



COMMONWEALTH of VIRGINIA

Department of Taxation

November 23, 2011

The Honorable Harry R. Purkey
General Assembly Building, Room 415
Capitol Square
Richmond, Virginia 23219

The Honorable Charles J. Colgan
General Assembly Building, Room 626
Capitol Square
Richmond, Virginia 23219

Dear Delegate Purkey and Senator Colgan:

Enclosed is Report 5 of the 2007-2011 Virginia Retail Sales and Use Tax Expenditure Study prepared by the Department of Taxation (Department) pursuant to *Va. Code* § 58.1-609.12.

This is the fifth report in the series on the Miscellaneous Retail Sales and Use Tax exemptions provided by *Va. Code* § 58.1-609.10 and the Nonprofit Entity Retail Sales and Use Tax exemption provided by *Va. Code* § 58.1-609.11. There are 19 exemption categories scheduled to be studied during the 2007-2011 period, and every five-year period thereafter.

The report includes a detailed analysis of exemptions that pertain to fuels for domestic consumption; occasional sales; tangible personal property for future use in a taxable lease or rental; tangible personal property delivered outside the Commonwealth for use outside the Commonwealth; tangible personal property purchased for use or consumption in the performance of maintenance and repair services at Nuclear Regulatory Commission-licensed nuclear power plants; multifuel heating stoves; and fabrication of certain animal meats, grains, vegetables, and other foodstuffs. (*Va. Code* § 58.1-609.10). It also includes updated information concerning the revenue impact of the exemption available to nonprofit entities that have applied to the Department and received an exemption certificate. *Va. Code* § 58.1-609.11 previously required an annual report on entities seeking a nonprofit exemption. Legislation enacted during the 2009 General Assembly authorized the Department to combine its Nonprofit Exemption

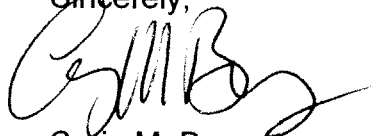
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Report with its yearly Retail Sales and Use Tax Expenditure Study. This is the third year the two reports have been combined.

As you will see, the revenues foregone as the result of these exemptions are significant. However, our analysis of the exemptions is not limited solely to foregone revenues, but also includes detailed information on the policy and economic impacts of each exemption. This includes a thorough analysis of the sales and use tax structures of other states, with particular emphasis on the tax structures of our neighboring states.

This report is also being submitted to the Division of Legislative Automated Systems.

Sincerely,

A handwritten signature in black ink, appearing to read 'CMB', with a long horizontal flourish extending to the right.

Craig M. Burns
Tax Commissioner

CMB/kp
Enclosures

c: The Honorable Richard D. Brown, Secretary of Finance
Division of Legislative Automated Systems

2007 - 2011 Virginia Retail Sales and Use Tax Expenditure Study

Volume 1, Number 5

Issued Pursuant to *Va. Code* § 58.1-609.12

Exemptions Studied:

- Home Heating Fuels (*Va. Code* § 58.1-609.10(1))
- Occasional Sales (*Va. Code* § 58.1-609.10(2))
- Purchases for Taxable Lease (*Va. Code* § 58.1-609.10 (3))
- Property Delivered Outside Virginia (*Va. Code* § 58.1-609.10(4))
- Property Purchased for Maintenance of Nuclear Power Plants Outside Virginia (*Va. Code* § 58.1-609.10(6))
- Multifuel Heating Stoves for Residential Use (*Va. Code* § 58.1-609.10(18))
- Fabrication of Animal Meats, Grains, Vegetables or Other Foodstuffs (*Va. Code* § 58.1-609.10(19))
- Nonprofit Entities (*Va. Code* § 58.1-609.11))

December 1, 2011

VIRGINIA RETAIL SALES AND USE TAX EXPENDITURE STUDY

Volume 1, Number 5

Richard D. Brown
Secretary of Finance

Craig M. Burns
Tax Commissioner

December 2011

This report provides a detailed analysis of the following Retail Sales and Use Tax exemptions:

- Home Heating Fuels (*Va. Code § 58.1-609.10(1)*)
- Occasional Sales (*Va. Code § 58.1-609.10(2)*)
- Purchases for Taxable Lease (*Va. Code § 58.1-609.10 (3)*)
- Property Delivered Outside Virginia (*Va. Code § 58.1-609.10(4)*)
- Property Purchased for Maintenance of Nuclear Power Plants Outside Virginia (*Va. Code § 58.1-609.10(6)*)
- Multifuel Heating Stoves for Residential Use (*Va. Code § 58.1-609.10(18)*)
- Fabrication of Animal Meats, Grains, Vegetables or Other Foodstuffs (*Va. Code § 58.1-609.10(19)*)
- Nonprofit Entities (*Va. Code § 58.1-609.11*)

Future reports will cover other subgroups of the Retail Sales and Use Tax exemptions provided by *Va. Code §§ 58.1-609.10 and 58.1-609.11*.

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We appreciate the assistance provided by the numerous individuals who made it possible for us to complete this report. However, the study staff is responsible for devising the methodology used in calculating the revenue impacts and performing the analysis of the various exemptions. Thus, those who assisted us or provided information are not accountable for any of the results or analytical conclusions presented in this report.

We express a special thank you to the Weldon Cooper Center for Public Service and the individual localities that provided data regarding the exemptions addressed in this report.

We hope that the study will be a valuable tool to policymakers in formulating the Retail Sales and Use Tax policies of the Commonwealth of Virginia, as well as to policymakers in other states.

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EXECUTIVE SUMMARY

Authorization for Study

Pursuant to *Va. Code* § 58.1-609.12, the Department of Taxation (Department) is charged with the responsibility of determining the fiscal, economic and policy impact of each of the Retail Sales and Use Tax exemptions provided for by *Va. Code* §§ 58.1-609.10 and 58.1-609.11 and reporting such findings to the chairmen of the House and Senate Finance Committees no later than December 1 of each year.

Subgroups of these exemptions are to be reviewed in periodic cycles and reports issued on a rotating basis in accordance with a schedule determined by the Tax Commissioner. When the reports have been completed for all of the subgroups, the Department is required to repeat the process beginning with the subgroup of exemptions for which a report was made in 2007. With the exception of the nonprofit exemption granted pursuant to *Va. Code* § 58.1-609.11, no exemption shall be analyzed more frequently than once every five years. Legislation enacted in 2009 (*Acts of Assembly* 2009, Chapter 24) authorized the Department to combine its yearly Sales and Use Tax Expenditure Study (“SUTES Study”) with its yearly report on the fiscal impact of the Sales and Use Tax exemption for nonprofit entities (“the Nonprofit Exemption Report”), previously required under *Va. Code* § 58.1-609.11. Thus, the fiscal impact of the nonprofit exemption is included in each SUTES Study going forward.

In addition to the yearly update on the nonprofit exemption, there are nineteen exemption categories scheduled to be studied during the 2007-2011 period, and every five-year period thereafter. This is the fifth report of the 2007-2011 series and includes a detailed analysis of exemptions that pertain to:

- *Va. Code* § 58.1-609.10(1) – Artificial or propane gas, firewood, coal or home heating oil used for domestic consumption. "Domestic consumption" means the use of artificial or propane gas, firewood, coal or home heating oil by an individual purchaser for other than business, commercial or industrial purposes. The Tax Commissioner shall establish by regulation a system for use by dealers in classifying individual purchases for domestic or nondomestic use based on the principal usage of such gas, wood, coal or oil. Any person making a nondomestic purchase and paying the tax pursuant to this chapter who uses any portion of such purchase for domestic use may, between the first day of the first month and the fifteenth day of the fourth month following the year of purchase, apply for a refund of the tax paid on the domestic use portion.
- *Va. Code* § 58.1-609.10(2) – An occasional sale, as defined in § 58.1-602. A nonprofit organization that is eligible to be granted an exemption on its purchases pursuant to § 58.1-609.11, and that is otherwise eligible for the exemption pursuant to this subdivision, shall be exempt pursuant to this subdivision on its

sales of (i) food, prepared food and meals and (ii) tickets to events that include the provision of food, prepared food and meals, so long as such sales take place on fewer than 24 occasions in a calendar year.

- *Va. Code* § 58.1-609.10(3) – Tangible personal property for future use by a person for taxable lease or rental as an established business or part of an established business, or incidental or germane to such business, including a simultaneous purchase and taxable leaseback.
- *Va. Code* § 58.1-609.10(4) – Delivery of tangible personal property outside the Commonwealth for use or consumption outside of the Commonwealth. Delivery of goods destined for foreign export to a factor or export agent shall be deemed to be delivery of goods for use or consumption outside of the Commonwealth.
- *Va. Code* § 58.1-609.10(6) – Tangible personal property purchased for use or consumption in the performance of maintenance and repair services at Nuclear Regulatory Commission-licensed nuclear power plants located outside the Commonwealth.
- *Va. Code* § 58.1-609.10(18) – Beginning July 1, 2007, and ending July 1, 2012, multifuel heating stoves used for heating an individual purchaser's residence. "Multifuel heating stoves" are stoves that are capable of burning a wide variety of alternative fuels, including, but not limited to, shelled corn, wood pellets, cherry pits, and olive pits.
- *Va. Code* § 58.1-609.10(19) – Fabrication of animal meat, grains, vegetables, or other foodstuffs when the purchaser (i) supplies the foodstuffs and they are consumed by the purchaser or his family, (ii) is an organization exempt from taxation under § 501(c)(3) or (c)(4) of the Internal Revenue Code, or (iii) donates the foodstuffs to an organization exempt from taxation under § 501(c)(3) or (c)(4) of the Internal Revenue Code.

The Department will not review the data center exemption enacted by Senate Bill 944 (2009 *Acts of Assembly*, Chapter 833) as the exemption was repealed by House Bill 302 and Senate Bill 130 (2010 *Acts of Assembly*, Chapters 826 and 784). A similar exemption was authorized in *Va. Code* § 58.1-609.3.

INTRODUCTION

Study Mandate

Pursuant to *Va. Code* § 58.1-609.12, enacted by House Bill 2852 (*Acts of Assembly* 2005, Chapter 853) and amended by House Bill 1370 (*Acts of Assembly* 2006, Chapter 559), the Department of Taxation (Department) is charged with the responsibility of determining the fiscal, economic and policy impact of each of the Retail Sales and Use Tax exemptions provided for by *Va. Code* §§ 58.1-609.10 and 58.1-609.11 and reporting such findings to the chairmen of the House and Senate Finance Committees no later than December 1 of each year.

Subgroups of these exemptions are to be reviewed in periodic cycles and reports issued on a rotating basis in accordance with a schedule determined by the Tax Commissioner. When the reports have been completed for each subgroup, the Department is required to repeat the process beginning with the subgroup of exemptions for which a report was made in 2007. With the exception of the nonprofit exemption granted pursuant to *Va. Code* § 58.1-609.11, no exemption shall be analyzed more frequently than once every five years. Legislation enacted in 2009 (*Acts of Assembly* 2009, Chapter 24) authorized the Department to combine its yearly Retail Sales and Use Tax Expenditure Study (SUTES Study) with its yearly report on the fiscal impact of the Sales and Use Tax exemption for nonprofit entities (“the Nonprofit Exemption Report”), previously mandated by *Va. Code* § 58.1-609.11. Thus, the fiscal impact of the nonprofit exemption is included in each SUTES Study going forward.

In addition to the exemption for nonprofit entities, there were nineteen exemption categories scheduled to be studied during the 2007-2011 period, and every five-year period thereafter.

TAX conducted a study of each of these according to the schedule set forth below:

<u>Citation</u>	<u>Volume</u>	<u>Year</u>	<u>Exemption</u>
<i>Code of Va.</i> § 58.1-609.11	1	2007	Nonprofit Entities
<i>Code of Va.</i> § 58.1-609.10(15)	1	2007	Donations Withdrawn from Inventory
<i>Code of Va.</i> § 58.1-609.10(16)	1	2007	Nonprofit churches
<i>Code of Va.</i> § 58.1-609.10(5)	2	2008	Food Stamp and WIC Purchases
<i>Code of Va.</i> § 58.1-609.10(8)	2	2008	School Lunches and Textbooks
<i>Code of Va.</i> § 58.1-609.10(9)	3	2009	Medicines and Drugs
<i>Code of Va.</i> § 58.1-609.10(11)	3	2009	Dialysis Drugs and Supplies

<i>Code of Va. § 58.1-609.10(14)</i>	3	2009	Nonprescription Drugs and Nonprescription Drug Samples
<i>Code of Va. § 58.1-609.10(17)</i>	4	2010	Medical Products and Supplies Purchased by Medicaid Recipients
<i>Code of Va. § 58.1-609.10(10)</i>	4	2010	Durable Medical Equipment
<i>Code of Va. § 58.1-609.10(12)</i>	4	2010	Motor Vehicle Equipment for Handicapped Persons
<i>Code of Va. § 58.1-609.10(13)</i>	4	2010	Communication Equipment for Handicapped Persons
<i>Code of Va. § 58.1-609.10(17)</i>	4	2010	Medical supplies Purchased by Medicaid Recipients through DMAS Agreements
<i>Code of Va. § 58.1-609.10(1)</i>	5	2011	Domestic Consumption of Heating Fuels
<i>Code of Va. § 58.1-609.10(2)</i>	5	2011	Occasional Sales
<i>Code of Va. § 58.1-609.10(3)</i>	5	2011	Purchases for Taxable Lease
<i>Code of Va. § 58.1-609.10(4)</i>	5	2011	Delivery of Property outside VA
<i>Code of Va. § 58.1-609.10(6)</i>	5	2011	Property Purchased for Maintenance of Nuclear Power Plants outside VA
<i>Code of Va. § 58.1-609.10(18)</i>	5	2011	Multifuel Heating Stoves for Residential Use
<i>Code of Va. § 58.1-609.10(19)</i>	5	2011	Fabrication of Animal Meats, Grains, Vegetables, or other Foodstuffs

This is the fifth and final report of the 2007-2011 Retail Sales and Use Tax Expenditure Study and includes a detailed analysis of exemptions that pertain to:

- *Va. Code § 58.1-609.10(1)* – Heating fuels for domestic consumption.
- *Va. Code § 58.1-609.10(2)* – Occasional sales.
- *Va. Code § 58.1-609.10(3)* – Purchases for taxable lease.
- *Va. Code § 58.1-609.10(4)* – Property delivered outside Virginia for use outside Virginia.
- *Va. Code § 58.1-609.10(6)* – Property purchased to perform maintenance and repair services at licensed nuclear power plants outside Virginia.
- *Va. Code § 58.1-609.10(18)* – Multifuel heating stoves.
- *Va. Code § 58.1-609.10(19)* – Fabrication of animal meats, grains, and other foodstuffs.

This report includes detailed information on the policy and fiscal impacts of these seven exemptions, as well as the apparent rationale for the exemptions and their legislative

history. This report also includes a comparison of the Virginia exemptions with the sales tax structures of other states, with particular emphasis placed on a comparison with the exemptions provided in contiguous states.

The goal of the SUTES Study is to provide a more complete picture of the revenue impact and policy issues surrounding each of the exemptions contained in the Retail Sales and Use Tax Act. Great care has been taken to provide the most accurate and comprehensive analysis possible. It is our hope that legislators, government officials, and other decision makers will find this report a useful tool in the formulation of public policy decisions on the goals to be furthered by the use of the Commonwealth's revenue resources.

Nonprofit Entities

Under the authority requiring this study, the Department is restricted from studying any exemption provided by *Va. Code* § 58.1-609.10 more frequently than once every five years. However, *Va. Code* § 58.1-609.11 previously required an annual report on entities seeking a nonprofit exemption. Legislation enacted during the 2009 General Assembly authorized the Department to combine its Nonprofit Exemption Report with its yearly Retail Sales and Use Tax Expenditure Study. Given the importance of this exemption for nonprofit entities provided by *Va. Code* § 58.1-609.11, the Department will include in each volume of the Retail Sales and Use Tax Expenditure Study an estimate of the foregone revenue attributable to the nonprofit entity exemption. This estimate is based on information reported to the Department by nonprofit entities seeking to obtain a new or renewed exemption under *Va. Code* § 58.1-609.11. No nonprofit entities were surveyed to obtain this data.

Tax Expenditures Defined

Tax expenditures are provisions in the Tax Code, such as exclusions, exemptions, preferential tax rates, deductions, deferrals or credits that are designed to provide an economic incentive for a certain activity or provide financial assistance in the form of tax relief to taxpayers in certain situations. The tax expenditure concept recognizes that the fiscal impact of a tax provision is similar to the outlay of a direct expenditure. One of the major differences between a tax expenditure and a direct expenditure is that the "cost" is measured by reduced tax collections, instead of by the level of expenditure authorized through the normal legislative appropriation process.

Tax expenditure studies are used more and more frequently as a method of ensuring that tax expenditures are subject to periodic review in a manner similar to direct budget expenditures. Because tax expenditures may escape periodic review, they generally remain in effect indefinitely, with only limited review as to whether they are accomplishing a worthwhile public purpose in a cost-effective manner. However, since tax expenditures are designed to accomplish certain public goals that otherwise might

be met through direct expenditures, it is only reasonable to apply to tax expenditures a review and analysis similar to that provided for direct expenditures.

The Virginia Retail Sales and Use Tax incorporates numerous tax expenditures, which, taken together, substantially reduce the revenues that could potentially be generated by the tax. This study focuses on one type of tax expenditure, the Miscellaneous Retail Sales and Use Tax exemptions. The periodic review of such exemptions that will be undertaken in the Retail Sales and Use Tax Expenditure Study provides a comprehensive tool for evaluating the revenue, economic and policy impact of each exemption. This type of review is particularly relevant considering the number of entities that have obtained sales and use tax exemptions since the enactment of the tax in 1966.

Exemption Analysis Criteria

As mandated by *Va. Code* § 58.1-609.12, eight criteria are used to analyze the fiscal, economic and policy impact of each exemption:

- Revenue Impact – Estimate the state and local retail sales and use tax foregone as a direct result of the exemption.
- Beneficiaries of the Exemption – Identify taxpayers or industries that actually benefit from the exemption. This includes identifying those persons who benefit directly from an exemption. It will also entail identifying the extent to which the benefit is passed on to others, such as customers or suppliers, who are considered to benefit indirectly from the exemption.
- Direct or Indirect Government Assistance – Identify the direct or indirect state budgetary assistance received by taxpayers or industries. Where possible, the federal budgetary assistance received by these groups will also be identified.
- Other States – Compare Virginia exemptions to the tax systems of other states and the District of Columbia which impose a sales, use or receipts tax. This will include determining whether the other taxing jurisdictions have exemptions or other tax expenditures analogous to the Virginia exemption. Particular attention will be given to the tax preferences in the states bordering Virginia, which include the District of Columbia, Kentucky, Maryland, North Carolina, Tennessee, and West Virginia.
- External Mandates – Identify whether the exemption is required as the result of constitutional, judicial, or statutory mandates, either federal or state.
- Other State and Local Tax Burdens – Ascertain whether the taxpayer, industry, property, or service, is subject to other Virginia state taxes.

-
- Similar Taxpayers – Identify taxpayers or industries that do not enjoy the exemption, even though they are similar in nature to taxpayers or industries that do enjoy the exemption.
 - Other Criteria – Focuses on other relevant issues that are unrelated to the first seven criteria. Such issues might include the impact of state regulation, state or local license fees, or local taxes upon exempt taxpayers and industries, and the special impact that an exemption or the lack thereof may have upon a particular locality or region of the state.

Revenue Analysis Methodology

Since tax expenditures are not funded by direct appropriations, but rather by uncollected revenues, their costs are difficult to determine and often not directly recorded. The goal of the revenue estimating process is to quantify (as accurately as possible) the costs of each sales and use tax exemption in terms of foregone state and local revenues. What follows is a general outline of the methodology used to determine the estimates and the inherent limitations placed upon those estimates.

In each case, the most accurate and complete sources of data were utilized. Forecasts and changes in taxpayer behavior were taken into account when appropriate and feasible. The revenue analysis in this study considers only the immediate and direct impact that elimination of an exemption would have on sales and use tax revenue. Not included is an examination of possible subsequent indirect effects on, for example, location decisions and employment in the affected industry due to imposition of the tax. An analysis of such secondary effects is beyond the scope of this study.

The information for this study was received from a number of sources.

Study Limitations

For several reasons, the reader should exercise caution in interpreting the estimates of fiscal impacts found in this report. Some of the major limitations of the estimating methodologies are discussed below.

The goal of the revenue estimating process is to quantify the costs of each sales tax exemption in terms of foregone state and local revenues. Because tax expenditures are funded not by direct appropriations, but rather by uncollected revenues, their costs normally are not directly recorded. Thus, it is important to understand the methodology used to determine the estimates and the inherent limitations placed upon those estimates.

Report Organization

This report contains a detailed analysis of the miscellaneous exemptions, as set forth below:

- *Va. Code* § 58.1-609.10(1) – Artificial or propane gas, firewood, coal or home heating oil used for domestic consumption.
- *Va. Code* § 58.1-609.10(2) – An occasional sale, as defined in § 58.1-602. A nonprofit organization that is eligible to be granted an exemption on its purchases pursuant to § 58.1-609.11, and that is otherwise eligible for the exemption pursuant to this subdivision, shall be exempt pursuant to this subdivision on its sales of 1) food, prepared food and meals and 2) tickets to events that include the provision of food, prepared food and meals, so long as such sales take place on less than 24 occasions in a calendar year.
- *Va. Code* § 58.1-609.10(3) – Tangible personal property for future use by a person for taxable lease or rental as an established business or part of an established business, or incidental or germane to such business, including a simultaneous purchase and taxable leaseback.
- *Va. Code* § 58.1-609.10(4) – Delivery of tangible personal property outside the Commonwealth for use or consumption outside of the Commonwealth. Delivery of goods destined for foreign export to a factor or export agent shall be deemed to be delivery of goods for use or consumption outside of the Commonwealth.
- *Va. Code* § 58.1-609.10(6) – Tangible personal property purchased for use or consumption in the performance of maintenance and repair services at Nuclear Regulatory Commission-licensed nuclear power plants located outside the Commonwealth.
- *Va. Code* § 58.1-609.10(18) – Beginning July 1, 2007, and ending July 1, 2012, multifuel heating stoves used for heating an individual purchaser's residence. "Multifuel heating stoves" are stoves that are capable of burning a wide variety of alternative fuels, including, but not limited to, shelled corn, wood pellets, cherry pits, and olive pits.
- *Va. Code* § 58.1-609.10(19) – Fabrication of animal meat, grains, vegetables, or other foodstuffs when the purchaser (i) supplies the foodstuffs and they are consumed by the purchaser or his family, (ii) is an organization exempt from taxation under § 501(c)(3) or (c)(4) of the Internal Revenue Code, or (iii) donates the foodstuffs to an organization exempt from taxation under § 501(c)(3) or (c)(4) of the Internal Revenue Code.

A summary of each exemption is provided. For each exemption, the following information is provided:

- **Authorization:** The legal authorization for the exemptions, including the text of the statute.
- **Exemption Summary:** A description of the exemption.
- **Rationale:** The background of the enactment of the exemptions, including the legislative history and information on any revisions, in addition to the rationale for the exemption.
- **Methodology:** A description of how the Department studied the exemptions, including sampling methods and survey techniques.
- **Revenue Analysis:** A summary of the estimated foregone state and local revenues as a result of the exemptions.
- **Beneficiaries:** A description of taxpayers and entities that benefit from the exemptions.
- **Direct or Indirect Government Assistance:** Explanation of any direct or indirect government assistance that inures to the beneficiaries of the exemptions.
- **State Comparisons:** A comparison of the Virginia exemptions with those in other states, particularly contiguous states.
- **External Mandates:** A description of any statutory, constitutional, or judicial mandates that are related to, or impacted by, the exemptions.
- **Other State and Local Tax Burdens:** Identification of any other state and local tax burdens on the beneficiaries of these exemptions.
- **Similar Taxpayers:** A discussion of those taxpayers and entities which are similar, but do not benefit from the exemptions.
- **Other Criteria:** If available, any other issues relevant to the exemptions. This category may be excluded if there is no added information.

The second portion of this study provides an estimate of the foregone revenue attributable to the nonprofit entity exemption. The study provides a summary of the nonprofit entity exemption, describes the background of the exemption, and sets forth the new process under which nonprofit organizations are eligible for exemption from the Retail Sales and Use Tax.

MISCELLANEOUS EXEMPTIONS

HEATING FUELS FOR DOMESTIC CONSUMPTION

AUTHORIZATION

Va. Code § 58.1-609.10(1) – Artificial or propane gas, firewood, coal or home heating oil used for domestic consumption. “Domestic consumption” means the use of artificial or propane gas, firewood, coal or home heating oil by an individual purchaser for other than business, commercial or industrial purposes. The Tax Commissioner shall establish by regulation a system for use by dealers in classifying individual purchases for domestic or nondomestic use based on the principal usage of such gas, wood, coal or oil. Any person making a nondomestic purchase and paying the tax pursuant to this chapter who uses any portion of such purchase for domestic use may, between the first day of the first month and the fifteenth day of the fourth month following the year of purchase, apply for a refund of the tax paid on the domestic use portion. (Enacted 1982).

EXEMPTION SUMMARY

This provision exempts from the state portion of the sales and use tax artificial or propane gas, firewood, coal, or home heating oil used by an individual purchaser for domestic consumption. The exemption is restricted to fuels used by individuals; organizations or businesses that purchase these fuels for use in their own facilities are subject to the tax; however, these entities may purchase fuels exempt if purchased on behalf of an individual for consumption by that individual.

The exemption applies to the 4% state portion of the tax only. The local 1% sales tax continues to apply to all purchases for domestic consumption of heating fuels unless the locality adopts an ordinance specifically exempting such fuels. Localities may adopt and rescind such ordinances at any time.

In addition, the statute provides for the establishment of an administrative process by which dealers may account for the collection of the tax and the process by which taxpayers may apply for refund of tax paid on individual purchases of heating fuels when a portion of the purchase is used for domestic purposes.

RATIONALE AND BACKGROUND

RATIONALE

Heating fuels and utility services are often seen as “consumer necessities.” Prior to enactment of the statute, consumers of heating fuels were subject to the sales tax on their purchases of such fuel for residential consumption. However, consumers of electricity or natural gas for home heating were not subject to the same tax burden due to an existing exemption for electricity, gas, and water delivered through mains and pipelines.

LEGISLATIVE HISTORY

The 1979 General Assembly established a joint subcommittee to study energy taxes paid by residential consumers and the tax inequities between the retail sales tax on fuel oil consumption and the applicable taxes on electricity and gas consumption.

Legislation was introduced in 1979 which proposed a sales tax exemption for fuel oil. However, the provision of a full exemption from the sales tax for fuel oil purchased for residential heating purposes would discriminate in favor of persons heating their homes with fuel oil as opposed to electricity or natural gas. Such action would not alleviate the inequity in energy taxation at either the state or local level. As such, legislation was passed in 1980 to exempt purchases of artificial or propane gas, wood, coal or home heating oil used for domestic consumption from the state portion of the retail sales tax. Although passed by the 1980 General Assembly, the statute did not become effective until July 1, 1982 to minimize the impact on sales tax revenues.

Domestic Consumption. The statute specifies that the exemption applies to purchases for domestic consumption. “Domestic consumption” includes purchases by owners or residents of single-family dwellings and purchases by individual residents of apartments, townhouses, trailer courts, condominiums or other multi-family dwellings. The exemption also applies to condominium or similar owner cooperative associations if the association is comprised solely of the owners of the dwelling and more than 50% of the fuel purchased is for use in owner-occupied units. “Domestic consumption” does not include purchases by:

- Nonprofit and charitable organizations to heat their facilities;
- Owners of apartments, townhouses, trailer courts, condominiums or other multi-family dwellings, unless fuel is used to heat such dwellings;
- Businesses operated by nonprofit organizations;
- For profit hospitals or nursing homes;
- For profit schools or institutions of learning;
- Hotels, motels, inns, cabins, or lodges; and
- Any business, industrial or commercial operation.

Local Sales Tax. The 1% local sales tax continues to apply to purchases of heating fuels for domestic consumption. The law authorizes localities to exempt such purchases by ordinance. When a locality does not adopt such an ordinance, the 1% sales tax is allocated to the locality in which the taxable sale takes place. In 2010, the Weldon Cooper Center for Public Policy conducted a survey to determine which Virginia localities levy the 1% local tax on fuels for domestic consumption. 134 localities were surveyed. Of the 126 localities that responded, 107 reported levying the 1% tax, while 19 indicated that fuels for domestic consumption are exempt from the 1% local tax.

Pursuant to *Va. Code* § 58.1-609.13, however, the 1% local sales tax does not apply to fuel for domestic consumption purchased by nonprofit churches to be donated to an

individual for use in his residence, regardless of whether the locality from which the fuel has been purchased has elected to exempt such fuels. This exemption from the 1% tax applies only for those churches that are either exempt from federal income taxation under Internal Revenue Code § 501(c)(3) or that have real property that is exempt from local taxation by classification.

Although the fuels may be delivered to and consumed in a different locality, the tax is distributed to the locality where the purchaser places the initial order.

RELATED OR SIMILAR EXEMPTIONS

State, local, and federal governments, nonprofit organizations that meet certain requirements and follow the procedures for obtaining a nonprofit exemption certificate, and churches may purchase heating fuels for their own use or consumption under the following exemptions. Additionally, any organization which qualifies for exemption from the sales tax on its purchases of tangible personal property may also purchase home heating fuels exempt of the tax, even if such purchases are for nondomestic use.

Governments. *Va. Code* § 58.1-609.1(4) exempts federal, state, and local governments from the state and local sales tax on their purchases.

Churches. *Va. Code* § 58.1-609.10(16) exempts certain purchases, including purchases of fuel, made by churches and used to carry out the work of the church and its related ministries.

Nonprofit organizations. *Va. Code* § 58.1-609.11 exempts purchases of tangible personal property for use or consumption by any nonprofit entity that meets the requirements set forth by statute and obtains a nonprofit exemption certificate from the Department of Taxation.

Multifuel Heating Stoves. *Va. Code* § 58.1-609.10(18) exempts multifuel heating stoves, which are capable of burning a wide variety of alternative fuels, and used to heat an individual's purchaser's residence.

VIRGINIA COURT CASES

The Virginia Supreme Court held in Commonwealth v. Blanks Oil Co., Inc., 255 Va. 242 (1998), that the corporation's place of business was the situs for assessment of the local sales tax on home heating fuel and determines whether the purchase of home heating fuel is exempt or taxable. The court found that *Va. Code* § 58.1-605 displays clear legislative intent to make the city or county of the dealer's place of business the situs for assessment of the local sales tax.

METHODOLOGY

In order to develop an estimate for the repeal of the heating fuels exemption, the Department consulted the 2009 Residential Sector Energy Expenditure Estimates report conducted by the U.S. Energy Information Administration (EIA). The report contains state expenditure estimates for coal, distillate fuel oil, kerosene, liquefied petroleum gas, and wood.

The Department also consulted a survey conducted by Weldon Cooper in 2010, which sought to determine the number of Virginia localities that elect to exempt heating fuels from the 1% local sales and use tax. Of the 134 localities surveyed, 126 localities responded, 107 of which reported levying the tax, while 19 reported exempting heating fuels from the tax.

REVENUE ANALYSIS

Using these figures and taking into account the number of localities that have elected to continue imposing the local 1% sales tax, it is estimated that the repeal of the home heating fuel exemption would increase sales and use tax revenues by \$32.94 million in Fiscal Year 2013.

BENEFICIARIES

Beneficiaries of this exemption include consumers of heating fuels for residential use.

DIRECT OR INDIRECT GOVERNMENT ASSISTANCE

Individual consumers who are elderly, disabled or low income may qualify for financial assistance from their localities to relieve part or all of their cost for home heating fuel.

STATE COMPARISONS

Of the 46 sales tax jurisdictions:

- 22 generally exempt heating fuels purchased for domestic consumption;
- 4 exempt heating fuels purchased for domestic consumption from the state tax and allow localities the option of exempting such fuels (Virginia, Colorado, Missouri, and Texas);
- 3 tax heating fuels purchased for domestic consumption at a reduced rate (Michigan, North Dakota, and Utah); and
- 17 generally tax heating fuels purchased for domestic consumption.

See Appendix 1 for a state-by-state comparison with other taxing jurisdictions.

Of the states that border Virginia, North Carolina and West Virginia generally tax heating fuels purchased for domestic consumption. The District of Columbia, Kentucky, Maryland, and Tennessee generally exempt heating fuels purchased for domestic consumption.

EXTERNAL MANDATES

There are no apparent state or federal constitutional or statutory mandates having an impact on this exemption.

OTHER STATE AND LOCAL TAX BURDENS

Residential consumers of heating fuels are subject to the one percent local tax in localities that have not specifically exempted fuels from the local sales tax in their ordinances. Additionally, the combined sales tax rate applies to purchases of heating fuels for consumption by businesses and for other nonresidential use.

SIMILAR TAXPAYERS

Under this exemption, sales tax relief is granted to residential consumers. Purchases made for use by businesses enjoy no such benefit. However, businesses may purchase heating fuels exempt of the tax when such purchases are on behalf of individuals.

OCCASIONAL SALES

AUTHORIZATION

Va. Code § 58.1-609.10(2) – An occasional sale, as defined in § 58.1-602. A nonprofit organization that is eligible to be granted an exemption on its purchases pursuant to § 58.1-609.11, and that is otherwise eligible for the exemption pursuant to this subdivision, shall be exempt pursuant to this subdivision on its sales of (i) food, prepared food and meals and (ii) tickets to events that include the provision of food, prepared food and meals, so long as such sales take place on fewer than 24 occasions in a calendar year. (Enacted 1966; Amended 2009).

EXEMPTION SUMMARY

As defined in *Virginia Code* § 58.1-602, an “occasional sale” means a sale of tangible personal property not held or used by a seller in the course of an activity for which he is required to hold a certificate of registration, including the sale or exchange of all or substantially all the assets of any business and the reorganization or liquidation of any business, provided such sale or exchange is not one of a series of sales and exchanges sufficient in number, scope and character to constitute an activity requiring the holding of a certificate of registration.

Occasional sales encompass five general types of transactions as follows:

- The sale by a person, business or organization which engages in sales on three or fewer separate occasions within one calendar year; or
- The sale by an eligible nonprofit organization of food, prepared food and meals, and tickets to events that include the provision of food and meals, provided such sales take place on fewer than 24 occasions in a calendar year;
- The sale of tangible personal property not held or used by a seller in the course of an activity for which he is required to hold a certificate of registration; or
- The sale of all or substantially all the assets of a business; or
- The liquidation or reorganization of any business.

The occasional sale exemption is founded primarily on the premise that persons not regularly engaged in the retail sale of tangible personal property should not be required to register and collect the tax on casual or isolated sales. Registering a multitude of sellers who only make a few sales of their private property and locating such persons would prove administratively difficult and render a minimal revenue gain to the Commonwealth.

LEGISLATIVE HISTORY

The occasional sale exemption was enacted in 1966 as one of the original exemptions from the retail sales and use tax. The definition of “occasional sale” was set out

separately in § 602 with other terms when Title 58 was recodified in 1984.

Since its inception, the exemption has been extended only once during the 2009 legislative session, to include food, prepared food and meals; and tickets to events that include the provision of food, prepared food, and meals sold by eligible nonprofit organizations. This nonprofit food sales exemption is currently limited to sales occurring on fewer than 24 occasions in a calendar year.

EXEMPTION ANALYSIS

The interpretation of the occasional sale exemption has primarily been shaped by regulation, opinions of the Attorney general and administrative rulings.

As noted above, the exemption applies to five general types of sales transactions. These transactions are discussed in greater detail as follows:

Sales on three or fewer separate occasions. The underlying nature of an occasional sale is that it is isolated and occurs infrequently and irregularly. While the number, scope, and character must be taken into account in determining whether the exemption is applicable, the general administrative rule is that the exemption applies to a person who is engaged in three or fewer sales within a calendar year. Such transactions include yard sales or garage sales of household goods, fund-raising sales by nonprofit organizations, church dinners, etc.

Provided such sales do not exceed the number, scope and character limitations, persons engaging in exempt occasional sales are not required to register and collect the tax. However, if the sale is of a large scope (i.e., range of operations, extended duration), or is one of a series of several sales, the exemption will not apply. For example, the sale of tote bags and posters sold over a period of two days would qualify as occasional. Contrarily, an organization's sale of audio cassette tapes and educational video tapes, available for purchase all during the year, as well as at each conference the organization holds, would not qualify. Furthermore, while a seller can normally purchase property exempt of the tax for resale, and collect the tax from the consumer, because the sale of the property sold is not taxed, the seller is required to pay the tax to vendors on its purchases.

Conversely, a sale of Christmas trees lasting 30 days or more and other seasonal sales, are not deemed to be occasional since these activities are sufficient in scope to require the holding of a certificate of registration. Under these examples the sellers are in direct competition for an extended period of time with businesses which are required under law to charge and collect the tax on their retail sales of similar products.

Food, Meals and Tickets to Events Sold by Nonprofits. Nonprofit organizations that are eligible to apply for a nonprofit entity exemption from taxation on their purchases of tangible personal property are deemed to be making exempt "occasional sales" of food, prepared food, and meals; and tickets to events that include the provision of food,

prepared food, and meals, provided such sales take place on fewer than 24 occasions in a calendar year. For purposes of determining what constitutes an occasion, the Department deems fundraising, social, or similar activities as one occasion, provided the event does not extend beyond a seven-day consecutive period. Every seven-day consecutive period thereafter constitutes an additional occasion.

The nonprofit organization is not required to apply for or be granted a certificate of exemption in order to qualify for exemption on its sales of food and tickets to events that include the provision of food. While the statutory exemption extends only to IRC § 501(c)(3) and § 501(c)(4) organizations, the Department authorizes all other § 501(c) organizations to qualify for exemption on their sales of food, prepared food, and meals, and tickets to events that include the provision of these items, provided such organizations: 1) are not required to register as a dealer in Virginia based on their other activities; 2) pay sales tax to their vendors on the purchase price paid by the organization for the food in the absence of a valid nonprofit exemption certified issued by the Department, 3) limit such events to 12, rather than 23 occasions per year; 4) use any profits from the sale of food or event tickets solely to support the organization or to donate to another IRC § 501(c) organization; and 5) maintain records for three years after each event to verify these requirements.

Property not held or used by a seller. A sale of tangible personal property not held or used by the seller in the course of an activity for which he is required to hold a certificate of registration is also deemed to be an occasional sale provided such sales are limited in number, scope, and character. For example, a bank which holds a certificate of registration for retail sales of checkbooks and checkbook covers may make exempt occasional sales of office furniture, provided such sales of office furniture are not sufficient in number, scope, and character to constitute an activity requiring the holding of a certificate of registration.

Notwithstanding the above, the occasional sales exemption does not apply merely because a registered dealer makes an infrequent sale of tangible personal property not normally sold by that dealer in the ordinary course of business. For example, a motel cannot make an exempt occasional sale of beds or mattresses since those articles are used by the motel in the activity which requires it to hold a certificate of registration.

Sale of all or substantially all the assets of any business. Such sales may also qualify as exempt occasional sales, as these transactions occur infrequently, without regularity and are outside the normal course of business. For example, the sale of all or substantially all the assets of any business, whether to one buyer or multiple buyers, is an occasional sale provided that such sale is of short duration. If those same assets are sold piece-meal over an extended period of time, the exemption will not apply. For example, the sale of a company's assets to many purchasers over an eleven-month period would exceed the scope of the exemption.

Furthermore, the term "any business" does not necessarily mean a separate business location regardless that each location is required to hold its own certificate of

registration. For example, if the owner of a chain of five restaurants sells three restaurants, but remains in business with the fourth and fifth, no occasional sale has occurred since not all or substantially all the assets were sold.

However, the term “any business” may apply to a separate division of a business. Therefore, the sale of all or substantially all the assets of a division may qualify as an occasional sale. Under this scenario, the division must be engaged in totally separate and distinct activities based on such considerations as separate books which are separately maintained, separate bank accounts, separation of fixed assets, separation of employees, and the flow of economic advantage from one division of the organization to another.

Liquidations and reorganizations. The occasional sale exemption applies to mergers or consolidations of two businesses, the acquisition of one corporation by another through the exchange of stock, or the acquisition of all the assets of one corporation by another corporation in exchange for stock. A merger or consolidation represents an exempt business reorganization, while stock-for-stock and stock-for-asset acquisitions of an entire business represent exempt sales or exchanges of all the assets of a business.

The exemption also applies to the complete liquidation of any business, provided that such sale is not sufficient in number, scope, and character to require the holding of a certificate of registration. For example, a liquidation which involves many transactions with several different purchasers over an extended period of time does not represent an occasional sale.

In addition to the five categories of exemptions set forth above, the Department has clarified the occasional sale exemption as it applies to other categories of sales.

Sales by auctioneers. Because auctioneers, factors and agents are in the business of making sporadic and occasional sales of tangible personal property, they cannot make an exempt occasional sale. Therefore, estate sales and other sales of short duration are subject to the tax, and the auctioneer must collect the tax on such sales. This holds true despite the fact that the owner of the auctioned property or the personal representative of the estate would enjoy the occasional sale exemption if the property were sold by that owner or personal representative and not through an auctioneer, agent or factor.

The one exception to the general rule of taxing sales by auctioneers is that auctioneers, factors, and agents can engage in an occasional sale when selling all or substantially all the assets of a liquidating or reorganizing business provided the sale occurs in three days or less.

Sales made at fairs, circuses, etc. Sales made by peddlers and street vendors at fairs, circuses, flea markets and carnivals are not occasional sales. Despite the fact that such vendors may make infrequent sales, such sales are the very nature of the

vendors' sales activity, and occur with regularity. These vendors are therefore required to collect the tax on such sales. The rationale behind this requirement is to prevent dealers at these events from being placed at a competitive advantage over other registered dealers in the community.

Leases. The lease of tangible personal property is never deemed to be an exempt occasional transaction, and lessors are required to register and collect the tax on the periodic lease payments they receive. This rule applies even if the leased property could have been sold exempt of the tax as an occasional sale. For example, an attorney, who is not required to hold a certificate of registration for the sale of his professional services and who makes three or fewer sales of property within a calendar year, disposes of some excess office equipment. If the attorney sells the equipment outright, the transaction would be an occasional sale. However, if the attorney leases the equipment to a lessee, the attorney is deemed to be engaged in a business activity which requires the holding of a certificate of registration. Furthermore, this rule also applies if the lessor is liquidating a business or disposing of all or substantially all of the business assets.

Purchases. Any person who purchases tangible personal property in an occasional sale transaction is likewise not liable for any use tax on such purchases.

VIRGINIA COURT CASES

In Steuart Petroleum Co. v. Virginia Dept. of Taxation, 44 Va. Cir. 392 (1998), the plaintiff was a corporation that sold off all the assets of a division in five separate transactions during a nine month period. The City of Richmond Circuit Court found that the company sold the assets pursuant to an orderly plan of liquidation and that there was no piecemeal disposition. Consequently, the court held that the occasional sale exemption applied to the transactions, and the taxpayer was not liable for the Retail Sales and Use Tax on its sale of assets.

REVENUE ANALYSIS

The revenue impact of this exemption is unknown. As the occasional sale exemption applies to incalculable private transactions that do not require any reporting with the Department, and is available to any individual making sales on three or fewer occasions annually, there is no way to estimate the cost of the exemption. While the impact of this exemption is unknown, it is likely substantial. In addition to transactions made at yard sales, garage sales, and nonprofit events, the exemption applies to corporate reorganization, liquidation, and business asset sales, which could garner considerable sales tax revenue if such sales were subject to tax.

BENEFICIARIES

The exemption benefits persons, organizations and businesses as they can make such sales without the administrative burden associated with registering, collecting, and

remitting the Retail Sales and Use Tax. Also, purchasers of tangible personal property purchased in an occasional sale transaction benefit because such purchases are not subject to the consumer use tax.

DIRECT OR INDIRECT GOVERNMENT ASSISTANCE

There is no apparent direct government assistance or subsidy that accrues to individuals and businesses that perform occasional sales. Because the exemption is available to such a wide range of recipients, some of its recipients may indirectly benefit from government assistance. For example, certain nonprofit organizations receive state and local government funding. Other taxpayers, such as industrial manufacturers and agricultural producers may receive assistance by virtue of a sales tax exemption on purchases of tangible personal property.

STATE COMPARISONS

Of the 46 sales tax jurisdictions, 42, including Virginia generally exempt tangible personal property purchased in an occasional sale, though the wording and amount of sales that qualify for the exemption vary. While the other four (Colorado, New York, Oklahoma, and Wyoming) generally tax tangible personal property purchased in an occasional sale, Colorado, New York, and Wyoming provide exemptions for some type of isolated sales. See Appendix 1 for a state-by-state comparison with other taxing jurisdictions.

Of the states that border Virginia, all provide an exemption for tangible personal property purchased in an occasional sale, with variances in the wording and amount of sales that qualify for the exemption.

EXTERNAL MANDATES

There are no apparent state or federal constitutional or statutory mandates that have an impact on this exemption.

STATE AND LOCAL TAX BURDEN

Individuals and businesses which qualify for the occasional sale exemption are liable for income tax on the proceeds derived from such sales.

Generally, property sold in an occasional sale (such as household goods purchased by individuals) was subject to the tax when the property was initially purchased. In some instances, however, businesses may make an exempt occasional sale of tangible personal property which was initially purchased exempt of the tax. For example, an agency of the Commonwealth may make an exempt purchase of tangible personal property, pursuant to its government exemption set forth in *Va. Code* § 58.1-609.1(4), and may subsequently sell such tangible personal property in a bankruptcy liquidation sale that qualifies as an exempt occasional sale.

SIMILAR TAXPAYERS

With respect to the occasional sale exemption available for sales of food, prepared food, and tickets to events including the provision of food, nonprofit organizations that are not classified under I.R.C. § 501(c)(3) or § 501(c)(4) may only qualify for exemption on their sales if such sales occur on 12 or fewer occasions per year.

LEASEBACKS

AUTHORIZATION

Va. Code § 58.1-609.10(3) – Tangible personal property for future use by a person for taxable lease or rental as an established business or part of an established business, or incidental or germane to such business, including a simultaneous purchase and taxable lease. (Enacted 1966).

EXEMPTION SUMMARY

This provision exempts from the sales and use tax purchases of tangible personal property for future taxable lease or rental by persons engaged in leasing as an established business. It also exempts purchases of property where the intent of the initial purchaser is to lease or rent the property in a simultaneous purchase-leaseback transaction. The initial purchase is made under the resale exemption and the leaseback transaction is subject to the sales tax, therefore avoiding double taxation.

RATIONALE AND BACKGROUND

RATIONALE

Generally, *Va. Code § 58.1-603(2)* imposes the sales tax on “the gross proceeds derived from the lease or rental of tangible personal property.” For purposes of the sales and use tax, leases are considered as a transfer of possession of tangible personal property without transfer of ownership.

As one of the original exemptions from the Retail Sales and Use Tax enacted in 1966, this exemption grants to persons engaged in providing tangible personal property for taxable lease or rental like tax treatment as persons engaged in purchasing tangible personal property for resale. Specifically, the exemption allows persons leasing tangible personal property for future taxable lease the authority to purchase the property under the resale exemption.

Notwithstanding, certain financing transactions involving the lease of tangible personal property frequently arise which allow for the taxing of the same property twice. To prevent double taxation, the leaseback exemption also applies to leasing transactions in which a purchaser acquires tangible personal property with the intention of reselling the property to a third party for subsequent leaseback to the purchaser. The property may be purchased exempt of the tax only when the purchaser notifies the vendor of its intent to involve a third party purchaser and such notification must be made prior to the passage of title. Moreover, any use of the property by the purchaser prior to the passage of title to the third party invalidates the use of the resale exemption.

For example, if a taxpayer purchases and pays tax on convenience store equipment, then sells the equipment to a leasing company in order to obtain financing, and

subsequently leases the equipment from the leasing company, the initial transaction between the taxpayer and the vendor is an exempt sale for resale, provided the taxpayer provides the vendor with written notification of an intent to involve a third party purchaser, and provided the taxpayer does not use the equipment prior to selling it to the leasing company. The subsequent sale of the equipment to the leasing company is similarly exempt from tax as an exempt purchase for future taxable lease. The leasing company must collect the Retail Sales and Use Tax from the taxpayer on the monthly lease payments.

Safe Harbor Leases. The Economic Recovery Tax Act of 1981 provided rules under which certain transactions, applicable to property placed into service on or after January 1, 1981, would be treated as leases for federal income tax purposes regardless of whether or not the transactions qualify as leases for state income tax purposes. Under IRC § 168, “safe harbor” leases allow for the transfer of federal tax benefits under a sale-leaseback arrangement. Generally, in a safe harbor lease transaction, a seller/lessee sells its equipment to a purchaser/lessor. The purchaser/lessor leases the same equipment back to the seller/lessee for various income tax advantages.

Federal law does not require passage of title for a transaction to be considered a sale and leaseback for federal income tax purposes. *Va. Code* § 58.1-602 defines sale as “any transfer of title or possession...lease or rental... of tangible personal property...for a consideration....” Therefore, where neither title nor possession of tangible personal property is transferred in such financial arrangements as safe harbor lease transactions, the Virginia sales tax would not apply.

RELATED OR SIMILAR EXEMPTIONS

Resale. *Va. Code* § 58.1-602 provides a definition of “retail sale” which exempts from the sales tax purchases of tangible personal property or taxable services for resale. The definition is as follows:

“Retail sale” or “sale at retail” means a sale to any person for any purpose other than for resale in the form of tangible personal property or services taxable under this chapter, and shall include any such transaction as the Tax Commissioner upon investigation finds to be in lieu of a sale. All sales for resale must be made in strict compliance with regulations applicable to this chapter. Any dealer making a sale for resale which is not in strict compliance with such regulations shall be personally liable for payment of the tax.

Motor Vehicle. *Va. Code* § 58.1-609.1(2) provides an exemption from the Virginia Retail Sales and Use Tax for “motor vehicles, trailers, and semitrailers, mobile homes and travel trailers.” Instead, these items are subject to the Virginia Motor Vehicle Sales and Use Tax, administered by the Virginia Department of Motor Vehicles (DMV), imposed under *Va. Code* § 58.1-2402. The motor vehicle tax does not apply to sales to a person for future rental as an established business or the rental of motor vehicles when such vehicles will be re-rented by an established business.

REVENUE ANALYSIS

The revenue impact of this exemption is unknown, but likely substantial. The leaseback exemption applies to any person acquiring tangible personal property for taxable lease or rental, and therefore extends to many different leasing industries. The exemption is comparable to the resale exemption in scope, and it is likely that the applicable transactions would produce substantial revenue if they were subject to sales tax. The third party financing transaction examples illustrate the complexity inherent in determining the tax implications where several layers of transactions are involved. Furthermore, the Department has opined that with such third-party financing transactions, a vendor may be relieved retroactively of the responsibility for the collection of the tax if the taxpayer furnishes a resale certificate of exemption indicating that it will resell the equipment to a third party. These challenges make obtaining data needed to estimate this exemption difficult.

BENEFICIARIES

The leasing industry and any business or person engaged in leasing tangible personal property are beneficiaries of this exemption.

DIRECT OR INDIRECT GOVERNMENT ASSISTANCE

There is no apparent direct government assistance or subsidy that accrues to businesses that purchase tangible personal property for taxable lease or rental.

STATE COMPARISONS

Of the 46 sales tax jurisdictions:

- 41 generally exempt tangible personal property purchased by businesses for taxable lease or rental, including Virginia; and
- 5 generally tax tangible personal property purchased by businesses for taxable lease or rental.

See Appendix 1 for a state-by-state comparison with other taxing jurisdictions.

Of the states that border Virginia, all provide an exemption for tangible personal property purchased by businesses for taxable lease or rental.

EXTERNAL MANDATES

There are no apparent state or federal constitutional or statutory mandates having an impact on this exemption.

STATE AND LOCAL TAX BURDENS

Businesses or persons engaged in simultaneous purchase-leaseback transactions must collect the sales tax on the leaseback portion of the transaction. Additionally, these entities are subject to state income taxation on the proceeds from such leases and local property taxation on the property itself.

SIMILAR TAXPAYERS

Businesses and persons engaged in the lease of motor vehicles, railcars, cargo containers and airplanes do not benefit from this exemption because leases of such property are governed by taxes other than the Retail Sales and Use Tax.

INTERSTATE/FOREIGN COMMERCE AND EXPORT FACTOR DELIVERIES

AUTHORIZATION

Va. Code § 58.1-609.10(4) – Delivery of tangible personal property outside the Commonwealth for use or consumption outside of the Commonwealth. Delivery of goods destined for foreign export to a factor or export agent shall be deemed to be delivery of goods for use or consumption outside of the Commonwealth. (Enacted 1966; Amended 1981).

EXEMPTION SUMMARY

This provision grants an exemption from the Retail Sales and Use Tax for interstate sales of tangible personal property. The exemption is intended to exempt the first “use” of property when such use occurs outside of Virginia. To qualify for the exemption, the tangible personal property must be delivered outside of Virginia and no use or consumption of the property may occur in Virginia.

The exemption further provides that delivery of goods destined for foreign export to a factor or export agent shall be deemed to be delivery for use or consumption outside Virginia.

RATIONALE AND BACKGROUND

RATIONALE

Interstate and Foreign Commerce: This was one of the original exemptions to the Retail Sales and Use Tax enacted in 1966. The exemption recognized the need to avoid the possible constitutional problems involved in taxing interstate and international sales. The Commerce Clause of the United States Constitution prevents the imposition by a state of taxes upon property which does not have a taxable situs within the borders of the taxing state.

The requirement that the delivery be for use or consumption outside Virginia exists to prevent avoidance of taxation through out-of-state delivery. When property is delivered outside Virginia for use or consumption in Virginia, the use tax applies.

Export Factor Deliveries: The export factor provision was enacted to encourage the flow of commerce through Virginia ports rather than through out-of-state ports. However, it is not intended that property acquired for personal use or consumption by the purchaser, including gifts, be exempt under this provision.

BACKGROUND

Interstate and Foreign Commerce: The United States Supreme Court in its 1977 decision in Complete Auto Transit, Inc. v. Brady 430 U.S. 274, set forth a four prong test for determining the validity of state taxes vis-à-vis the Commerce Clause. To meet the test: (1) the taxed activity must have substantial nexus to the taxing state; (2) the tax must be fairly apportioned to the taxing state; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to services provided by the state. Complete Auto set forth the concept that the Commerce Clause does not prohibit the taxation of interstate commerce by states and that given certain restrictions, interstate commerce may be required to pay its fair share of state taxes.

For Virginia purposes, a sale of tangible personal property in interstate commerce occurs when title or possession to the property being sold passes to the purchaser outside of Virginia and no use of the property is made within Virginia. The exemption does not apply to products merely intended for distribution outside of Virginia.

The federal courts have also upheld the proposition that property coming to rest in a state can be taxed even if it is ultimately used elsewhere. In Itel Containers International Corp. v. Huddleston, 507 U.S. 60 (Feb. 23, 1993), the United States Supreme Court upheld Tennessee's imposition of sales tax on the in-state lease of containers owned by a domestic corporation and leased for use exclusively in foreign commerce. The court noted that the sales tax was not based on the importation of containers, but rather taxed the transfer of containers in Tennessee on a non-discriminatory basis. Consequently, the taxing scheme did not violate either the Commerce Clause or the Export-Import Clause of the United States Constitution.

Export Factor Deliveries: In 1981, the interstate and foreign commerce exemption was extended to items delivered to a factor or agent of tangible personal property for foreign export, provided the property is delivered by the seller to the factor or export agent in the seller's vehicle, by common carrier, by licensed contract carrier or independent trucker hired by the seller or by U.S. mail. Prior to the amendment, the Sales and Use Tax applied to all retail sales of tangible personal property where delivery was made in Virginia, even when the property was subsequently shipped to a foreign country. The Department has ruled that the terms "factor" and "export agent" refer to a middleman or jobber who sells merchandise for a manufacturer.

SCOPE

Delivery to Purchaser: Transactions qualifying for the exemption include those where delivery is made to the purchaser outside of Virginia in the seller's vehicle, by an independent trucker or contract carrier hired by the seller, or by the U.S. Post Office or a common carrier. Title or possession does not pass until the property reaches its ultimate destination. Because no title or possession is transferred in Virginia, no sale takes place in Virginia. Therefore, a retailer is not required to collect the sales tax from an out-of-state customer when delivery of the product sold is made to the customer

outside of Virginia by one of the means listed above.

First Use: The exemption is only available when “first use” of the property occurs outside of Virginia. Use is not solely limited to placing an item into service within Virginia. It includes the taking of possession of an item within Virginia and the immediate delivery of the item to a location outside Virginia. Similarly, the act of storing tangible personal property in Virginia constitutes use, thus the tax liability is incurred by the taxpayer at the moment the property is brought into Virginia and stored for use by the taxpayer, even if it will be subsequently shipped out-of-state.

Three Party Transactions/Drop Shipments: Purchases from an out-of-state company by a taxpayer located in Virginia but shipped directly to a company in another state are exempt from the Virginia sales tax since the taxpayer does not take title to or possession of the tangible personal property in Virginia or otherwise make any use of the property in the state.

If a resident or nonresident purchases a gift in Virginia and requests the seller to ship or mail the gift to another person, the purchaser is deemed to receive title to the gift at the time of purchase, as well as possession of the gift by virtue of the “constructive possession” doctrine, and the transaction is taxable in Virginia. The location of the recipient of the gift has no bearing upon the taxability of the transaction.

RELATED OR SIMILAR EXEMPTIONS

Contractor’s Temporary Storage in Virginia. *Va. Code* § 58.1-609.3(1) exempts personal property purchased by a contractor which is to be used solely in another state or in a foreign country, which could be purchased by such contractor for such use free from sales tax in such other state or in such foreign country, and which is stored temporarily in Virginia pending shipment to such state or country.

Ships or Vessels. *Va. Code* § 58.1-609.3(4) provides an exemption from the tax for ships or vessels used or to be used exclusively or principally in interstate or foreign commerce, or repairs or alterations thereof; or fuel and supplies for use or consumption aboard ships or vessels plying the high seas; or tangible personal property used directly in the building, conversion or repair of the ships or vessels.

Airlines. *Va. Code* § 58.1-609.3(6) provides an exemption for tangible personal property sold or leased to an airline operating in intrastate, interstate or foreign commerce as a common carrier providing scheduled air service on a continuing basis to one or more Virginia airports for use or consumption by such airline directly in the rendition of its common carrier service.

VIRGINIA COURT CASES

The Virginia Supreme Court decision in Commonwealth v. Pounding Mill Quarry, 215 Va. 647 (1975), established the principle that if a taxable event occurs in Virginia, subsequent delivery of property outside of Virginia does not exempt the property from the tax. The court held that since both sales and delivery occurred in Virginia, the sales tax was validly imposed, even though the parties knew that the purchaser intended to immediately transport the property to another state and use it there.

In WTAR Radio-TV v. Commonwealth of Virginia, 217 Va. 877 (1977), the Virginia Supreme Court ruled that it is not necessary that the purchaser take physical possession of property in Virginia for the purchaser to exercise rights inherent in the ownership of the property. The court found the airing of an advertisement over the television airwaves to be “tantamount of delivery” of the property to the purchaser even though the purchaser never took actual physical possession of the property. Consequently, when a purchaser exercises rights incident to the ownership of the property while it is still in Virginia, the transaction will not qualify for the interstate commerce exemption and the sales tax will apply.

In Commonwealth v. Miller-Morton Company, 220 Va. 852 (1980), the Virginia Supreme Court held that the exemption for delivery of property outside Virginia for use outside Virginia applies to the act of delivery, not the holding of goods in Virginia for delivery outside Virginia.

REVENUE ANALYSIS

The estimated revenue impact of this exemption is zero. Repealing the exemption on goods delivered outside of Virginia would violate the Commerce Clause of the United States Constitution, which prohibits the imposition by a state of taxes upon goods in interstate commerce. As this exemption is mandated by the U.S. Constitution, its repeal is not feasible.

BENEFICIARIES

The primary beneficiaries of the exemption are out-of-state purchasers of goods who make no use of the property in Virginia.

DIRECT OR INDIRECT GOVERNMENT ASSISTANCE

There is no apparent direct government assistance or subsidy that accrues to individuals or businesses delivering tangible personal property outside the Commonwealth for use or consumption outside of the Commonwealth.

STATE COMPARISONS

Of the 46 sales tax jurisdictions, all including Virginia exempt sales for delivery and use outside their state. See Appendix 1 for a state-by-state comparison with other taxing jurisdictions.

EXTERNAL MANDATES

The exemption for sales of tangible personal property in interstate or foreign commerce is mandated by the U.S. Constitution, which prevents states from imposing a tax on property which does not have a taxable situs within the borders of the taxing state. There are no apparent state or federal constitutional or statutory mandates having an impact on the extension of the exemption to property destined for foreign export and delivered to a factor or export agent. While the U.S. Constitution prohibits states from imposing any taxes or duties on imports or exports without the consent of Congress (Art. I, Sec. 10, cl. 2), this prohibition does not extend to sales and use taxes which are imposed uniformly on all sales made within a taxing jurisdiction.

STATE AND LOCAL TAX BURDENS

As the exemption primarily benefits out-of-state purchasers, the beneficiaries bear no state or local tax burden. Foreign export factors or agents located in Virginia are subject to state income tax and Retail Sales and Use Tax on their purchases.

SIMILAR TAXPAYERS

Consumers who purchase tangible personal property in Virginia or who make first use of the property in Virginia are subject to the tax. In addition, importers of goods into Virginia are subject to the tax.

NUCLEAR POWER PLANTS EXEMPTION

AUTHORIZATION

Va. Code § 58.1-609.10(6) - Tangible personal property purchased for use or consumption in the performance of maintenance and repair services at Nuclear Regulatory Commission-licensed nuclear power plants located outside the Commonwealth. (Enacted 2000)

EXEMPTION SUMMARY

This provision grants an exemption from the Retail Sales and Use Tax for tangible personal property purchased for use in maintenance and repair services at nuclear power plants licensed by the Nuclear Regulatory Commission located outside of Virginia.

The Nuclear Regulatory Commission is a federal agency which licenses all nuclear power plants currently operating in the United States.

RATIONALE

This exemption was introduced to allow companies that perform maintenance and repair services for nuclear power plants located outside of Virginia to withdraw tangible personal property from storage in Virginia for such services without incurring a liability for use tax.

Virginia law imposes the use tax on the “use, consumption, distribution, and storage” of tangible personal property in Virginia. *Virginia Code § 58.1-623(C)* provides that “[i]f a taxpayer who gives a certificate under this section makes any use of the property other than an exempt use or retention, demonstration, or display while holding property for resale, distribution, or lease in the regular course of business, such use shall be deemed a taxable sale by the taxpayer as of the time the property or service is first used by him ...” This statute was interpreted by the Virginia Supreme Court in Commonwealth v. Miller-Morton, 220 Va. 852, 263 S.E. 2d 413 (1980), which held taxable the storage of tangible personal property in Virginia, even though the property would ultimately be withdrawn from storage and shipped outside of the state.

Pursuant to the law, storage of property in Virginia is taxable unless specifically exempt regardless of whether the property may subsequently be used outside of Virginia. Prior to 2000, when this exemption was enacted, the only exception was for the temporary storage of tangible personal property purchased by a contractor which is used solely in another state or country and which could be purchased free from sales tax in such state or country.

LEGISLATIVE HISTORY

The exemption for tangible personal property purchased for use or consumption in the performance of maintenance or repair services at licensed nuclear power plants outside Virginia was enacted in the 2000 General Assembly session with an effective date of July 1, 2000.

REVENUE ANALYSIS

The revenue impact of this exemption is unknown. *Va. Code* § 58.1-3 provides that, except in accordance with a proper judicial order or as otherwise provided by law, the Tax Commissioner or agent “shall not divulge any information acquired by him in the performance of his duties with respect to the transactions, property, including personal property, income or business of any person, firm or corporation.” However, *Va. Code* § 58.1-3 does allow for “the publication of statistics so classified as to prevent the identification of particular reports or returns and the items thereof...” The Department’s policy is not to publish statistics of categories with a small number of beneficiaries to prevent confidential tax information from being identified.

As the exemption applies to a very narrow category of organizations, the small number of businesses qualifying for the exemption prevents the release of any information under the Department’s long-standing policy established pursuant to *Va. Code* § 58.1-3.

BENEFICIARIES

The exemption benefits persons purchasing tangible personal property for use or consumption in maintenance or repair services at licensed nuclear power plants located outside of Virginia, specifically companies providing maintenance and repair services to licensed nuclear power plants.

DIRECT OR INDIRECT GOVERNMENT ASSISTANCE

There is no apparent direct government assistance or subsidy that accrues to businesses that perform maintenance or repair services on nuclear power plants.

STATE COMPARISONS

Of the 46 sales tax jurisdictions, all but Virginia tax tangible personal property for use or consumption in maintenance or repair services on nuclear power plants. See Appendix 1 for a state-by-state comparison with other taxing jurisdictions.

EXTERNAL MANDATES

There are no apparent state or federal constitutional or statutory mandates having an impact on this exemption.

STATE AND LOCAL TAX BURDENS

Generally, businesses are subject to Virginia state income taxes and to the Retail Sales and Use Tax on purchases of tangible personal property not specifically exempt. They are also subject to local property taxes. Many localities impose the Machinery and Tools Tax, and may impose either the Business, Professional, Occupational and License (“BPOL”) Tax or Merchants Capital Tax on businesses.

SIMILAR TAXPAYERS

Contractors may purchase exempt tangible personal property which is used solely in another state or country, and which could be purchased free from the sales tax in such state or country, and is temporarily stored in Virginia pending shipment to such state or country. All other withdrawals of tangible personal property from storage in Virginia for purposes other than resale are taxable. Tangible personal property purchased for use in maintenance and repair services at nuclear power plants in the Commonwealth is taxable.

MULTIFUEL HEATING STOVES

AUTHORIZATION

Va. Code § 58.1-609.10(18) – Beginning July 1, 2007, and ending July 1, 2012, multifuel heating stoves used for heating an individual purchaser’s residence. “Multifuel heating stoves” are stoves that are capable of burning a wide variety of alternative fuels, including, but not limited to, shelled corn, wood pellets, cherry pits, and olive pits. (Enacted 2007).

EXEMPTION SUMMARY

This provision exempts from the sales and use tax multifuel heating stoves used in heating an individual purchaser’s residence. In order to qualify for the exemption, the heating stove must be capable of burning a wide variety of alternative fuels, such as shelled corn, wood pellets, cherry pits, and olive pits. Thus, the exemption does not apply to furnaces that only burn wood or fossil fuels.

In addition, the exemption applies to purchases made to heat an individual’s residence. Purchases made by organizations or businesses are therefore subject to the tax. The exemption applies to qualifying heating stoves, but not to the alternative fuels used in such stoves. Furthermore, the exemption is limited to the actual heating stove, and does not extend to the parts used to make the stoves function.

RATIONALE AND BACKGROUND

Heating fuels, utility services, and heating devices are often seen as “consumer necessities.” Prior to enactment of the statute, consumers of artificial or propane gas, firewood, coal or home heating oil used for domestic consumption were exempt from the sales and use tax on their purchases of such fuel for residential consumption. Consumers of electricity or natural gas for home heating were similarly exempt from the tax due to an exemption for electricity, gas, and water delivered through mains and pipelines. Stoves that burned these alternative fuels, however, were subject to the tax.

LEGISLATIVE HISTORY

The exemption for multifuel heating stoves used for heating an individual purchaser’s residence was enacted in the 2007 Virginia General Assembly session with an effective date of July 1, 2007. The provision is scheduled to expire on July 1, 2012.

RELATED OR SIMILAR EXEMPTIONS

Electricity or Natural Gas. *Va. Code § 58.1-609.1(3)* exempts gas and electricity when delivered to consumers through mains, lines, or pipes.

Fuels for Domestic Consumption. *Va. Code* § 58.1-609.10(1) exempts artificial or propane gas, firewood, coal, or home heating oil used by an individual purchaser for domestic consumption from the state portion of the Retail Sales and Use Tax. The 1% local tax continues to apply in those localities that have not adopted an ordinance specifically exempting such fuels.

REVENUE ANALYSIS

The revenue impact of this exemption is unknown. There is no Virginia data available on sales of multifuel heating stoves. Although national data on shipments of multifuel heating stoves is available, it varies significantly from year to year. Although the revenue impact of this exemption is unknown, it is likely minimal.

BENEFICIARIES

Beneficiaries of this exemption include purchasers of multifuel heating stoves used to heat their residences.

DIRECT OR INDIRECT GOVERNMENT ASSISTANCE

There is no apparent direct government assistance or subsidy that accrues to individuals that purchase multifuel heating stoves for heating their residences.

STATE COMPARISONS

Of the 46 sales tax jurisdictions, all but Virginia tax purchases of multifuel heating stoves for heating individual residences. See Appendix 1 for a state-by-state comparison with other taxing jurisdictions.

EXTERNAL MANDATES

There are no apparent state or federal constitutional or statutory mandates having an impact on this exemption.

STATE AND LOCAL TAX BURDENS

Generally, businesses are subject to Virginia state income taxes and to the Retail Sales and Use Tax on purchases of tangible personal property not specifically exempt.

SIMILAR TAXPAYERS

Purchasers of multifuel heating stoves used to heat a commercial or other nonresidential facility are subject to the Retail Sales and Use Tax. Similarly, purchasers of heating stoves capable of burning only one type of fuel do not qualify for exemption. Purchasers of the alternative fuels used to heat these stoves are also subject to tax.

FABRICATION OF FOODSTUFFS EXEMPTION

AUTHORIZATION

Va. Code § 58.1-609.10(19) - Fabrication of animal meat, grains, vegetables, or other foodstuffs when the purchaser (i) supplies the foodstuffs and they are consumed by the purchaser or his family, (ii) is an organization exempt from taxation under § 501(c)(3) or (c)(4) of the Internal Revenue Code, or (iii) donates the foodstuffs to an organization exempt from taxation under § 501(c)(3) or (c)(4) of the Internal Revenue Code. (Enacted 2009)

EXEMPTION SUMMARY

This provision grants an exemption from the Retail Sales and Use Tax for the fabrication of foodstuffs when the purchaser i) supplies the foodstuffs and they are consumed by the purchaser or his family, ii) is an organization exempt from taxation under § 501 (c)(3) or (c)(4) of the Internal Revenue Code (“IRC”), or iii) donates the foodstuffs to an organization exempt from taxation under § 501 (c)(3) or (c)(4) of the IRC.

RATIONALE

This exemption was introduced to allow individuals and nonprofit organizations to purchase fabrication labor of foodstuffs for the purchaser’s own consumption or for the organization without paying the Retail Sales and Use Tax.

Virginia law imposes the Retail Sales and Use Tax on fabrication labor, including “the fabrication of tangible personal property for consumers who furnish, either directly or indirectly, the materials used in fabrication.” The Department’s regulation on fabrication, 23 *Virginia Administrative Code* 10-210-560, provides, in pertinent part, that “[a]n operation which changes the form or state of tangible personal property is fabrication. . . . A person regularly engaged in the fabrication of tangible personal property for sale at retail must collect and pay the tax on the sales price of the property. . . . The tax applies to the charges for the fabrication of tangible personal property for users or consumers who furnish, either directly or indirectly, the materials used in the fabrication work. For example, a tailor who makes an article of wearing apparel from materials furnished by the customer must collect and pay the tax on the charge for making the apparel.”

LEGISLATIVE HISTORY

The exemption for the fabrication of foodstuffs when the purchaser i) supplies the foodstuffs and they are consumed by the purchaser or his family, ii) is an organization exempt from taxation under § 501 (c)(3) or (c)(4) of IRC, or iii) donates the foodstuffs to an organization exempt from taxation under § 501 (c)(3) or (c)(4) of the IRC was enacted in the 2009 General Assembly session with an effective date of July 1, 2009.

REVENUE ANALYSIS

The Department is unable to determine the revenue impact of this exemption because charges for fabrication labor covered by the exemption are not reported to the Department. While the revenue impact is unknown, it is likely minimal as the exemption is very narrow in its application. The exemption only applies to a small portion of fabrication labor, such as butchering animal meat, canning fruits and vegetables, and milling grains for the purchaser's own consumption.

BENEFICIARIES

The exemption benefits persons purchasing fabrication labor of foodstuffs supplied by the person for consumption by his self or family and persons purchasing fabrication labor of foodstuffs for donation to an organization exempt from taxation under § 501 (c)(3) or (c)(4) of the IRC. The exemption also benefits organizations exempt from taxation under § 501 (c)(3) or (c)(4) of the IRC purchasing fabrication labor of foodstuffs.

DIRECT OR INDIRECT GOVERNMENT ASSISTANCE

To the extent that they are exempt from federal income taxation pursuant to IRC § 501(c)(3) or (c)(4) and subsequently exempt from Virginia income taxation, nonprofit organizations receive some indirect government assistance. Some organizations may also indirectly benefit from an exemption from local property taxes.

STATE COMPARISONS

Of the 46 sales tax jurisdictions:

- 36 generally exempt fabrication labor of foodstuffs supplied by the purchaser, including Virginia;
- 2 generally tax the fabrication of tangible personal property on special order for consideration (Maryland and Massachusetts); and
- 8 generally tax the fabrication of tangible personal property.

See Appendix 1 for a state-by-state comparison with other taxing jurisdictions.

Of the states that border Virginia, the District of Columbia, North Carolina, and Kentucky generally exempt fabrication labor of foodstuffs supplied by the purchaser. Tennessee and West Virginia generally tax the fabrication of tangible personal property, and Maryland generally taxes the fabrication of tangible personal property on special order for consideration.

EXTERNAL MANDATES

There are no apparent state or federal constitutional or statutory mandates having an impact on this exemption.

OTHER STATE AND LOCAL TAX BURDENS

Generally, individuals are subject to the Virginia state income tax. Individuals are also subject to the Retail Sales and Use Tax on purchases of tangible personal property not specifically exempt.

Nonprofit organizations that meet the statutory requirements under § 501 (c)(3) or (c)(4) of IRC bear no state income tax burden unless they derive income from business activities unrelated to the purposes for which they received exemption from federal income taxation. Such organizations are subject to income tax withholding and reporting requirements for their employees. In addition, they are subject to the Sales and Use Tax on purchases of tangible personal property that do not fall within their exemption.

SIMILAR TAXPAYERS

The Retail Sales and Use Tax is not applicable to butchers, slaughterhouses and other agricultural product processors when they process meat or other agricultural products that will be resold. Such transactions qualify for the “sale for resale” exemption. Additionally, livestock and livestock products, poultry and poultry products, and farm and agricultural products are exempt from the Retail Sales and Use Tax when produced by a farmer and used or consumed by him and the members of his family.

NONPROFIT EXEMPTION

NONPROFIT ENTITY EXEMPTION

SUMMARY

The 2003 General Assembly enacted Chapters 757 and 758, 2003 *Acts of Assembly* (House Bill 2525 and Senate Bill 743) to simplify the process of qualifying nonprofit organizations for sales and use tax exemptions. As part of this legislation, the Department is required to file an annual report by December 1 of each year disclosing the annual fiscal impact of the sales and use tax exemptions for nonprofit entities.

BACKGROUND

Prior to the 2003 General Assembly, there was no general exemption from Virginia's Retail Sales and Use Tax for nonprofit organizations. Virginia's Retail Sales and Use Tax exemptions were generally tailored for specific nonprofit organizations, although any organization meeting the exemption criteria would qualify for the exemption. When the Retail Sales and Use Tax first took effect in 1966 there were 22 exemptions. By 2003 this number had increased to 1,702. In general, Sales and Use Tax exemptions were granted through legislative action by the General Assembly. An organization seeking an exemption could acquire one in two ways. If the organization met the statutory language of an existing exemption by classification, it could apply directly to the Department for an exemption by providing evidence that it met the statutory classification. If the organization did not meet the criteria of an existing classification, the organization had to acquire one by designation through the enactment of a new exemption or the amendment of an existing exemption.

With the exception of certain Sales and Use Tax exemptions that applied to broad classes of businesses, most exemptions were enacted with a sunset date. Virginia law required that nonprofit organizations periodically update information about the organization with the Department in order to renew their exemption. This information was identical to the information required when an organization requested a new exemption. The Department reviewed the information and certified that the organization met the requirements. This information was then given to the Division of Legislative Services for drafting legislation to extend the individual exemptions.

NEW EXEMPTION PROCESS

House Bill 2525 and Senate Bill 743 were based on recommendations made by the 2003 House Special Study Committee studying Retail Sales and Use Tax exemptions. With the passage of this legislation, the process was simplified and many nonprofit organizations may now apply to the Department to receive an exemption certificate provided they meet certain qualifications. The legislation also grandfathered the exemptions held by nonprofit organizations under the old exemption system for a limited time. This legislation grants to qualifying nonprofit organizations an exemption from paying Retail Sales and Use Tax on purchases of tangible personal property.

Additionally, certain grandfathered entities are allowed an exemption from the Retail Sales and Use Tax on services that are subject to the tax.

To be granted an exemption by the Department, an entity must meet all the applicable criteria:

- Exemption from federal income taxation 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 be in compliance with state solicitation laws, if applicable.
- The entity must have annual administrative costs that are 40% or less of annual gross receipts.
- If the entity's gross annual revenue was at least \$750,000 in the previous year, the entity must provide a financial review performed by an independent certified public accountant. If the entity's gross annual revenue was at least \$1 million in the previous year, the Department has the discretion to require the entity to provide a financial audit performed by an independent certified public accountant.
- The entity must provide the Department with a copy of its federal Forms 990, 990 EZ, 990-N or a list of its Board of Directors.
- The entity must provide the Department with an estimate of its total taxable purchases.

The process requires renewal on a five to seven-year cycle, but eliminates the need for legislative action. Nonprofit organizations that held a valid exemption certificate under the old system would enjoy their exemption status, but are required to file under the new process when their exemption sunsets. As shown below, all of the original exemption groups have expired and many have applied for an exemption using the new process.

ORIGINAL EXEMPTION SUNSET DATES

Civic and community service (first half) (*Va. Code* § 58.1-609.8) July 1, 2004
Civic and community service (second half) (*Va. Code* § 58.1 -609.8) July 1, 2005
Cultural and Miscellaneous (*Va. Code* §§ 58.1 -609.9 and 58.1 -609.10) July 1, 2006
Educational (*Va. Code* § 58.1 -609.4) July 1, 2007
Medical-Related (*Va. Code* § 58.1 -609.7) July 1, 2008

TECHNICAL AMENDMENTS TO NEW EXEMPTION PROCESS

There have been several technical amendments made to this process since the nonprofit exemption was first enacted in 2003.

In 2004, Chapters 515 and 536, *Acts of Assembly* (House Bill 515 and Senate Bill 585), clarified that churches have two options. They may continue using the self-issued exemption certificate, which entitles them to the Retail Sales and Use Tax exemption available under the law as it existed on June 30, 2003, or they could apply for a general exemption certificate under the new process. An additional provision was added to ensure that nonprofit organizations that provide rescue or firefighting services but do not have IRC §§ 501 (c)(3) or 501 (c)(4) status may obtain an exemption via the new process from July 1, 2004 through June 30, 2006. This bill also grandfathered the exemption from collecting the tax on fundraiser sales that was enjoyed by certain organizations, and clarified that the Department is authorized to refuse to grant exemption certificates to applicants that fail to disclose their total taxable purchases for the preceding year.

In 2005, the General Assembly passed a technical amendment clarifying the law as it applies to taxable services for certain organizations. Under Chapters 42 and 89, 2005 *Acts of Assembly* (House Bill 2100 and Senate Bill 1105), organizations holding a valid exemption as of June 30, 2003, may continue to purchase taxable services exempt of the tax, provided they comply with certain procedures and meet certain requirements. This legislation affected the exemption status of only twelve organizations, some of which actually renewed under the new process, and two of which did not qualify under the new process, as they have a federal designation of IRC § 501 (c)(19) and no longer qualify for an exemption.

The 2006 General Assembly expanded the Retail Sales and Use Tax exemption for nonprofit churches exempt from taxation under IRC § 501 (c) (3), or whose real property is exempt from local taxation pursuant to the provisions of *Va. Code* § 58.1-3606. Under Chapter 338, *Acts of Assembly* (House Bill 576) the exemption was expanded to include tangible personal property used for recording and reproducing services. The exemption applies to a nonprofit church's purchase of video recording equipment, microphones, cassette players, and similar items that are used for recording and reproducing services.

The exemption for nonprofit churches was originally enacted in 1979 and was limited to tangible personal property used by a nonprofit church in its religious worship services or in a regular school of religious education. Since its enactment, the exemption has been expanded several times.

Legislation passed in 2007 expanded the Retail Sales and Use Tax exemption for nonprofit churches exempt from taxation under IRC § 501 (c)(3) or whose real property is exempt from local taxation pursuant to the provisions of *Va. Code* § 58.1-3606. House Bill 2724 (Chapter 758) expanded the exemption to include tangible personal property used in the care or maintenance of any property owned by these churches. The exemption would include, but not be limited to, such items as mowing equipment and building materials that are installed by the church rather than through a contract. This report studies the cost of exempt purchases made by churches under the nonprofit

entity exemption. The cost of the self-issued exemption certificate authorized under *Va. Code* § 58.1-609.10(16) was addressed in Report 1 of the 2007-2011 SUTES Study.

During the Special Session of the 2006 General Assembly, House Bill 5002 (Chapter 3, Special Session 1 of 2006) and House Bill 5012 (Chapter 2, Special Session 1 of 2006) modified the criteria that nonprofit entities were required to meet in order to qualify for a Retail Sales and Use Tax exemption. Previously, one of the criteria required organizations with gross annual revenues of \$250,000 or greater during the previous year to provide a financial audit performed by an independent certified public accountant to the Department. These bills changed this requirement to allow an entity with between \$250,000 and \$500,000 of gross annual revenue in the previous year to provide a review of its financial statements in lieu of a full audit. The review had to be performed by an independent certified public accountant. Entities with more than \$500,000 of gross annual revenue were still required to provide a full audit performed by an independent certified public accountant. Entities with less than \$250,000 of gross annual revenue continued to have no requirement to provide any type of financial audit or review.

The 2007 General Assembly passed legislation that modified the audit requirement for nonprofit organizations applying for a Retail Sales and Use Tax exemption. House Bill 2545 (Chapter 698), House Bill 3062 (Chapter 704) and Senate Bill 743 (Chapter 709) allowed nonprofit organizations with gross annual revenues between \$750,000 to \$1,000,000, the choice of providing a full "financial audit" or a "financial review" in lieu of a full financial audit, both of which had to be performed by an independent certified public accountant. Nonprofit organizations with gross annual revenues of \$1 million or greater were required to provide a full financial audit performed by an independent certified public accountant. Entities with less than \$750,000 of gross annual revenue had no requirement to provide any type of financial audit or review.

In 2009, legislation was enacted that modified these audit requirements again. House Bill 2330 (Chapter 106) and Senate Bill 1222 (Chapter 526) required that nonprofit organizations with \$750,000 in gross annual revenues in the previous year file a financial review performed by an independent certified public accountant. For nonprofit organizations with at least \$1 million in gross annual revenues in the previous year, the Department has the discretion to require that entity to provide a financial audit in lieu of a financial review.

ONLINE EXEMPTION PROCESS

Nonprofit Online, (<https://www.npo.tax.virginia.gov>) is an online application that was developed to provide a quick, efficient and secure way for an organization to apply for a Virginia sales and use tax exemption for the first time or renew its exemption certificate. Since June 2003, over 12,000 nonprofit organizations have accessed Nonprofit Online. Customers accessing Nonprofit Online may print out a copy of their Virginia sales and use certificate, edit certain registration information as it changes, as well as reprint lost certificates without having to contact the Department. The Department continues to receive high marks for its online application from organizations that have submitted applications online.

REVENUE IMPACT

The table below sets forth the Department’s estimate of the total annual state and local Retail Sales and Use Tax revenue impact of the Nonprofit Entity Exemption. This estimate is based on information reported to the Department by nonprofit entities seeking to obtain a new or renewed exemption under *Va. Code* § 58.1-609.11. No nonprofit entities were surveyed to obtain this data.

Exemption certificates issued for nonprofit entities in Fiscal Year 2011 totaled 1,665. This included 840 renewed exemption certificates and 825 new exemptions. Each organization granted a new exemption retains that exemption for a five-year period, after which time, they must renew their exemption.

Table: State and Local Retail Sales and Use Tax Expenditure Resulting from Purchases Made by Nonprofit Organizations.

2011	\$150,273,915
2012	\$153,681,535*
2013	\$157,231,671*

* Projected using the Consumer Pricing Index for All Urban Consumers (CPI-U).

APPENDIX

APPENDIX 1

	Fuel for Domestic Consumption	Occasional Sales	TPP for Taxable Leases and Rentals	Delivery outside the State	Multifuel Heating Stoves	TPP for Maintenance and Repair Services at Nuclear Plants	Fabrication of Foodstuffs
Alabama	T	E	E	E	T	T	E*
Arizona	T	E	T	E	T	T	E
Arkansas	T	E	E	E	T	T	E
California	E	E	T*	E	T	T	E
Colorado	E*	T*	T	E	T	T	E
Connecticut	E	E	E	E	T		E
District of Columbia	E	E	E	E	T	T	E
Florida	E	E	E	E	T	T	E
Georgia	T	E	E	E	T	T	T
Hawaii	T	E	E	E	T	T	T
Idaho	E	E	E	E	T	T	T
Illinois	T	E	T*	E	T	T	E
Indiana	T	E	E	E	T	T	E*
Iowa	E	E	E	E	T	T	E*
Kansas	T	E	E	E	T	T	E
Kentucky	E	E	E	E	T	T	E
Louisiana	E*	E	E	E	T	T	E
Maine	E	E	E	E	T	T	E
Maryland	E	E	E	E	T	T	T*
Massachusetts	E	E	E	E	T	T	T*
Michigan	T*	E	E	E	T	T	E
Minnesota	E	E	E	E	T	T	E
Mississippi	E	E	E	E	T	T	E
Missouri	E*	E	E	E	T	T	T
Nebraska	T	E	E	E	T	T	E*
Nevada	E	E	E	E	T	T	E

	Fuel for Domestic Consumption	Occasional Sales	TPP for Taxable Leases and Rentals	Delivery outside the State	Multifuel Heating Stoves	TPP for Maintenance and Repair Services at Nuclear Plants	Fabrication of Foodstuffs
New Jersey	T	E	T*	E	T	T	E
New Mexico	T	E	E	E	T	T	T
New York	E	T*	E	E	T	T	T
North Carolina	T	E	E	E	T	T	E
North Dakota	T*	E	E	E	T	T	E
Ohio	T	E*	E	E	T	T	E
Oklahoma	E*	T	E	E	T	T	E
Pennsylvania	E	E	E	E	T	T	E
Rhode Island	E	E	E	E	T	T	E
South Carolina	E	E	E	E	T	T	E*
South Dakota	T	E	E	E	T	T	E*
Tennessee	E	E	E	E	T	T	T
Texas	E*	E	E	E	T	T	E
Utah	T*	E	E	E	T	T	E*
Vermont	E	E	E	E	T	T	E
VIRGINIA	E*	E	E	E	E	E	E
Washington	T	E	E	E	T	T	E
West Virginia	T	E	E	E	T	T	T
Wisconsin	E	E	E	E	T	T	E
Wyoming	T	T*	E	E	T	T	E

KEY:

E = Exempt

T = Taxable

NOTES:

The following states do not have a general sales and use tax: Alaska, Delaware, Montana, New Hampshire, and Oregon.

Alabama	*Fabrication – Fabrication services are exempt if performed on property belonging to others and billed separately.
California	*Leases – Leases of property in substantially the same form as acquired upon which tax has already been paid are exempt.
Colorado	*Heating Fuels – Localities have option to exempt or tax. *Occasional Sales – Occasional sales by charitable organizations are exempt.
Illinois	*Leases – Purchases of property that is available for sale during the lease period are exempt.
Indiana	*Fabrication – Charges for fabrication services performed before the sale of the property are taxable.
Iowa	*Fabrication – Charges for fabrication services performed before the sale of the property are taxable.
Louisiana	*Heating Fuels – Exemption applies to electricity and gas.
Maryland	*Fabrication – Fabrication of tangible personal property on special order for consideration is taxable.
Massachusetts	*Fabrication – Fabrication of tangible personal property on special order for consideration is taxable.
Michigan	*Heating Fuels – Taxed at a reduced rate.
Missouri	*Heating Fuels – Localities have option to exempt or tax.
Nebraska	*Fabrication – Charges for fabrication services performed before the sale of the property are taxable.
New Jersey	*Leases – Purchases of property for leasing purposes area exempt if the property, use of property, or lessee of the property qualifies for an exemption.
New York	*Occasional Sales – Occasional sales at a person's private residence are exempt.
North Dakota	*Heating Fuels – Taxed at a reduced rate.
Ohio	*Occasional Sales – Casual sales by a person or auctioneer employed directly to conduct the sale are exempt.
Oklahoma	*Heating Fuels – Exemption applies to electricity and gas.
South Carolina	*Fabrication – Charges for fabrication services performed before the sale of the property are taxable.
South Dakota	*Fabrication – Charges for fabrication services performed before the sale of the property are taxable.
Texas	*Heating Fuels – State exemption applies to electricity and natural gas. Localities have option to exempt or tax.
Utah	*Heating Fuels – Taxed at a reduced rate.
Virginia	*Fabrication – Charges for fabrication services performed before the sale of the property are taxable.
Wyoming	*Heating Fuels – Localities have option to exempt or tax. *Occasional Sales - Occasional sales by religious or charitable organizations for fund raising for the conduct of regular functions and activities are exempt.

ATTACHMENT

Va. Code § 58.1-609.10. Miscellaneous exemptions.

The tax imposed by this chapter or pursuant to the authority granted in §§ 58.1-605 and 58.1-606 shall not apply to the following:

1. Artificial or propane gas, firewood, coal or home heating oil used for domestic consumption. "Domestic consumption" means the use of artificial or propane gas, firewood, coal or home heating oil by an individual purchaser for other than business, commercial or industrial purposes. The Tax Commissioner shall establish by regulation a system for use by dealers in classifying individual purchases for domestic or nondomestic use based on the principal usage of such gas, wood, coal or oil. Any person making a nondomestic purchase and paying the tax pursuant to this chapter who uses any portion of such purchase for domestic use may, between the first day of the first month and the fifteenth day of the fourth month following the year of purchase, apply for a refund of the tax paid on the domestic use portion.
2. An occasional sale, as defined in § 58.1-602.
3. Tangible personal property for future use by a person for taxable lease or rental as an established business or part of an established business, or incidental or germane to such business, including a simultaneous purchase and taxable leaseback.
4. Delivery of tangible personal property outside the Commonwealth for use or consumption outside of the Commonwealth. Delivery of goods destined for foreign export to a factor or export agent shall be deemed to be delivery of goods for use or consumption outside of the Commonwealth.
5. Tangible personal property purchased with food coupons issued by the United States Department of Agriculture under the Food Stamp Program or drafts issued through the Virginia Special Supplemental Food Program for Women, Infants, and Children.
6. Tangible personal property purchased for use or consumption in the performance of maintenance and repair services at Nuclear Regulatory Commission-licensed nuclear power plants located outside the Commonwealth.
7. Beginning July 1, 1997, and ending July 1, 2006, a professional's provision of original, revised, edited, reformatted or copied documents, including but not limited to documents stored on or transmitted by electronic media, to its client or to third parties in the course of the professional's rendition of services to its clientele.
8. School lunches sold and served to pupils and employees of schools and subsidized by government; school textbooks sold by a local board or authorized agency thereof; and school textbooks sold for use by students attending a nonprofit college or other

institution of learning, when sold (i) by such institution of learning or (ii) by any other dealer, when such textbooks have been certified by a department or instructor of such institution of learning as required textbooks for students attending courses at such institution.

9. Medicines, drugs, hypodermic syringes, artificial eyes, contact lenses, eyeglasses, eyeglass cases, and contact lens storage containers when distributed free of charge, all solutions or sterilization kits or other devices applicable to the wearing or maintenance of contact lenses or eyeglasses when distributed free of charge, and hearing aids dispensed by or sold on prescriptions or work orders of licensed physicians, dentists, optometrists, ophthalmologists, opticians, audiologists, hearing aid dealers and fitters, nurse practitioners, physician assistants, and veterinarians; controlled drugs purchased for use by a licensed physician, optometrist, licensed nurse practitioner, or licensed physician assistant in his professional practice, regardless of whether such practice is organized as a sole proprietorship, partnership, or professional corporation, or any other type of corporation in which the shareholders and operators are all licensed physicians, optometrists, licensed nurse practitioners, or licensed physician assistants engaged in the practice of medicine, optometry, or nursing; medicines and drugs purchased for use or consumption by a licensed hospital, nursing home, clinic, or similar corporation not otherwise exempt under this section; and samples of prescription drugs and medicines and their packaging distributed free of charge to authorized recipients in accordance with the federal Food, Drug, and Cosmetic Act (21 U.S.C.A. § 301 et seq., as amended). With the exceptions of those medicines and drugs used for agricultural production animals that are exempt to veterinarians under subdivision 1 of § 58.1-609.2, any veterinarian dispensing or selling medicines or drugs on prescription shall be deemed to be the user or consumer of all such medicines and drugs.

10. Wheelchairs and parts therefor, braces, crutches, prosthetic devices, orthopedic appliances, catheters, urinary accessories, other durable medical equipment and devices, and related parts and supplies specifically designed for those products; and insulin and insulin syringes, and equipment, devices or chemical reagents that may be used by a diabetic to test or monitor blood or urine, when such items or parts are purchased by or on behalf of an individual for use by such individual. Durable medical equipment is equipment that (i) can withstand repeated use, (ii) is primarily and customarily used to serve a medical purpose, (iii) generally is not useful to a person in the absence of illness or injury, and (iv) is appropriate for use in the home.

11. Drugs and supplies used in hemodialysis and peritoneal dialysis.

12. Special equipment installed on a motor vehicle when purchased by a handicapped person to enable such person to operate the motor vehicle.

13. Special typewriters and computers and related parts and supplies specifically designed for those products used by handicapped persons to communicate when such equipment is prescribed by a licensed physician.

14. a. (i) Any nonprescription drugs and proprietary medicines purchased for the cure, mitigation, treatment, or prevention of disease in human beings and (ii) any samples of nonprescription drugs and proprietary medicines distributed free of charge by the manufacturer, including packaging materials and constituent elements and ingredients.

b. The terms "nonprescription drugs" and "proprietary medicines" shall be defined pursuant to regulations promulgated by the Department of Taxation. The exemption authorized in this subdivision shall not apply to cosmetics.

15. Tangible personal property withdrawn from inventory and donated to (i) an organization exempt from taxation under § 501 (c) (3) of the Internal Revenue Code or (ii) the Commonwealth, any political subdivision of the Commonwealth, or any school, agency, or instrumentality thereof.

16. Tangible personal property purchased by nonprofit churches that are exempt from taxation under § 501 (c) (3) of the Internal Revenue Code, or whose real property is exempt from local taxation pursuant to the provisions of § 58.1-3606, for use (i) in religious worship services by a congregation or church membership while meeting together in a single location and (ii) in the libraries, offices, meeting or counseling rooms or other rooms in the public church buildings used in carrying out the work of the church and its related ministries, including kindergarten, elementary and secondary schools. The exemption for such churches shall also include baptistries; bulletins, programs, newspapers and newsletters that do not contain paid advertising and are used in carrying out the work of the church; gifts including food for distribution outside the public church building; food, disposable serving items, cleaning supplies and teaching materials used in the operation of camps or conference centers by the church or an organization composed of churches that are exempt under this subdivision and which are used in carrying out the work of the church or churches; and property used in caring for or maintaining property owned by the church including, but not limited to, mowing equipment; and building materials installed by the church, and for which the church does not contract with a person or entity to have installed, in the public church buildings used in carrying out the work of the church and its related ministries, including, but not limited to worship services; administrative rooms; and kindergarten, elementary, and secondary schools.

17. Medical products and supplies, which are otherwise taxable, such as bandages, gauze dressings, incontinence products and wound-care products, when purchased by a Medicaid recipient through a Department of Medical Assistance Services provider agreement.

18. Beginning July 1, 2007, and ending July 1, 2012, multifuel heating stoves used for heating an individual purchaser's residence. "Multifuel heating stoves" are stoves that are capable of burning a wide variety of alternative fuels, including, but not limited to, shelled corn, wood pellets, cherry pits, and olive pits.