that the entity's administrative costs, which may not exceed 40 percent of annual gross revenues, include travel and office expenses.

By requiring entities to donate or use at least 60 percent of their annual gross revenue for charitable purposes, many IRC § 501c(3) and (4) organizations may lose their exemptions because they are organized for religious, educational and other purposes that are not technically “charitable.” The Department suggests that a technical amendment be made to charitable or other purposes set forth § 501 (c)(3) of the Internal Revenue Code

Other Legislation

HB 515 and **SB 585** would modify the new sales and use tax exemption process for nonprofit entities that is scheduled to go into effect on July 1, 2004 by: (a) allowing churches to continue to use self-issued exemption certificates; (b) grandfathering the exemption from collecting sales tax on fund-raising sales currently enjoyed by certain organizations; and (c) authorizing the Department of Taxation to refuse to grant exemption certificates to applicants that that fail to disclose their total taxable purchases for the preceding year.

cc : Secretary of Finance

Date: 1/27/2004 JEM