DEPARTMENT OF TAXATION
2006 Fiscal Impact Statement

1. Patron M. Kirkland Cox

2. Bill Number HB 212

House of Origin:
X **Introduced**
____ **Substitute**
____ **Engrossed**

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

3. Committee House Finance

4. Title Sales and Use Tax Exemption; Nonprofit Military Organizations

5. Summary/Purpose:

This bill would permit nonprofit organizations of past or present members of the Armed Forces of the United States, classified as § 501(c)(19) organizations by the Internal Revenue Code, to obtain a sales tax exemption on all purchases of tangible personal property by filing an application with the Department of Taxation, meeting the applicable criteria, and being issued a certificate of exemption from the Department of Taxation.

The effective date of this bill is not specified.

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

7. Budget amendment necessary: No

8. Fiscal implications:

The exemption of purchases made by nonprofit organizations of past or present members of the Armed Forces, classified as § 501(c)(19) organizations would result in a loss of tax revenue of unknown magnitude.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

<u>Generally</u>

Currently, nonprofit entities classified as § 501(c)(3) or § 501(c)(4) organizations by the Internal Revenue Code may obtain an exemption from the sales and use tax on their purchases of tangible personal property provided they 1) file an appropriate application with the Department of Taxation, 2) meet the applicable criteria, and 3) are issued a certificate of exemption from the Department of Taxation for the period of time covered by the certificate. As the law currently stands, the exemption is only available to nonprofit entities that have been designated as § 501(c)(3) or § 501(c)(4) organizations.

This bill would expand the entities entitled to receive the exemption to include all § 501(c)(19) organizations that followed the steps enumerated above. Consequently, this bill would make the exemption available to most Veteran Service Organizations (VSO's).

History of Exemption Process for Nonprofit Entities

Prior to July 1, 2004, the sales tax portion of Virginia's Tax Code separately listed and exempted over 180 non-profit entities from Virginia's sales tax. Entities not exempt under the Code were required to seek redress through the Virginia General Assembly. Legislation enacted in the 2003 Virginia General Assembly, which became effective in July of 2004, altered the process by eliminating the need for exempt organizations to seek new sales tax exemptions through the legislature. Instead, the Assembly grandfathered those organization's exemptions for a specified term and required that, upon expiration, the organization would have to adhere to a three-part process to include applying to TAX, meeting applicable criteria, and being issued a certificate of exemption from TAX. For those organizations that were not previously granted an exemption, they too would have to follow the process set forth above in order to obtain an exemption. The result of this legislation was that organizations no longer needed to apply to the General Assembly to receive an exemption or to renew an exemption, so long as they met the applicable criteria and performed all the necessary procedures. If all requirements were met, TAX could grant the organization a sales tax exemption for an additional period to expire in no less than five and no more than seven years, at which time the process could be repeated.

Since inception of the new process for nonprofit entities, certain organizations that once were eligible for an exemption are no longer eligible under the new process. Sunset provisions were made part of the exemptions available under the old process. Organizations that do not meet the criteria set forth for nonprofit exemptions under the new process will have their exemptions expire, according to the expiration dates given under the old law.

Prior to the law change, the Virginia Army/Air National Guard Enlisted Association and the Virginia National Guard Association qualified for an exemption on their purchases of all tangible personal property as well as meals and lodging for members. This exemption is set to expire on July 1, 2006, and neither organization will qualify for the exemption under the new process because neither will meet the criteria set forth under the new process. These organizations were both classified as § 501(c)(19) organizations by the Internal Revenue Code, but they are the only two § 501(c)(19) organizations to which an exemption was given under the old process. The remaining § 501(c)(19) organizations were not granted an exemption under the old process, nor do they qualify for an exemption under the new process.

Classification of VSO's as § 501(c)(19) organizations

There appear to be over 150 different types of both federally chartered and non-chartered VSO's. Prior to the passage of Public Law 92-418, most veterans' organizations were classified as § 501(c)(4) social welfare organizations. Typically, these organizations now fall under § 501(c)(19) of the Internal Revenue Code.

While there are VSO's that maintain a § 501(c)(3) or § 501(c)(4) status, most VSO's are characterized as § 501(c)(19) organizations. To achieve § 501(c)(19) status, the post or organization must consist of past or present members of the Armed Forces of the United States, or an auxiliary unit or society of, or a trust or foundation for, any such post or organization. In addition, it must meet the following requirements:

- The organization must be organized in the U.S. or any of its possessions,
- At least 75% of the members must be past or present members of the Armed Forces of the U.S. and substantially all of the other members must be individuals who are cadets, or are spouses, widows, widowers, ancestors, or lineal descendants of past or present members of the Armed Forces of the U.S. Note: "substantially all" has been defined in Senate Report No. 92-1082 as 90%.
- No part of the net earnings of the organization may inure to the benefit of any private shareholder or individual.

This Proposal

This bill would broaden the exemption criteria established by the 2003 General Assembly, to include § 501(c)(19) organizations that otherwise meet the established criteria.

cc : Secretary of Finance

Date: 01/20/2006 KP
DLAS File Name: HB212F161.doc