

**DEPARTMENT OF TAXATION
2009 Fiscal Impact Statement**

1. **Patron** Mark D. Obenshain

2. **Bill Number** SB 1222

3. **Committee** House Finance

House of Origin:

 Introduced

 Substitute

 Engrossed

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

Second House:

 X **In Committee**

 Substitute

 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 requiring that nonprofit organizations with gross annual revenues in the previous year of at least \$750,000 provide a financial review performed by an independent certified public accountant. In addition, this bill would give TAX the discretion to determine whether nonprofit entities with gross annual revenues in the previous year of at least \$1 million must provide a full financial audit or a financial review in order to qualify for exemption.

Under current law, nonprofit entities must meet certain audit requirements, among other requirements, in order to be eligible for exemption from the Retail Sales and Use Tax. A nonprofit entity with gross annual revenues in the previous year of \$1 million or greater is required to provide a full financial audit performed by an independent certified public accountant, while nonprofits with gross annual revenues between \$750,000 and \$1 million in the previous year are given the choice of providing a full financial audit or a financial review, both of which must be performed by an independent certified public accountant.

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

To the extent that TAX exercises the authority granted by this bill to allow nonprofit entities with gross annual revenues of \$1 million or more to apply for a Retail Sales and Use Tax exemption and file a financial review rather than a more costly full financial audit, additional entities may decide to apply for and obtain a nonprofit exemption certificate. To the extent that such entities make tax exempt sales, this bill would result in a state revenue loss, the magnitude of which is unknown.

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 sales tax portion of Virginia's Tax Code separately listed and exempted over 180 nonprofit 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.

Current Requirements

To qualify for the nonprofit exemption, an organization must currently meet the following requirements:

- The entity is exempt from federal income taxation under either § 501(c)(3) or § 501(c)(4) of the Internal Revenue Code;
- The entity is in compliance with all applicable state solicitation laws, and where applicable, provides appropriate verification of such compliance; and

- The entity's annual general administrative costs, including salaries and fundraising, relative to its annual gross revenue, under generally accepted accounting principles, is not greater than 40 percent; and
- If the entity's gross annual revenue was \$1 million or greater in the previous year, the entity must provide a financial audit performed by an independent certified public accountant. If the entity's gross annual revenue fell between \$750,000 and \$1 million, then the entity is given the choice of providing a full financial audit or a "financial review," both of which must be performed by an independent certified public accountant.
- If the entity filed a federal 990 or 990 EZ tax form, or the successor forms to such forms, with the IRS, then it must provide a copy of such form to the Department of Taxation, and if the entity filed neither a federal 990 or 990 EZ form with the IRS, then it must provide the Department of Taxation with information including a list of its Board of Directors and the location of its financial records.

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. 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 was authorized to submit a "review of its financial statements" in lieu of a full financial audit. In the 2007 Session of the General Assembly, this requirement was changed to allow organizations with gross annual revenues between \$750,000 and \$1 million to choose between providing a full financial audit or a financial review, both of which must be performed by an independent certified public accountant. Organizations with gross annual revenues of \$1 million or greater are required to submit 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 requiring that nonprofit organizations with gross annual

revenues in the previous year of at least \$750,000 provide a financial review performed by an independent certified public accountant. Under the provisions of this bill, TAX would be given the discretion to determine whether nonprofit entities with gross annual revenues in the previous year of at least \$1 million must provide a full financial audit or a financial review in order to qualify for exemption.

The effective date of this bill is not specified.

Other Legislation

House Bill 2330 is identical to this bill.

House Bill 1779 would allow a nonprofit entity that is eligible to apply for an exemption from taxation under *Va. Code* § 58.1-609.11 and that is otherwise entitled to the occasional sale exemption to be entitled to exemption on its sales of 1) food, prepared food, and meals; and 2) tickets to events that include the provision of food, prepared food and meals, provided the organization holds such sales on fewer than 24 occasions in a calendar year.

cc : Secretary of Finance

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