

**REPORT
OF
HOUSE FINANCE SPECIAL SUBCOMMITTEE
ON
SALES AND USE TAX EXEMPTIONS FOR NONPROFIT ENTITIES**

Introduction

The House Finance Special Subcommittee on Sales and Use Tax Exemptions for Nonprofit Entities was established by the Honorable Harry J. Parrish, Chairman of the House Finance Committee, to make findings and recommendations regarding the appropriate policy and procedure for consideration of granting new exemptions and renewing current exemptions for such entities.

The Subcommittee was chaired by Delegate Robert D. Orrock, Sr., and was comprised of the following other members: Delegate Thelma Drake, Delegate R. Lee Ware, Jr., Delegate Johnny S. Joannou, Delegate Joseph P. Johnson, Delegate Robert S. Bloxom, Delegate Kathy J. Byron, and Delegate Vivian E. Watts.

A total of four meetings were held -- in May, June, July, and August. The Subcommittee heard presentations, among others, from: (i) staff on the history of sales and use tax exemptions in the Commonwealth, prior legislative studies on the issue, and a survey of what other states are doing; (ii) the Tax Department on the current status of granting exemptions, and the procedure used in nearby states; (iii) the Coalition of Virginia Nonprofits and other nonprofit organizations on the perspective of the nonprofit community; (iv) representatives of the Internal Revenue Service on the federal process for granting tax-exempt status; and (v) all other interested parties who wanted to speak.

Continue Exemptions

The initial issue was whether sales and use tax exemptions should continue to exist in some form for certain nonprofit entities. The subcommittee found that the vast majority of states provide some type of relatively broad sales and use tax exemption for various nonprofit entities.

The subcommittee determined that such a tax exemption for appropriate nonprofit entities produces a net benefit to the Commonwealth because of the breadth and volume of services provided by the nonprofit entities.

As a result, the Subcommittee then worked to determine (i) what general procedure should be followed in granting the exemptions, and (ii) then what criteria should be used for determining which nonprofit entities should receive a sales and use tax exemption.

Procedure

The Subcommittee found that only Virginia and Alabama utilize a procedure whereby individual nonprofit entities obtain exempt status by the passage of individual bills through the legislature. Other states prescribe broad criteria for exemption and then have the individual exemptions handled administratively by an executive branch agency such as the Department of Taxation.

The subcommittee decided that Virginia's current procedure is cumbersome, inefficient, and not user-friendly for the nonprofit entities, the Tax Department, and for the General Assembly. Accordingly, it was agreed that Virginia should join the ranks of almost all other states in setting broad criteria for the exemption of nonprofit entities and having the Tax Department administer the individual exemptions.

Criteria

The subcommittee agreed on the following criteria that a nonprofit entity must meet to be granted a sales and use tax exemption by the Tax Department:

- A. 1. The entity is federally tax exempt (i) under § 501 (c) (3) or (ii) under § 501 (c) (4) and the entity (if it is under § 501 (c) (4)) is organized for charitable purposes; or
2. The entity has annual receipts less than the threshold required under § 501 (c) (3) and § 501 (c) (4) (\$5,000), and

- B. The entity is serving the public good and provides a statement as to the specific public good being served; and
- C. The entity is in compliance with state solicitation laws; and
- D. The entity's administrative costs are less than _____, relative to its gross revenue (no consensus on specific restriction); and
- E. If the entity's gross annual revenue was \$250,000 or greater in the previous year, then the entity must provide a financial audit performed by an independent certified public accountant; and
- F. If the entity filed a federal 990 or 990 EZ tax form with IRS, then it must provide a copy of such form to the Tax Dept.
- G. If the entity does not file a federal 990 or 990 EZ tax form with IRS, then the entity must provide the following information:
 - 1. A list of the Board of Directors or other responsible agents of the entity (comprised of at least two individuals), with names and addresses (addresses must be where the individual physically can be found); and
 - 2. The location where the financial records of the entity are available for public inspection.

Tax Department Procedures

In addition to the criteria set forth above, the Tax Department shall ask each entity for: (i) an estimate of total taxable purchases for the next year (and where possible, for the total taxable purchases made in the preceding year); and (ii) any other information that the Tax Department determines is appropriate for the efficient and effective operation of the exemption process. Provided, however, that no information provided pursuant to this paragraph (including the failure to provide requested information) shall be a basis for the Tax Department to refuse to exempt an entity.

The duration of each exemption granted by the Tax Department shall be no less than five years and no greater than seven years. To maintain an

exemption that otherwise would expire, each entity must provide the Tax Department the same information as required upon initial exemption and meet the same criteria.

The Tax Department shall develop all other reasonable rules and regulations necessary to carry out the exemption process within the constraints set forth herein. The Tax Department shall file an annual report with the Chairmen of the House Finance Committee, the House Appropriations Committee, and the Senate Finance Committee, setting forth the annual fiscal impact of the exemptions for nonprofit entities.

2003 Session of the General Assembly

The subcommittee recommends that legislation be introduced consistent with the foregoing to be effective July 1, 2004. Accordingly, the current procedures for seeking a new sales and use tax exemption would apply through the 2004 Session. These procedures include (i) the nonprofit entity filing an appropriate form with the Tax Department that has been signed by a member of the General Assembly, no later than November 1, and (ii) the General Assembly member introducing a bill seeking the exemption.