

DEPARTMENT OF TAXATION

2019 Fiscal Impact Statement

1. **Patron** Michael J. Weibert

3. **Committee** Senate Finance

4. **Title** Retail Sales and Use Tax; Exemption;
Nonprofits; Limited Liability Companies

2. **Bill Number** HB 1950

House of Origin:

 Introduced

 Substitute

 Engrossed

Second House:

 X **In Committee**

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would clarify that single-member limited liability companies whose only member is a nonprofit organization may qualify for the Retail Sales and Use Tax exemption for nonprofit organizations.

Under current law, one of the criteria for the Retail Sales and Use Tax exemption for nonprofit organizations is certification by the Internal Revenue Service as a 501(c) entity. However, the Internal Revenue Service will not consider the 501(c) status of an entity that is disregarded for federal tax purposes. The policy of the Department has been to grant the exemption to limited liability companies owned by a nonprofit entity based on the 501(c) status of the nonprofit owner if they are able to meet all other requirements of the exemption.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

6. **Budget amendment necessary:** No.

7. **No Fiscal Impact** (See Line 8.)

8. **Fiscal implications:**

Administrative Cost

The Department of Taxation ("the Department") considers implementation of this bill to be routine and does not require additional funding.

Revenue Impact

This bill would have no impact on state revenues.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

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.

Retail Sales and Use Tax, Generally

Currently, nonprofit entities exempt from federal income tax under Internal Revenue Code ("I.R.C.") §§ 501(c)(3) or (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).

Current Nonprofit Requirements

The 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.

Existing Department Policy

Under current law, single-member limited liability companies are considered by the Internal Revenue Service to be disregarded entities for federal tax purposes and therefore these companies are not considered for 501(c) classification. Consequently, single-member limited liability companies whose sole member is a nonprofit organization cannot obtain certification from the Internal Revenue Service.

In evaluating the exemption status of these nonprofit-owned LLC's, the policy of the Department has been to allow limited liability companies whose sole member is a nonprofit organization to qualify for the sales tax exemption for nonprofit organizations without proof of 501(c) status so long as all other eligibility criteria are met.

Proposal

This bill would clarify that single-member limited liability companies whose only member is a nonprofit organization may qualify for the Retail Sales and Use Tax exemption for nonprofit organizations.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

cc : Secretary of Finance

Date: 2/4/2019 VB
DLAS File Name: HB1950FH1161