

# DEPARTMENT OF TAXATION

## 2007 Fiscal Impact Statement

1. **Patron** Edward T. Scott

2. **Bill Number** HB 3062

3. **Committee** Passed House and Senate

**House of Origin:**

           **Introduced**

           **Substitute**

           **Engrossed**

4. **Title** Retail Sales and Use Tax Exemption;  
Modifies Audit Requirements for Nonprofits

**Second House:**

           **In Committee**

           **Substitute**

  X   **Enrolled**

### 5. **Summary/Purpose:**

This bill would modify the criteria for nonprofit organizations to receive an exemption from the Retail Sales and Use Tax by permitting nonprofit organizations that have gross annual revenues between \$750,000 to \$1,000,000 the choice of providing a full "financial audit" or a "financial review" in lieu of a full financial audit, both of which would be performed by an independent certified public accountant. Nonprofit organizations with gross annual revenues of \$1 million or greater would be required to provide a full financial audit performed by an independent certified public accountant.

Under current law, as a result of budget language included in the Budget Bill (House Bill 5002 (Chapter 3, Special Session 1 of 2006) and House Bill 5012 (Chapter 2, Special Session 1 of 2006)), nonprofit organizations with gross annual revenues ranging from \$250,000 to \$499,999 are permitted to submit a financial review in lieu of a full financial audit in order to qualify for exemption. Nonprofit organizations with gross annual revenues of \$500,000 or greater must submit a full financial audit.

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 considers implementation of this bill as routine, and does not require additional funding.

#### Revenue Impact

This bill would result in a loss of revenue of unknown magnitude. The procedural changes proposed in this bill would allow more nonprofit organizations to qualify for exemption from

the Retail Sales and Use Tax due to the relaxed audit requirement. The expense of obtaining a full financial audit has deterred some nonprofit organizations from applying for a Retail Sales and Use Tax exemption in the past.

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

TAX

**10. Technical amendment necessary:** No.

**11. Other comments:**

History of Exemption Process for Nonprofit Entities

Prior to July 1, 2004, the Code of Virginia separately listed and provided a sales tax exemption for over 180 categories of non-profit entities. Entities not exempt by statutory classification were required to seek exemption through the Virginia General Assembly. Legislation enacted in the 2003 Virginia General Assembly, which became effective July 1, 2004, altered the process by eliminating the need for exempt organizations to renew their sales tax exemptions through the legislature. The legislature extended those organizations' exemptions for a specified term and required that, upon expiration, the organizations 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. Organizations that were not previously granted an exemption were also required 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, provided that they met the applicable criteria and performed all the necessary procedures. If all requirements were met, TAX could grant each 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 organization would have to reapply for exemption status.

Current Requirements

The new exemption process requires that nonprofit organizations meet the following criteria to be eligible for exemption:

- The entity must be either an organization exempt under Internal Revenue Code ("IRC") §§ 501(c)(3) or 501(c)(4), 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 TAX with an estimate of its total taxable purchases

- The entity must provide TAX with a copy of its Form 990 or a list of its board of directors.
- The entity must provide TAX with a copy of a full financial audit, if its gross annual revenues are \$500,000 or more. A nonprofit organization with gross annual revenues ranging from \$250,000 to \$499,999 is subject to “financial review” rather than a full financial audit, and must present documentation of that review to TAX. An entity with less than \$250,000 of gross annual revenue is not required to provide any type of financial audit or review.

Prior to 2006, nonprofit entities were required to provide TAX with a copy of a full financial audit if their gross annual revenues were equal to or exceeded \$250,000, rather than \$500,000. As a result of budget language included in the Budget Bill (House Bill 5002 (Chapter 3, Special Session 1 of 2006) and House Bill 5012 (Chapter 2, Special Session 1 of 2006)), a nonprofit organization with gross annual revenue ranging from \$250,000 to \$499,999 may submit a “review of its financial statements” in lieu of a full financial audit.

The American Institute of Certified Public Accountants (AICPA) in its Statements on Standards for Accounting and Review Services identifies “compilation, review, and audit as the three forms of financial examination and distinguishes between the audit and review of financial statements. According to the AICPA, a “review” process entails, “performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statements for them to be in conformity with generally accepted accounting principles.” In contrast, an “audit” provides the accountant with a “reasonable basis for expressing an opinion regarding the financial statements taken as a whole.” The *Standards for Auditing* require that an accountant conducting an audit state whether, in his opinion, the financial statements are presented in conformity with generally accepted accounting principles (AICPA PROFESSIONAL STANDARDS, AR § 110.01). An audit will entail obtaining an understanding of internal control, assessing control risk, testing accounting records, and responding to inquiries by obtaining corroborating evidential matter through inspection, observation, or confirmation. Of these two forms of examination, the audit is clearly the most stringent procedure.

### Proposal

This bill would modify the criteria for nonprofit organizations to receive an exemption from the Retail Sales and Use Tax by permitting nonprofit organizations that have gross annual revenues between \$750,000 and \$1 million the choice of providing a full “financial audit” performed by an independent certified public accountant or a “financial review,” in lieu of a full financial audit. Nonprofit organizations with gross annual revenues of \$1 million or greater would be required to provide a full financial audit performed by an independent certified public accountant.

### Similar Legislation

**House Bill 2545** and **Senate Bill 743** are identical to this bill.

cc : Secretary of Finance

Date: 3/6/2007 KP

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