DEPARTMENT OF TAXATION
2006 Fiscal Impact Statement

REVISED

1. **Patron** John C. Watkins

2. **Bill Number** SB 595

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

3. **Committee** Senate Finance

4. **Title** Retail Sales and Use Tax: Refund Process For Nonprofit Organizations

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

5. **Summary/Purpose:**

This Fiscal Impact Statement is drawn to the bill as it will be amended to clarify that the refund process is mandatory.

Effective January 1, 2007, this bill would replace the current retail sales and use tax exemption process utilized by nonprofit organizations with a refund process that would require qualifying exempt nonprofit organizations to pay the sales and use tax on all tangible personal property and taxable services at the time of purchase and apply to TAX for a refund of sales and use taxes paid. Currently, qualifying nonprofit organizations enjoy an exemption from the sales and use tax on purchases of tangible personal property at the point of sale. This bill would repeal the current exemption available to nonprofit organizations and eliminate the renewal process nonprofit organizations currently are required to go through in order to maintain their exempt status.

This bill would be effective January 1, 2007.

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

6a. Expenditure Impact:

Fiscal Year	*Dollars*	*Positions*	*Fund*
2006-07	$687,400	3	GF
2007-08	$256,000	3	GF
2008-09	$133,000	3	GF
2009-10	$135,000	3	GF
2010-11	$137,000	3	GF
2011-12	$136,100	3	GF

6b. Revenue Impact:

Fiscal Year	*Dollars*	*Fund*
2006-07	$18.1 million	GF
	$2.6 million	TTF
	$5.3 million	Local
2007-08	($10.9 million)	GF
	($1.6 million)	TTF
	($3.2 million)	Local

7. **Budget amendment necessary:** Yes.
Page 1, Revenue Estimates
Item 265, Department of Taxation

8. **Fiscal implications:**

Administrative Costs Impact

TAX implemented a new Integrated Revenue Management System (IRMS) in August 2005. IRMS replaced TAX's 20-year-old tax processing system. IRMS includes an imaging system, a data entry system, a remittance system, a customer relationship management system, a collections system, an audit system, an Internet suite of systems, and back-office systems that process the registrations of taxpayers and the processing of their returns and payments.

Since the implementation, there has been a significant software modification to implement 2005 legislative changes. In addition, other necessary enhancements to the system have been developed. Other additional software releases are planned throughout the summer of 2006.

The modifications to IRMS necessary to allow TAX to process the anticipated level of sales tax refunds would require changes to virtually **all** of the IRMS subsystems. While TAX can begin work to implement this bill to be effective January 1, 2007, TAX would not be able to issue refunds until July 1, 2007. TAX is recommending an amendment authorizing TAX to issue such refunds on and after July 1, 2007.

Taxpayers would still qualify for a sales tax refund on qualifying purchases made on and after January 1, 2007. TAX would accumulate those refunds filed between January 1, 2007 and June 30, 2007 and would process such requests on or after July 1, 2007. Refunds filed for sales and use taxes paid on qualifying purchases after July 1, 2007 would be processed as received. Limitations regarding the time limitation for filing refund claims would be based on the date the claim is filed, not the date the refund is processed.

If this bill is passed, TAX will incur administrative costs for systems development, customer service personnel, salaries and benefits of $687,430 in FY 2007, $256,050 in FY 2008, $133,050 in FY 2009, $135,050 in FY 2010, $137,050 in FY 2011, and

$136,100 in FY 2012. Systems development costs include analysis, design, coding, and testing. Customer service costs include three full time employees for refund verification, equipment set-up, office space, phone service, salaries and benefits.

<u>Revenue Impact</u>

Based on the effective date in this bill of January 1, 2007, and the fact that TAX will not able to issue refunds until July 1, 2007 or after, the net revenue gain for the five month period of FY 2007 as a result of nonprofit organizations paying sales tax on their purchases will be $26.0 million. The revenue loss in FY 2008 associated with refunds issued on and after July 1, 2007 will be $15.7 million. For FY 2009 and beyond, there will be no revenue impact.

Currently qualifying nonprofit organizations are exempt from the retail sales and use tax at the time of purchase at the point of sale. By requiring nonprofit organizations to apply to TAX for a refund of all sales and use tax paid would result in TAX refunding more tax than was remitted. For collecting and remitting the retail sales and use tax, registered dealers are allowed to retain part of tax collected in the form of a dealers discount.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

In order to allow TAX to begin issuing refunds on and after July 1, 2007, the following amendments are requested:

Page 4, Line 233, At the end of the line.
Insert: 3. For all refunds of state and local retail sales and use taxes claimed on or after January 1, 2007, but before July 1, 2007, the Department of Taxation is authorized to issue such refunds on and after July 1, 2007.

Page 4, Line 234
Strike: 3
Insert: 4

Page 4, Line238
Strike: 4
Insert: 5

11. Other comments:

<u>Current Process</u>

The 2003 General Assembly passed House Bill 2525 (Chapter 757, 2003 Acts of Assembly) and Senate Bill 743 (Chapter 758, 2003 Acts of Assembly) to create an administrative process for granting sales and use tax exemption to nonprofit organizations and established standard criteria that would be used to qualify nonprofit organization for sales and use tax exemption. As a part of the Joint Subcommittee to Study and Revise Virginia's State Tax Code (HJR 685 and SJR 387, 2001; HJR 60, 2002), the use of a refund process for nonprofit organizations was considered, but ultimately rejected in favor of an exemption process, by the General Assembly.

Effective July 1, 2004, all Internal Revenue Code § 501c(3) and § 501c(4) organization qualified for the exemption provided they met certain criteria established by the General Assembly. The Department of Taxation currently administers this process. Prior to this legislation, each nonprofit organization was required to seek a separate exemption from the General Assembly.

Under the new process, to be granted an exemption by the Department of Taxation, an entity must meet all the applicable criteria:

- The entity must be either a 501(c)(3) or 501(c)(4) organization, or have annual gross receipts of less than $5,000 and be organized for a charitable purpose.
- The entity must have annual administrative costs that are 40% or less of annual gross receipts.
- The entity must be in compliance with state solicitation laws, if applicable.
- The entity must provide the Department with an estimate of its total taxable purchases.
- The entity must provide the Department with a copy of its Form 990 or a list of its board of directors.
- The entity must provide the Department with a copy of a financial audit, if its gross annual revenues are over $250,000.

The process requires renewal on a five-year cycle, but eliminates the need for legislative action. Entities holding valid exemption certificates under the old system could continue to enjoy their exempt status, but are required to file under the new process when their exemption sunsets.

The same criteria and procedures that apply to organizations that are newly applying for the exemption would also apply to those organizations that held the exemption prior to the law change.

Proposal in this Bill

Qualifying nonprofit organizations currently enjoy an exemption from the sales and use tax at the point of sale. This bill would require all qualifying nonprofit organizations to pay the sales and use tax on tangible personal property and taxable services at the time of purchase and apply to TAX for a refund of taxes paid to vendors. Under this bill, nonprofit organizations would still be required to meet all the criteria currently imposed on a nonprofit organization in order to apply for a refund. TAX would continue to be the certifying authority by verifying tax exempt status prior to the issuance of a refund using the same criteria currently imposed. Nonprofit organization would not be required to renew their exempt status every five years as currently required. The proposal in this bill to require qualifying nonprofits to pay the tax on purchases and taxable services and apply to TAX for a refund would replace the current process of allowing nonprofit organizations to make purchases tax-exempt at the point of sale.

Refund Provisions

This bill provides that nonprofit organizations would apply for refunds of sales taxes paid on purchases on a quarterly basis beginning in calendar year 2007. If a nonprofit organization qualifies for refunds of $5,000 or more during a calendar year, they may apply for a refund at any time during the calendar year. The quarterly filing requirement for refunds by nonprofit organizations will reduce the number of refunds TAX would have to issue throughout the calendar year. The application for a refund would be on forms prescribed by the Tax Commissioner and filed within three years of the last day of the calendar year in which the purchase was made and sales taxes paid. Interest will be paid on all refund not issued within 59 days after the Tax Commissioner has received the application for such refund. Interest will begin to accrue from a date 60 days after the Tax Commissioner has received a properly executed refund application and will end on a date determined by the Tax Commissioner preceding the date of the refund check by not more than five days.

Impact on Dealers

Effective January 1, 2007, dealers would no longer be responsible for requesting a copy of a nonprofit organizations exemption certificate in order to make tax exempt sales. Dealers would be require to collect and remit the tax from nonprofit organizations just like they would any other customer.

Local Tax Distribution

The amount of the refund attributable to the local portion of the sales tax will be deducted from the 1 percent local distribution based on school age population for the respective cities or counties. The amount of the refund attributable to local taxes will be determined from the nonprofit organization application for refund. The net deduction of the localities share of the net revenue will occur in the month following the month in which the refund was issued.

This Fiscal Impact Statement is reflective of Senate Bill 595 as it will be amended when presented to the Senate Finance Committee.

cc : Secretary of Finance

Date: 02/06/2006 WBS
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