

DEPARTMENT OF TAXATION

2008 Fiscal Impact Statement

1. **Patron** Kenneth R. Melvin

2. **Bill Number** HB 1204

3. **Committee** House Finance

House of Origin:

X **Introduced**

 Substitute

 Engrossed

4. **Title** Retail Sales and Use Tax; Tangible Personal
Property Purchased by a Contractor for
Custom Structural Metal Fabrication

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would provide an exemption from the Retail Sales and Use Tax for tangible personal property that is purchased by a real property contractor for use or consumption in custom structural metal fabrication when such fabrication is performed in an economically distressed locality pursuant to a real property contract to be performed by the contractor outside of Virginia. An economically distressed area is defined as "a city or county with an unemployment rate for the preceding year at least 0.5% higher than the average statewide unemployment rate for such year."

Under current law, a fabricator who contracts to perform services with respect to real property construction, and in connection with the construction fabricates tangible personal property for incorporation in real estate, causing it to lose its identity as tangible personal property is classified as a using and consuming contractor and must pay the tax on the cost price of the raw materials which make up such fabricated property.

The effective date of this bill is not specified.

6. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

6b. **Revenue Impact:**

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2007-08	\$0	GF
	\$0	TTF
	\$0	Local
2008-09	(\$597,000)	GF
	(\$ 87,000)	TTF
	(\$175,000)	Local
2009-10	(\$657,000)	GF
	(\$ 96,000)	TTF
	(\$192,000)	Local

2010-11	(\$660,000)	GF
	(\$ 97,000)	TTF
	(\$193,000)	Local
2011-12	(\$665,000)	GF
	(\$ 97,000)	TTF
	(\$194,000)	Local
2012-13	(\$664,000)	GF
	(\$ 97,000)	TTF
	(\$194,000)	Local
2013-14	(\$665,000)	GF
	(\$ 97,000)	TTF
	(\$195,000)	Local

7. Budget amendment necessary: Yes.

Page 1, Revenue Estimates

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

It is estimated that the sales tax exemption proposed in this bill would reduce state and local revenues by \$859,000 in Fiscal Year 2009, \$945,000 in Fiscal Year 2010, \$950,000 in Fiscal Year 2011, \$956,000 in Fiscal Year 2012, \$955,000 in Fiscal Year 2013, and \$957,000 in Fiscal Year 2014. Based on the Virginia Economic Development Partnership’s 2007 list of economically distressed areas in Virginia, six steel fabrication plants in Virginia would potentially qualify for exemption under the terms of this bill. Although the VEDP recognized 64 Virginia communities that qualified as economically distressed in 2007, only six steel fabrication plants in Virginia were located in areas that were identified on that list as economically distressed.

9. Specific agency or political subdivisions affected:

TAX

10. Technical amendment necessary: No.

11. Other comments:

Current Law Regarding Contractors

Under current law, a contractor is deemed the user or consumer of all tangible personal property furnished to him or by him in connection with real property construction, reconstruction, installation, repair, and similar contracts. Current law defines a contractor as any person who contracts to perform construction, reconstruction, installation, repair or any other service with respect to real estate or fixtures thereon, including highways, and in connection therewith to furnish tangible personal property, whether such person be a prime contractor or subcontractor.

Virginia law permits construction contractors to purchase construction materials that will be temporarily stored in Virginia and ultimately used in exempt construction projects in other states or foreign countries exempt of the Retail Sales and Use Tax. The exemption is restricted to construction materials incorporated into exempt real property construction. The Retail Sales and Use Tax still applies to equipment, tools, supplies, etc., used in performance of the construction contract. In order to receive this exemption, construction contractors must make a written request to TAX, in which the contractor includes information that shows that the construction materials could be purchased by the contractor free from sales or use tax in the other state or foreign country. If TAX is satisfied that all the requirements are met, the contractor will be granted a certificate of exemption.

Current Law Regarding Fabrication

Fabrication is defined as an operation that changes the form or state of tangible personal property. Tangible personal property which is bent, bored, cut, drilled, machined, punched, sawed, sewn, shaped, sheared, threaded, welded, or otherwise subjected to an operation which changes the property's form or state has therefore undergone fabrication.

Under current law, a fabricator who contracts to perform services with respect to real property construction, and in connection with the construction fabricates tangible personal property for incorporation in real estate causing it to lose its identity as tangible personal property, is classified as a using and consuming contractor and must pay the tax on the cost price of the raw materials which make up such fabricated property. The contractor is required to pay tax at the time of purchase to all suppliers who are authorized to collect the tax, and in instances where the supplier is not so authorized, or fails to collect the tax, the contractor must remit consumer use tax directly to TAX.

Some fabricators operate in a dual capacity, in which they fabricate tangible personal property both for sale or resale and for their own use or consumption in the performance of real property construction contracts. In such cases, the contractor is required to follow a primary purpose rule based on gross receipts to determine the sales and use tax application. If more than 50% of the fabricator's gross receipts from one plant are from

retail sales, the fabricator is considered to be fabricating primarily for sale or resale, and may purchase items used to fulfill contracts for the provision of fabrication services exempt of the Retail Sales and Use Tax and collect such tax from its customers. By contrast, if more than 50% of the fabricator's gross receipts from one plant are derived from real property construction contracts, the fabricator is considered to be operating as a using and consuming contractor, and will be deemed a using and consuming contractor who must pay the tax on the cost price of the raw materials which make up such fabricated property.

Proposal

This bill would provide an exemption from the Retail Sales and Use Tax for tangible personal property that is purchased by a real property contractor for use in custom structural metal fabrication when such fabrication is performed in an economically distressed locality pursuant to a real property contract to be performed by the contractor outside of Virginia.

"Structural metal fabrication" would be defined as those activities described under 2007 Industry Number 332312 of the North American Industry Classification System, a system adopted by the Office of Management and Budget of the federal government to classify establishments by type of economic activity. Industry number 332312 is comprised of establishments primarily engaged in fabricating structural metal products, such as concrete reinforcing bars and fabricated bar joists.

Under the terms of the proposal, in order to qualify for exemption from the Retail Sales and Use Tax, the custom structural metal fabrication must be performed in an economically distressed locality. An area qualifies as an economically distressed area if it is a city or county with an unemployment rate for the preceding year at least 0.5 percent higher than the average statewide unemployment rate for such year. The state average for 2006 was 3.1%, thus all counties or cities with an unemployment rate of 3.6 percent or above qualified as "economically distressed" in 2007. Sixty-four Virginia communities qualified for the 2007 list; however, only six Virginia structural steel fabrication plants are currently located in economically distressed areas.

Similar Legislation

Senate Bill 89 is identical to this bill.

cc : Secretary of Finance

Date: 1/20/2008 KP
DLAS File Name: HB1204.doc