

DEPARTMENT OF TAXATION

2006 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 96

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 all tangible personal property purchased by a real property contractor used solely in the construction, reconstruction, installation, or repair in fulfilling a contract with a local school division. The provisions of this bill shall apply only to contracts awarded on or after July 1, 2006.

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 Impact

TAX has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, TAX considers implementation of this bill as "routine," and does not require additional funding.

TAX will provide specific administrative costs on any legislation that is not "routine." Additionally, TAX will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, TAX will identify the costs at that time.

Revenue Impact

The available data on school construction costs from the Department of Education does not break out tangible personal property costs from other expenditure. 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 2004 and fiscal year 2005 construction costs, it is estimated that the total sales and use tax revenue loss could be in excess of \$6.9 million annually.

9. Specific agency or political subdivisions affected:

Department of Taxation
Local School Divisions

10. Technical amendment necessary: No.

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.

Similar Legislation

House Bills 248, 536, 1251, 1315 and Senate Bills 254, 478 are all identical bills and provide an exemption from the sales and use tax to any person who contracts on or after July 1, 2006, to perform services for and provide tangible personal property for use or consumption by the Federal, State, or local government, provided title to the property passes to the government entity.

Proposed Budget Bill

The Proposed Budget Bill (HB 30 and SB 30) provides that TAX will cease its current practice of applying the “true object” test to the contract as a whole for contractors who provide services and tangible personal property to the Federal, State, or local government. Beginning July 1, 2006, government contractors will apply the “true object” test to each transaction of contract based on separate “work order”, “statement of work”, or “task order”, as opposed to the contract as a whole.

cc : Secretary of Finance

Date: 01/16/2006 WBS
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