

Fiscal Impact Review 2017 General Assembly Session

Date: February 17, 2017

Bill number: HB 1518 – Sales and use tax; automotive repair supplies

Review requested by: Co-Chairmen Norment and Hanger, Senate Finance Committee

JLARC Staff Fiscal Estimates

JLARC staff do not concur with the fiscal impact statement for HB 1518 developed by the Department of Taxation (TAX), which indicates that the bill would have a positive impact on state revenue. Current law requires businesses to pay the tax on purchases of supplies they use during automotive repairs, but exempts them from the tax—under a sale-for-resale exemption—on supplies that transfer to the customer, so the tax is instead collected from the customer. HB 1518 would exempt businesses from paying the tax on purchases of all supplies used in automotive repairs and allow them to collect the tax from the customer. The impact statement prepared by TAX assumes that automotive repair businesses are currently paying the tax on supplies as required under current law. However, the tax is often collected incorrectly because there is confusion about who should pay the tax. The impact on state revenue collections—if any—should be minimal, but it is unknown whether it would be positive or negative. Information necessary to accurately predict the impact is not available.

An explanation of the JLARC staff review is included on the pages that follow.

Authorized for release:



Hal E. Greer, Director

Bill summary

HB 1518 would require that the Retail Sales and Use Tax (sales tax) be collected by automotive repair businesses on separately stated charges to their customers for supplies used during automotive repairs, regardless of whether title or possession of the supplies passes to the customer. This bill would allow these businesses to be exempt from the sales tax on all purchases of supplies. Current law requires automotive repair businesses to pay the tax when they purchase supplies that they consume (shop rags and parts cleaners) but exempts them from the tax—under a sale-for-resale exemption—when they purchase supplies that transfer to the customer (transmission fluid).

Discussion of fiscal implications

According to the Department of Taxation (TAX) impact statement, HB 1518 would have an unknown positive impact on state revenues if the tax collected from customers exceeds the tax that would have been paid by the automobile repair business when it purchased the supplies. An increase in state tax revenue could occur for two reasons: (1) Automotive repair businesses could mark up the costs of the supplies for their own profit, and the customers would be taxed on this higher price. (2) Businesses could charge more than 100 percent of the cost of the supplies to their customers depending on how they apply the charges.

JLARC staff do not concur with the fiscal impact statement prepared by TAX because it assumes that automotive repair businesses are currently paying the tax on supplies correctly under current law. However, there appears to be sufficient confusion about who should pay the tax on supplies that the tax is often collected incorrectly. Therefore, it is difficult to determine how HB 1518 would impact tax collections, and the information necessary to accurately predict the overall impact on state sales tax collections is not available.

Sales tax on supplies used for automotive repairs are often collected incorrectly

Sales taxes on supplies used during automotive repairs are often collected incorrectly. Current law requires that the automotive repair business pay the tax when it purchases supplies it uses during repairs. However, the sales tax on these supplies is often paid by the customer, not the business (similar to method proposed in HB 1518), or both the business and the customer (double taxation), according to representatives of the Virginia Automobile Dealers Association and the Virginia Automotive Association. Many automotive repair businesses charge customers a “supply charge” or “shop fee,” or charge the costs under another category. If the business includes a separately stated

charge for supplies, it may apply the tax depending on its policy. When a business does not separately state the charges for supplies, but includes the costs under another category, such as “parts” or “parts and labor,” it is taxed as required by law.

Businesses appear to collect the tax using different methods, according to automotive repair businesses interviewed by JLARC staff.

Example 1. One business does not pay the tax on the purchase of supplies it consumes under the sale-for-resale exemption, and instead collects the tax from customers on the shop supply fee. This method is contrary to current law but consistent with HB 1518.

Example 2. Another business sometimes pays the tax when purchasing these supplies, depending on the distributor from which it is purchasing supplies. This business charges the customer a separately stated supply fee, and taxes the fee. This collection method may result in double taxation of the purchases of some supplies.

It is possible that sales taxes are not collected for the purchase of some supplies. This would occur if the business does not pay the tax when it purchases supplies and does not collect taxes from its customers. Some businesses do not pass the cost of supplies on to their customers at all. Other businesses pass on these costs to customers through supply charges that are separately stated but not taxed.

Several factors explain why sales tax on supplies is often collected incorrectly

Some businesses may incorrectly pass the tax on supplies that they use during automotive repairs to customers because they are misinterpreting current law. The Code of Virginia (§ 58.1-602) and regulations (23 VAC 10-210-280 and 23 VAC 10-210-3050) only provide general guidance. Businesses may be unaware of additional guidance explaining the specific supplies for which the business should pay the tax and those for which the customer should pay the tax that are provided in rulings of the Tax Commissioner (Table 1). Businesses often request additional guidance on how to tax dual-purpose supplies, such as windshield washer fluid, according to a Virginia Automobile Dealers Association representative.

TABLE 1: Specific guidance on who should pay the tax is found in Tax Commissioner Rulings but not in Code or regulations

Type of supplies	Examples	Payer of tax
Non-transferrable	Shop cleaning supplies (rags, drop cloths, mops and buckets) Parts cleaners (soaps, degreasers, and thinners) Auto body painting supplies (sand paper and steel wool)	Automotive repair business
Transferrable bulk	Brake fluid, grease and lubricants, windshield washer fluid, antifreeze, power steering fluid, and transmission fluid	Customer of repair business
Dual purpose	Windshield washer fluid used to top off fluid in customers' cars and used by repair shop to clean windshields	Apportioned according to percentage used by each

SOURCE: Ruling of Tax Commissioner. Public Document 96-392, December 30, 1996.

NOTE: Non-transferable means supplies are consumed by the business and do not transfer to the customer's car. Transferable means supplies transfer to the customer's car and are consumed by the customer.

Even though it is contrary to current law, some businesses may pass the tax on to the customer because it is administratively burdensome to determine in which instances it should be passed on versus paid by the business. Some business also report that it is safer policy to always collect the tax from the customer.

Impact of HB 1518 on sales tax collections could vary by business

It is not possible to accurately predict the impact HB 1581 would have on state revenue because of the variation in how taxes on shop supplies are currently collected. The bill should have no impact on revenue collections attributed to automotive repair businesses that are already using their sale-for-resale exemption and taxing their customers (Table 2). The bill could have either a positive or negative impact on revenue collections attributed to other businesses, depending on how the supplies are currently taxed.

TABLE 2: HB 1518 could have a positive, negative, or no impact on sales tax collections

How taxes are currently collected for supplies used by business	Potential impact of bill on sales tax collections
Business uses its sale-for-resale exemption to purchase supplies and taxes its customers (similar to method proposed in bill)	None
Business pays the tax on supplies it consumes (current law)	Positive: if tax collected from each customer is greater than the tax that would have been collected from the business Negative: if business has substantial receipts from customers that are exempt from paying sales tax (governments and nonprofits)
Both the business and customer pays tax on supplies consumed by the business (double taxation)	Negative: tax would now be collected on the customer (not both business and customer)
Business uses its sale-for-resale exemption to purchase supplies and does not tax customer (no tax collected)	Positive: tax would now be collected

Information to accurately predict the impact of HB 1518 on state revenue is not available

To calculate the impact of HB 1518 on state revenue, it would be necessary to have the (1) amount of current sales tax collections and (2) information—such as the costs of supplies used by automotive repair shops and how they would allocate these costs to customers for collecting the tax—to estimate the amount of taxes that would be collected under HB 1518. However, none of this information is available. Data available on sales tax collections from TAX and receipts of automobile repair businesses from the U.S. Census Bureau are not sufficiently detailed to determine amounts attributable to supplies used during automotive repairs.

Other considerations

Neither the bill nor current law specifies which businesses would be affected. TAX anticipates this bill would affect repairs performed by businesses classified under the North American Industry Classification System as automotive repair and maintenance; gasoline stations; automotive dealers; and automotive parts, accessories, and tire stores.

The bill does not consider how businesses would handle collection of the sales tax for supplies used to repair heavy duty vehicles and other equipment not considered to be automobiles.

Budget amendment necessary? No

Agencies affected: Department of Taxation

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