

DEPARTMENT OF TAXATION

2005 Fiscal Impact Statement

1. **Patron** Harry B. Blevins

3. **Committee** Senate Finance

4. **Title** Retail Sales and Use Tax:
Exemption for School Contractors

2. **Bill Number** SB 917

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would provide an exemption from the retail sales and use tax for tangible personal property purchased by a contractor for sole use in the construction, reconstruction, installation, repair, or any other service with respect to real estate owned or leased by a local school division pursuant to a contract with the local school division.

The exemption under this bill would apply to purchases made (not contracts awarded) on or after the effective date (presumably July 1, 2005), even though the tax on such tangible personal property may be included in the contract price at the time the contract is awarded.

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

This bill would have no administrative impact on the Department.

Revenue Impact

The available data on school construction costs from the Department of Education does not break out tangible personal property costs from other expenditures. Therefore, the revenue loss from this bill is unknown. The data does include costs for new construction, additions and renovations. It is assumed that the industry standard is that about 50% of construction costs represent labor. Using 50% for tangible personal property costs applied to the average of fiscal year 2003 and fiscal year 2004 construction costs, it is estimated that the total sales and use tax revenue loss could be in excess of \$7.5 million annually.

9. Specific agency or political subdivisions affected:

Department of Taxation
Local School Divisions

10. Technical amendment necessary: Yes.

The exemption under this bill would apply to purchases made on or after July 1, 2005, regardless that the contract may have been awarded prior to that date. For contracts awarded before that date, contractors who included sales tax in the contract bid price would be entitled to seek refunds unless the contract is revised to exclude the tax from the contract price. Contractors would be able to apply for a refund of the taxes, but would be under no obligation to return this amount to the local school divisions. To avoid this, it is suggested that the bill be amended to limit the exemption to contracts awarded on or after July 1, 2005, as follows:

Page 2, line 105, After: service.

Insert: This exclusion applies to tangible personal property purchases pursuant to a contract awarded on or after July 1, 2005.

11. Other comments:

Current Law

Generally, when a contractor contracts to perform construction, reconstruction, installation, repair, or any other service with respect to real estate or fixtures, the contractor is deemed the user and consumer of such property and must pay the tax at the time of purchase of such property. In instances when the contractor is furnished tangible personal property for use under its contract, by the entity for whom the contract is performed and the sales and use tax has not been paid, the contractor becomes liable for the tax as the user and consumer of the property in the performance of its contract.

There is an exception to the “contractor rule” in Virginia Code § 58.1-610(B) that shields a contractor from the tax when the contractor is furnished tangible personal property for use in the performance of work for certain entities that enjoy exemptions from the sales and use tax. The exception applies to tangible personal property provided by a government, i.e., the Commonwealth, any political subdivision of the Commonwealth, or the United States, Virginia Code § 58.1-609.1(4). Local school divisions are political subdivisions of the Commonwealth and would be entitled to make purchases of tangible personal property exempt of the sales tax and provide such property to a contractor without the contractor incurring the tax.

This bill would allow the contractor when engaged in a real property construction services contract with a local school district to make exempt purchases of tangible personal property for its use and consumption in the performance of its real property services contract with such local school division. This bill would not benefit contractors who contract with Virginia state government or other political subdivisions of Virginia, the

federal government or the private sector. This bill would create different tax results for real property construction service contracts from contracts for other services.

The exemption provided in this bill would not override the prohibition in Virginia Code § 58.1-609.1(4) that restricts the purchase of tangible personal property by the Commonwealth or any of its political subdivisions for transfer to private businesses for their use in a facility or real property improvement for use by a private entity or for nongovernmental purposes.

Technical Amendment

A technical amendment is suggested in Item 10 to limit the application of this bill to purchases made pursuant to contracts awarded on or after July 1, 2005.

Similar Legislation

House Bill 1839 would provide an exemption for tangible personal property purchased by a contractor for use in the construction of a memorial for a branch of the U. S. Armed Forces pursuant to a contract with an exempt nonprofit entity.

House Bill 2092 would provide an exemption for tangible personal property purchased by a contractor for use in the performance of a contract with a government.

cc : Secretary of Finance

Date: 1/22/2005VHM
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