

# DEPARTMENT OF TAXATION

## 2007 Fiscal Impact Statement

1. **Patron** William R. Janis

2. **Bill Number** HB 2088

3. **Committee** House Finance

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

4. **Title** Retail Sales and Use Tax Exemption;  
Eliminates Certain Requirements for  
Nonprofit Schools to be Eligible

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

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

This bill would relieve any nonprofit entity organized for the purpose of operating a school from the following two requirements currently necessary for a nonprofit organization to receive an exemption from the Retail Sales and Use Tax: 1) that the entity's administrative costs, including salaries and fundraising, relative to its annual gross revenue not exceed 40% and 2) that if the entity's gross annual revenue in the year prior to application for exemption is \$500,000 or more, then the entity must provide a financial audit performed by an independent certified accountant. This bill would also change the criteria for all other nonprofit organizations to qualify for a sales tax exemption by permitting those entities with gross annual revenues in the previous year of \$500,000 or more to choose between submitting a full financial audit or filing a "financial review," both of which must be performed by an independent certified public accountant.

Under current law, nonprofit organizations with gross annual sales of \$500,000 or more must submit a "full financial audit" to qualify for a Retail Sales and Use Tax exemption. Nonprofit organizations with sales ranging from \$250,000 to \$499,999 must file a financial review, rather than a full audit, to qualify.

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 has not assigned any administrative costs to this proposal 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

This bill would result in a loss of revenue of unknown magnitude. The changes proposed in this bill would allow more nonprofit schools to qualify for exemption from the Retail Sales and Use Tax due to the elimination of two of the criteria and could increase the number of other nonprofit organizations that qualify due to the relaxed audit requirement.

#### **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 in 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 exceed \$500,000. A nonprofit organization with gross annual sales ranging from \$250,000 to \$500,000 will be 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 \$250,000 or more. 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 sales ranging from \$250,000 to \$499,999 may submit a “review of its financial statements” in lieu of a full financial audit.

### Proposal

Under the provisions of this bill, nonprofit schools would have to meet only three of the five requirements set forth above to be eligible for exemption from the Retail Sales and Use Tax. Nonprofit schools would not be required to have annual administrative costs including salaries and fundraising, that are 40% or less of annual gross receipts. Nonprofit schools would not be required to provide TAX with any type of financial review or audit. All other nonprofit entities would still be required to satisfy all five criteria to be eligible for exemption, unless they qualified under another exemption classification.

This bill would also modify the criteria that all other nonprofit entities must meet in order to qualify for a sales and use tax exemption by permitting organizations with annual gross revenues of \$500,000 or greater in the previous year the choice of providing TAX with a copy of a full financial audit or providing a review of its financial statements in lieu of a full audit.

### Similar Legislation

**House Bill 1948** and **Senate Bill 743** would provide a Retail Sales and Use Tax exemption for volunteer fire departments, rescue squads and related organizations without meeting the statutory requirements imposed on other nonprofit organizations.

**House Bill 2545** would allow nonprofit entities with annual gross revenues of \$500,000 or more to submit a “financial review” in lieu of a “full financial audit” performed by an independent certified public accountant.

cc : Secretary of Finance

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