DEPARTMENT OF TAXATION
2013 Fiscal Impact Statement

1. Patron Linda T. Puller

2. Bill Number SB 730

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

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

3. Committee Senate Finance

4. Title Retail Sales and Use Tax; Nonprofit Exemption for I.R.C. § 501(c)(19) Organizations

5. Summary/Purpose:

This bill would permit nonprofit Veteran Service Organizations (VSOs) that are exempt from federal income taxation under § 501(c)(19) of the Internal Revenue Code (I.R.C.) to obtain an exemption from the Retail Sales and Use Tax on all purchases of tangible personal property. VSOs would need to follow the nonprofit entity exemption process of filing an application with the Department of Taxation, meeting the applicable criteria, and obtaining a certificate of exemption from the Department.

Under current law, organizations exempt from federal income taxation under I.R.C. § 501(c)(3) or § 501(c)(4), or entities with annual gross receipts less than $5,000 organized for one of the purposes set forth in § 501(c)(3) or § 501(c)(4) are eligible for the Retail Sales and Use Tax exemption available to qualifying nonprofit entities on their purchases of tangible personal property.

The effective date of this bill is not specified.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Not available. (See Line 8.)

8. Fiscal implications:

Administrative Costs

The Department considers implementation of this bill as “routine” and does not require additional funding.

Revenue Impact

The Department analyzed a similar bill during the 2012 Virginia General Assembly Session (Senate Bill 114) and estimated that the bill could potentially decrease state and local revenues by $118,000 by Fiscal Year 2018. The Department has since discovered additional data that significantly alters this estimate.

This bill would result in a revenue loss, the magnitude of which is unknown. Based on available data from the National Center for Charitable Statistics and the Weldon Cooper Center for Public Service, the annual revenue loss associated with this bill could potentially be as much as $1.77 million. However, the revenue impact may be significantly less to the extent that it may include purchase already qualifying for another exemption, such as the resale exemption. In addition, § 501(c)(19) organizations with annual gross receipts of less than $5,000 that are organized for one of the purposes set forth in § 501(c)(3) or § 501(c)(4) that have annual gross receipts of $5,000 may qualify under the current nonprofit entity exemption.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Generally

Currently, nonprofit entities classified as § 501(c)(3) or § 501(c)(4) organizations by the I.R.C. may obtain an exemption from the Retail Sales and Use Tax on their purchases of tangible personal property, provided they: 1) file an appropriate application with the Department; 2) meet the applicable criteria; and 3) are issued a certificate of exemption from the Department. The exemption is available only to nonprofit entities that have been designated as § 501(c)(3) or § 501(c)(4) organizations, or entities with annual gross receipts of less than $5,000 that are organized for one of the purposes set forth in § 501(c)(3) or § 501(c)(4).

History of Virginia 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 nonprofit 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 the Department, meeting applicable criteria, and being issued a certificate of exemption from the Department. 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 they met the applicable criteria and performed all the necessary procedures. If all requirements were met, the Department 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.

Since inception of the new process for nonprofit entities, certain organizations that once were eligible for an exemption are no longer eligible. Sunset provisions were made part of the exemption available under the old process. Organizations that did not meet the criteria set forth for nonprofit exemptions under the new process had 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 expired on July 1, 2006, and because both organizations are classified as § 501(c)(19) organizations by the Internal Revenue Code, neither organization qualifies for exemption from the sales and use tax under the new process. These organizations are the only two § 501(c)(19) organizations to which an exemption was available under the old process. The remaining § 501(c)(19) organizations were not granted an exemption under the old process, unless they qualified as a § 501(c)(3) or § 501(c)(4) organization.

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 I.R.C. § 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 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 full financial review performed by an independent certified public accountant if its gross annual revenue was at least $750,000 in the previous year. For nonprofit organizations with gross annual revenues of at least $1 million, the Department may require that the entity provide a full financial audit performed by an independent certified public accountant in lieu of a financial review.

Classification of VSOs as I.R.C. § 501(c)(19) Organizations

Current law grants an exemption from the federal income tax for IRC § 501(c)(19) organizations. As of 2008, there were over 150 different types of both federally chartered and non-chartered VSOs. 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 some VSOs meet the requirements of § 501(c)(3) or § 501(c)(4), most VSOs are characterized as § 501(c)(19) organizations. Under I.R.C. § 501(c)(19), a post or organization 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 that meets the following requirements is exempt from federal income taxes: 1) organized in the United States or any of its possessions; 2) at least 75% of the members are past or present members of the Armed Forces and substantially all of the remaining members are cadets, spouses, widows, widowers, ancestors, or lineal descendants of past or present members of the Armed Forces of the United States or of cadets, and 3) no part of the net earnings inure to the benefit of any private shareholder or individual.

Other States

A number of states currently provide an exemption from the Retail Sales and Use Tax to organizations designated as § 501(c)(19) organizations. Florida, Maryland, Minnesota, New York, Tennessee, and Texas specifically exempt organizations that qualify for exemption under § 501(c)(19) on their purchases of tangible personal property. Other states, such as New Jersey, Massachusetts, Pennsylvania, South Carolina, and Washington exempt veterans' organizations without requiring that such organizations meet the requirements set forth in § 501(c)(19). In Oklahoma, the exemption applies only to the Veterans of Foreign Wars, and to certain purchases made by Blue Star Mothers of America.

In some states, there are specific limitations on the exemption. In Colorado, the exemption only applies for accommodations rented by veterans' organizations, or when such purchases are for a special event, meeting or other function that is not part of the organization's regular activities. In Vermont, the exemption applies only on the purchases of U.S. flags made by veterans' organizations.

Proposal

This bill would permit nonprofit Veteran Service Organizations (VSOs) that are exempt from federal income taxation under § 501(c)(19) of the Internal Revenue Code (I.R.C.), to obtain an exemption from the Retail Sales and Use Tax on all purchases of tangible personal property by following the nonprofit exemption process of filing an application with the Department of Taxation, meeting the applicable criteria, and obtaining a certificate of exemption from the Department.

The effective date of this bill is not specified.

Similar Legislation

House Bill 1581 would exempt entities organized under § 501(c)(6) of the Internal Revenue Code from collecting sales and use tax on occasional sales of meals that occur fewer than 24 times a year.

cc : Secretary of Finance

Date: 1/12/2013 KP
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