

DEPARTMENT OF TAXATION

2007 Fiscal Impact Statement

1. **Patron** Jeffrey M. Frederick

3. **Committee** House Finance

4. **Title** Retail Sales and Use Tax; Exemption for
Government Contractors

2. **Bill Number** HB 1620

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would provide a retail sales and use tax exemption for tangible personal property that is purchased by a government contractor pursuant to a contract to perform services or provide property to a government entity, entered into on or after July 1, 2006, when title to the property will pass to the Commonwealth, any political subdivision of the Commonwealth, or the United States Government. The government entity would be required to certify that title to such tangible personal property would pass to that government entity in order for the contractor to claim the exemption.

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:

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 magnitude of the revenue loss associated with this bill is unknown, but potentially large.

As a result of language included in the 2006 Budget Bill (House Bill 5002, Chapter 3, 2006 Acts, Special Session 1), TAX changed the application of the true object test for contractors who provide services to federal, state, and local government entities, requiring that the true object test be applied at the task order, work order, or statement of work level, rather than applying it to the underlying contract between the government entity and the contractor.

9. Specific agency or political subdivisions affected:

TAX

10. Technical amendment necessary: No.

11. Other comments:

Background

As established by the Virginia Supreme Court in WTAR Radio-TV v. Commonwealth, 217 Va. 877, 234 S.E.2d 245 (1977), a “true object” test is applied to mixed transactions calling for both the provision of services and the sale of property. The true object test is used to determine whether a transaction constitutes an exempt service or the taxable retail sale of tangible personal property. Under Virginia law, when the true object of a contract is the retail sale of tangible personal property to the government, the contractor may purchase the property exempt of the retail sales and use tax for resale. When the true object of the contract is the provision of services to the government, the contractor is generally liable for the sales or use tax on all tangible personal property purchased pursuant to the contract, even though title to the property may pass to the government, or the contractor may be fully and directly reimbursed by the government, or both.

Prior to July 1, 2006, for service contracts between government contractors and government entities, TAX applied the true object test to the underlying contract without regard to the individual orders issued in furtherance of the overall contract.

Current Policy

Effective July 1, 2006, as a result of language included in the 2006 Budget Bill (House Bill 5002, Chapter 3, 2006 Acts, Special Session 1), TAX changed its policy with regard to the true object of government contracts. For task orders, work orders, or statements of work entered into on and after July 1, 2006, the tax application to government contracts is based on the application of the true object test to each separate work order, statement of work, or task order, as opposed to applying the true object test to the underlying contract between the government entity and the contractor. TAX has been charged with promulgating emergency regulations to implement this change in policy. To that end, TAX

has established a working group of industry representatives and tax officials to develop and issue the regulations on or before June 30, 2007.

Proposal

This bill would provide a retail sales and use tax exemption for tangible personal property that is purchased by a government contractor pursuant to a contract to perform services or provide property to a government entity, entered into on or after July 1, 2006, when title to the property will pass to the Commonwealth, any political subdivision of the Commonwealth, or the United States Government. The government entity would be required to certify that title to such tangible personal property would pass to that government entity in order for the contractor to claim the exemption.

This bill would extend the exemption in all cases, regardless of the nature of the task order, work order, and statement of work to any tangible personal property that ultimately passes to a government entity. This bill would affect the current treatment for government service contractors, including contractors who provide real property construction services.

Contracts with the federal government, the Commonwealth, and political subdivisions of the Commonwealth generally mandate that title to the property purchased by the contractor passes to the government at the time of purchase. Accordingly, this bill would exempt from taxation the bulk of the contractor's purchases.

Similar Legislation

Senate Bill 994 would provide a sales and use tax exemption for personal property purchased by a contractor on or after July 1, 2007, and used solely in any construction project for a local school division.

cc : Secretary of Finance

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