



Virginia Department of Planning and Budget **Economic Impact Analysis**

23 VAC 10-210 Retail Sales and Use Tax
Department of Taxation
Town Hall Action/Stage: 6173 / 9906
April 24, 2023

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with § 2.2-4007.04 of the Code of Virginia (Code) and Executive Order 19. The analysis presented below represents DPB's best estimate of these economic impacts.¹

Summary of the Proposed Amendments to Regulation

Following a periodic review,² the Department of Taxation (Department) proposes to update the regulation to incorporate provisions of: i) Chapters 436 and 449 (identical) of the 2017 Acts of Assembly³ that shifted the collection and remittance responsibility of sales and use tax on certain construction materials from installer to the supplier of these items and ii) Chapter 758 of the 2019 Acts of Assembly⁴ which repealed the restriction prohibiting sales and use tax dealers from absorbing the payment of the tax. The Department also proposes a discretionary change in rules applicable to overcollection of the tax to simplify and to indicate that sales tax rates differ in some areas of the Commonwealth.

¹ Code § 2.2-4007.04 requires that such economic impact analyses determine the public benefits and costs of the proposed amendments. Further the analysis should include but not be limited to: (1) the projected number of businesses or other entities to whom the proposed regulatory action would apply, (2) the identity of any localities and types of businesses or other entities particularly affected, (3) the projected number of persons and employment positions to be affected, (4) the projected costs to affected businesses or entities to implement or comply with the regulation, and (5) the impact on the use and value of private property.

² <https://townhall.virginia.gov/l/ViewPReview.cfm?PRid=2187>

³ <https://lis.virginia.gov/cgi-bin/legp604.exe?171+ful+CHAP0436> & <https://lis.virginia.gov/cgi-bin/legp604.exe?171+ful+CHAP0449>

⁴ <https://lis.virginia.gov/cgi-bin/legp604.exe?191+ful+CHAP0758>

Background

Chapters 436 and 449 (identical) of the 2017 Acts of Assembly shifted the collection and remittance responsibility of sales and use tax on fences, venetian blinds, window shades, awnings, storm windows and doors, floor coverings, cabinets, countertops, kitchen equipment, window air conditioning units or other like or comparable items from the contractor who sold and installed these items to the contractor's supplier/vendor.

Although most consumers are familiar with paying sales tax on their purchases from grocery or department stores, special rules apply to tangible personal property installed on real estate. Examples of these types of items are construction materials for plumbing, electrical, roofing systems, central air conditioning, heating, and heat pump units. Once sold and installed by a contractor respecting real estate, these items lose their identity as a tangible property and become part of the real estate. In that sense, contractors are considered to be the users of tangible personal property as a general rule and pay the sales tax on these items when they obtain them from their supplier or vendor. The supplier or vendor is treated as the sales tax dealer and remits the amount collected from contractors to the Department.

Prior to the 2017 legislative change, however, fences, venetian blinds, window shades, awnings, storm windows and doors, floor coverings, cabinets, countertops, kitchen equipment, window air conditioning units or other like or comparable items were specifically exempted from the general rule and the homeowner was considered to be the user of these items. Therefore, contractors were required to collect sales tax when they sold and installed these items and remit it to the Department. Furthermore, since the homeowner was treated as the user, the contractor was expected to obtain these items from its vendors by using its sales tax exemption certificate so as not to pay double sales tax on them.

According to the Department, the differential sales tax treatment of these specific items listed in the legislation from the general rule created confusion among the contractors. As a result, two national home improvement chains sponsored the 2017 legislative amendments which made the sales tax treatment of such items the same as any other tangible personal property installed on real estate. Pursuant to the legislation, this action removes the regulatory language regarding the exempt treatment of the affected items from the general sales tax rule applicable to tangible property installed on real estate.

Another proposed change incorporates in the regulatory text language from Chapter 758 of the 2019 Acts of Assembly, which repealed the restriction prohibiting retail sales and use tax dealers from absorbing the payment of the tax. Prior to this law change, dealers were generally prohibited from absorbing, or advertising or holding out to the public that they will absorb payment of, all or any part of the sales or use tax due on a taxable transaction. Under the amended statute, a dealer is now allowed to absorb all, or a portion of the sales tax provided it separately states the sales price of the item and the full amount of tax due on the item at the point of sale and remits to the Department the full amount of tax due. This action would also edit the regulatory text to incorporate the 2019 legislative change.

The last proposed change would remove references, in the rules applicable to overcollection of the tax, to specific areas of the Commonwealth that have a different sales tax rate than the 5.3% generally applicable statewide rate. The proposed text would reference the Department's website on sales and use tax for the statutory rates applicable at different areas of the Commonwealth.

Estimated Benefits and Costs

The main impact of the incorporation of the legislative changes in the regulatory text is to make the text consistent with the statutes and prevent possible confusion from conflicting language. Although the anticipated impact of incorporation of the two changes in regulation is relatively small, the legislative changes themselves appear to be substantial.

The 2017 legislation appears to have eliminated a significant source of confusion with respect to collection and remittance of the sales tax by contractors that sold and installed the specific list of tangible property on real estate. Because of the general rule, most contractors have grown accustomed to purchasing tangible property from their suppliers with sales tax and not collecting the tax from their customers. However, according to the Department, the exemption from this general rule at that time had required the contractors to obtain materials from their suppliers without paying the tax using an exemption certificate and instead collecting the tax from their customers and later remitting the amount collected to the Department. The Department acknowledges that there were significant compliance issues as a result of that exempt treatment of such items from the general rule. Additionally, contractors usually add a markup to the items they resell to their customers. This practice has a direct impact on the

amount subject to the sales tax. Since the collection of the sales tax on the certain items affected by the legislation changed from the sales price charged by the contractor to the price charged by the contractor's vendor, a reduction on sales tax due would have likely occurred. However, the Department has no information on the data elements needed to estimate the magnitude of the likely revenue impact (e.g. compliance rates with the exemption to the general rule, statewide vendor sales of affected items, and the markup contractors charge).

Similarly, the impact of the 2019 legislative change that allowed absorption of the sales tax by retailers likely included providing more flexibility in advertising or an additional promotional tool. It is not unusual to hear or see commercials during the sales tax holidays in order to promote sales of items that are temporarily exempt from sales tax under Virginia law. With the 2019 legislation, retailers have been free to absorb the sales tax due for a variety of purposes such as to promote the goods they sell or to show customer appreciation. To the extent this legislative change enhanced the availability of marketing approaches and had promoted sales, a positive sales tax revenue impact would have likely occurred.

Finally, the proposed edits to the text regarding the overcollection of the tax strike references to specific areas of the Commonwealth that have different sales tax rate than the 5.3% rate otherwise applicable statewide. Instead, the proposed text would reference the Department's website on sales and use tax for the statutory rates applicable at different areas of the Commonwealth. According to the Department, this change would eliminate the need for future regulatory amendments of the section whenever there is a legislative rate change. Thus, this change appears to be mainly editorial in nature and is not expected to create any other economic effects.

Businesses and Other Entities Affected

The proposed amendments to the regulatory text apply to all entities subject to Virginia sales and use tax. Suppliers, contractors and installers of fences, venetian blinds, window shades, awnings, storm windows and doors, floor coverings, cabinets, countertops, kitchen equipment, window air conditioning units or other like or comparable items may be particularly affected.

The Code of Virginia requires DPB to assess whether an adverse impact may result from the proposed regulation.⁵ An adverse impact is indicated if there is any increase in net cost or reduction in net revenue for any entity, even if the benefits exceed the costs for all entities combined. As noted above, this action incorporates legislative changes that occurred a number of years ago and the proposed discretionary change is editorial in nature with no adverse impact. Thus, no adverse impact on any entity is indicated.

Small Businesses⁶ Affected:⁷

The proposed amendments to the regulatory text do not appear to adversely affect small businesses.

Localities⁸ Affected⁹

The proposed amendments to the regulatory text do not introduce costs for local governments or affect any locality more than others.

Projected Impact on Employment

The proposed amendments to the regulatory text do not appear to affect employment.

Effects on the Use and Value of Private Property

The proposed amendments to the regulatory text do not affect the use and value of private property or real estate development costs.

⁵ Pursuant to Code § 2.2-4007.04(D): In the event this economic impact analysis reveals that the proposed regulation would have an adverse economic impact on businesses or would impose a significant adverse economic impact on a locality, business, or entity particularly affected, the Department of Planning and Budget shall advise the Joint Commission on Administrative Rules, the House Committee on Appropriations, and the Senate Committee on Finance. Statute does not define “adverse impact,” state whether only Virginia entities should be considered, nor indicate whether an adverse impact results from regulatory requirements mandated by legislation.

⁶ Pursuant to § 2.2-4007.04 of the Code of Virginia, small business is defined as “a business entity, including its affiliates, that (i) is independently owned and operated and (ii) employs fewer than 500 full-time employees or has gross annual sales of less than \$6 million.”

⁷ If the proposed regulatory action may have an adverse effect on small businesses, Code § 2.2-4007.04 requires that such economic impact analyses include: (1) an identification and estimate of the number of small businesses subject to the proposed regulation, (2) the projected reporting, recordkeeping, and other administrative costs required for small businesses to comply with the proposed regulation, including the type of professional skills necessary for preparing required reports and other documents, (3) a statement of the probable effect of the proposed regulation on affected small businesses, and (4) a description of any less intrusive or less costly alternative methods of achieving the purpose of the proposed regulation. Additionally, pursuant to Code § 2.2-4007.1, if there is a finding that a proposed regulation may have an adverse impact on small business, the Joint Commission on Administrative Rules shall be notified.

⁸ “Locality” can refer to either local governments or the locations in the Commonwealth where the activities relevant to the regulatory change are most likely to occur.

⁹ § 2.2-4007.04 defines “particularly affected” as bearing disproportionate material impact.