

DEPARTMENT OF TAXATION

2016 Fiscal Impact Statement

1. **Patron** L. Scott Lingamfelter

2. **Bill Number** HB 63

3. **Committee** Senate Finance

House of Origin:

 Introduced

 Substitute

 Engrossed

4. **Title** Retail Sales and Use Tax; Business
Professional Occupational and License Tax;
Exemption for Veteran Service Organizations

Second House:

 X **In Committee**

 Substitute

 Enrolled

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 purchases of tangible personal property. In addition, the bill would allow organizations that have annual gross receipts below \$5,000 and that are organized for one of the purposes set forth in *I.R.C.* § 501(c)(19) to qualify for exemption from the tax. In either case, the sales and use tax exemption would not apply to tangible personal property used primarily for social and recreational activities for members or for providing insurance benefits to members or members’ dependents. As with other nonprofit organizations, VSOs would need to file an application with the Department of Taxation, meet the applicable criteria, and obtain a certificate of exemption from the Department to make purchases of qualifying tangible personal property exempt of the sales and use tax.

This bill would also exempt the gross receipts of these *I.R.C.* § 501(c)(19) organizations from the Business Professional Occupational and License (“BPOL”) tax, except to the extent the organization has receipts from an unrelated trade or business, which receipts are subject to federal income tax under *I.R.C.* § 511.

Under current law, organizations exempt from federal income taxation under *I.R.C.* § 501(c)(3) or, if organized for a charitable purpose, *I.R.C.* § 501(c)(4), or entities with annual gross receipts less than \$5,000 organized for one of the purposes set forth in *I.R.C.* § 501(c)(3) or one of the charitable purposes set forth in *I.R.C.* § 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. Currently, localities are prohibited from imposing license taxes on the gross receipts of *I.R.C.* § 501(c)(3) organizations, except to the extent the organization has receipts from an unrelated trade or business. Additionally, gross receipts from gifts, contributions and membership dues of all *I.R.C.* § 501(c) organizations, including, for example, *I.R.C.* § 501(c)(4) organizations, are exempt from the BPOL tax.

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 Impact

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

Revenue Impact

The proposed expansion of the Retail Sales and Use Tax nonprofit exemption would result in a state and local revenue loss, the magnitude of which is unknown. To the extent that a locality imposes the BPOL tax and has *I.R.C.* § 501(c)(19) organizations with definite places of business operating within the locality, the locality would experience an additional decrease in local revenues, the magnitude of which is unknown. The Department lacks sufficient data to estimate the revenue impact of expanding the sales tax and BPOL tax exemptions to include *I.R.C.* § 501(c)(19) organizations or organizations organized for *I.R.C.* § 501(c)(19) purposes.

Groups qualifying for exemption from federal taxation under *I.R.C.* § 501(c)(19) include, for example, posts or auxiliaries of the American Legion, Veterans of Foreign Wars, and similar organizations. Trusts or foundations for a veterans’ organization also may apply for exemption from federal taxation. In 2013, 624 VSOs in Virginia filed the Form 990 or related informational returns.

9. Specific agency or political subdivisions affected:

Department of Taxation
All localities that impose the BPOL Tax

10. Technical amendment necessary: No.

11. Other comments:

Veteran Service Organizations, Background

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 *I.R.C.* § 501(c)(4) social welfare organizations. Typically, these organizations now fall under *I.R.C.* § 501(c)(19). While some VSOs meet the requirements of *I.R.C.* § 501(c)(3) or *I.R.C.* § 501(c)(4), most VSOs are characterized as *I.R.C.* § 501(c)(19) organizations.

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

Current law grants an exemption from the federal income tax for *I.R.C.* § 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.

An *I.R.C.* § 501(c)(19) organization must be operated for one or more of the following eight purposes:

- Promotion of the social welfare of the community;
- Assisting disabled and needy war veterans and members of the U.S. Armed Forces and their dependents, and the widows and orphans of deceased veterans;
- Providing entertainment, care, and assistance to hospitalized veterans or members of the U.S. Armed Forces;
- Carrying on programs to perpetuate the memory of deceased veterans and members of the Armed Forces, and to comfort their survivors;
- Conducting programs for religious, charitable, scientific, literary or educational purposes;
- Sponsoring or participating in patriotic activities;
- Providing insurance benefits to members or members' dependents, or
- Providing social and recreational activities for members.

I.R.C. § 501(c)(19) organizations may conduct social and recreational activities without jeopardizing their federal tax-exempt status if the activities are conducted with post members. Such activities may include operating bars and restaurants, gambling, and holding dinners and dances.

Requirements for I.R.C. § 501(c)(4) Organizations

Federal law also grants a federal income tax exemption for organizations that meet the requirements under *I.R.C.* § 501(c)(4). These organizations must not be organized for profit and must be operated exclusively to promote social welfare; i.e., organized primarily to further the common good and general welfare of the community, rather than private individuals or private groups. *I.R.C.* § 501(c)(4) organizations are prohibited from operating social clubs or engaging in social activities as their primary activities for the benefit of their members, and may not carry on a business with the general public in a manner similar to organizations operated for profit. Thus, a qualifying *I.R.C.* § 501(c)(4) organization may not operate restaurants, bars, or similar businesses.

Retail Sales and Use Tax, Generally

Currently, nonprofit entities exempt from federal income tax under *I.R.C.* § 501(c)(3) or *I.R.C.* § 501(c)(4) may obtain an exemption from the Virginia 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 *I.R.C.* § 501(c)(3) organizations or, *I.R.C.* § 501(c)(4) organizations that have been organized for a charitable purpose; or entities with annual gross receipts of less than \$5,000 that are organized for one of the purposes set forth in *I.R.C.* § 501(c)(3) or one of the charitable purposes under *I.R.C.* § 501(c)(4).

History of Virginia Sales Tax 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 exempt from federal income tax under *I.R.C.* § 501(c)(19), neither organization qualifies for exemption from the sales and use tax under the new process. These organizations are the only two *I.R.C.* § 501(c)(19) organizations that qualified for an exemption under the old process. The remaining *I.R.C.* § 501(c)(19) organizations were not granted an exemption under the old process, unless they qualified as an *I.R.C.* § 501(c)(3) or *I.R.C.* § 501(c)(4) organization.

Current Nonprofit Requirements

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

- The entity must be an organization exempt under *I.R.C.* § 501(c)(3) or, if organized for a charitable purpose, *I.R.C.* § 501(c)(4), or have annual gross receipts of less than \$5,000 and be organized for one of the purposes set forth in *I.R.C.* § 501(c)(3) or one of the charitable purposes set forth in *I.R.C.* § 501(c)(4).
- 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.

Currently, 7,620 nonprofit organizations hold a nonprofit exemption certificate that was issued under this process.

Sales Tax Treatment in Other States

A number of states currently provide an exemption from the Retail Sales and Use Tax to organizations designated as *I.R.C.* § 501(c)(19) organizations. Florida, Maryland, Minnesota, New York, Tennessee, and Texas specifically exempt organizations that qualify for exemption under *I.R.C.* § 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 *I.R.C.* § 501(c)(19). In Oklahoma, the exemption applies only to the Veterans of Foreign Wars.

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.

BPOL Tax Generally

The BPOL Tax is a tax on businesses for the privilege of engaging in business at a definite place of business within a Virginia locality. The measure or basis of the BPOL tax generally is the gross receipts of the business. The BPOL tax is a tax on gross receipts,

not net income. Under current BPOL law, any locality may charge a license fee in an amount not to exceed:

- \$50 for any locality of 25,000 and greater
- \$30 for any locality with a population smaller than 25,000

The locality may not assess a license tax on gross receipts upon which it charges a license fee. Additionally, the locality may not impose a license tax on a business with gross receipts:

- less than \$100,000 in any locality with a population greater than 50,000
- less than \$50,000 in any locality with a population of 25,000 but no more than 50,000.

Any business with gross receipts in excess of these thresholds may be subject to license tax at a rate not to exceed the rates set forth below

- Contracting - sixteen cents per \$100 of gross receipts
- Retail sales - twenty cents per \$100 of gross receipts
- Financial, real estate and professional services - fifty eight cents per \$100 of gross receipts
- Repair, personal and business services, and all other businesses - thirty six cents per \$100 of gross receipts

Localities that imposed a higher rate structure on January 1, 1978 are allowed to continue to impose the tax at those rates.

BPOL Tax Exemption for Nonprofits

Localities are prohibited from imposing BPOL taxes and fees on certain receipts from “charitable nonprofit” and “nonprofit organizations”. Charitable nonprofit organizations are organizations exempt from federal income tax under *I.R.C.* § 501(c)(3), for which contributions by contributors are deductible under federal income tax law. For purposes of this definition, eligible educational institutions are limited to schools, colleges, and other similar institutions of learning. To the extent that a qualifying *I.R.C.* § 501(c)(3) organization has receipts from an unrelated trade or business, the income of which is taxable under *I.R.C.* § 511, the organization is presumed to have gross receipts from an activity that is subject to BPOL taxes or fees.

Localities must also exempt the receipts collected from gifts, contributions and membership dues paid to a “nonprofit organization,” which is defined as any organization, other than a “charitable nonprofit organization,” which is exempt from federal income tax under *I.R.C.* § 501, such as an *I.R.C.* § 501(c)(4) organization. Other activities conducted for a consideration remain subject to licensure taxes and fees.

Proposal

This bill would permit nonprofit Veteran Service Organizations that are exempt from federal income taxation under *I.R.C.* § 501(c)(19) to obtain an exemption from the Retail

Sales and Use Tax on purchases of tangible personal property. In addition, the bill would allow organizations that have annual gross receipts below \$5,000 and that are organized for one of the purposes set forth in *I.R.C.* § 501(c)(19) to qualify for exemption from the tax. In either case, the sales and use tax exemption would not apply to tangible personal property used primarily for social and recreational activities for members or for providing insurance benefits to members or members' dependents. As with other nonprofit organizations, VSOs would need to file an application with the Department of Taxation, meet the applicable criteria, and obtain a certificate of exemption from the Department to make purchases of tangible personal property exempt of the sales and use tax.

This bill would also exempt the gross receipts of these *I.R.C.* § 501(c)(19) organizations from the BPOL tax, except to the extent the organization has receipts from an unrelated trade or business, which receipts are subject to federal income tax under *I.R.C.* § 511. Because the gross receipts collected from gifts, contributions and membership dues paid to all *I.R.C.* § 501(c) organizations are already exempt from the BPOL tax, this bill would provide a more expansive exemption to § 501(c)(19) organizations, than is available to other § 501(c) "nonprofit organizations," other than *I.R.C.* § 501(c)(3) organizations.

The effective date of this bill is not specified.

cc : Secretary of Finance

Date: 2/17/2016 KP
DLAS File Name: HB 63FE161