

Notice of Meeting
Retail Sales and Use Tax Treatment of Government Contractors
October 18, 2006

As a result of budget language included in the 2006 Budget Bill (House Bill 5002, Chapter 3, 2006 Acts, Special Session I), the Department of Taxation (TAX) changed its policy with respect to the “true object” test under the Retail Sales and Use Tax as it applies to contractors doing business with the federal, state and local governments. Effective July 1, 2006, the taxation of a government contract is no longer based on the application of the “true object” test to the overall underlying contract. For “task orders”, “work orders”, or “statements of work” entered into on or after July 1, 2006, the sales and use tax application will be based on the “true object” of each separate “task order”, “work order”, or “statement of work”. (See Tax Bulletin 06-4, attached).

TAX has been charged with the task of promulgating an Emergency Regulation with the assistance of the government contracting community on or before June 30, 2007, to implement this change in policy. TAX will be holding an open meeting/teleconference from 10:00 A.M. to 12 P.M. on Wednesday, October 18, 2006, at the law offices of McGuireWoods, LLP, located in One James Center, 901 East Cary Street, Richmond, Virginia. Interested parties, unable to attend the meeting, may join the public meeting by teleconference. In order that TAX may reserve sufficient lines, please respond by e-mail before the close of business October 13 if you are interested in receiving the teleconference number and pass code. For those interested parties wishing to attend the meeting in person, the receptionist on the 2nd floor will direct you to the conference room.

The purpose of this meeting/teleconference will be to (1) present to the government contractor industry and tax practitioners, TAX’s Work Plan for the development of this Emergency Regulation, (2) identify issues to be addressed by the Emergency Regulation and (3) identify parties wishing to participate further in this process as a member of a Technical Advisory Committee to be established. Attendance at this meeting or participation in this teleconference is not a prerequisite for participation in the implementation process and the development of this Emergency Regulation.

This message is being sent to all potentially interested parties that TAX could initially identify. Please feel free to forward this message to the appropriate representatives of your business or its affiliates. You may also send this message to any tax professionals that represent your business or trade organizations that represent your industry.

All parties interested in attending the meeting should contact Bland Sutton at Bland.Sutton@tax.virginia.gov no later than October 13, 2006.



TAX BULLETIN 06-4
Virginia Department of Taxation
July 7, 2006

IMPORTANT INFORMATION REGARDING
Retail Sales and Use Tax Treatment of
Government Contractors

Effective July 1, 2006, the Department of Taxation (TAX) changed its current interpretation of the “true object” test under the Retail Sales and Use Tax as it applies to contractors doing business with the federal, state and local governments. This policy change is the result of budget language included in the Budget Bill (House Bill 5002, Chapter 3, 2006 Acts, Special Session 1).

Current Policy With Respect to Government Contractors

Generally under the Virginia Retail Sales and Use Tax Act, tangible personal property purchased by contractors for use and consumption in fulfilling contracts with the federal, state or local government is subject to tax to the contractor at the time of purchase. This applies regardless of whether title to such property passes directly to the government entity upon purchase by the contractor or the contractor is reimbursed directly by the government entity for the cost of such property. The only exception to this treatment is if the credit of the government entity is bound directly and the contractor has been designated as the official purchasing agent of the government entity.

In cases where a contract involves the conveyance of tangible personal property, TAX uses the “true object” test to determine the tax application to the purchases made in fulfillment of the contract. Currently, TAX applies the “true object” test to the overall purpose of the contract, without regard to the individual “work orders” or “statements of work”. If the overall objective of the contract is determined to be for the provision of services, the contractor must pay the tax on all tangible personal property purchased by the contractor in fulfilling the contract. If the overall “true object” of the contract is the conveyance of tangible personal property to the government entity, the contractor may purchase the tangible personal property exempt of the tax for resale and subsequently sell the property to the government entity without collecting tax on the sale because sales to government entities are exempt.

Change in Policy Effective July 1, 2006

Effective July 1, 2006, TAX will change its policy and no longer make the taxability determination regarding the “true object” of the transaction between the government entity and its contractor based upon the underlying contract. For “task orders,” “work orders,” or “statements of work” entered into on and after July 1, 2006, the tax application to government contracts will be based on the application of the “true object” test to each separate “work order,” “statement of work,” or “task order,” as opposed to applying the “true object” test to the underlying contract between the government entity and the contractor. This change in the application of the “true object” test from the overall underlying contract, to separate “work orders,” “statements of work,” or “task orders,” will **not** relieve government contractors from the sales and use tax liability with respect to real estate construction contracts with government entities.

Due to this change in policy, Virginia Regulation 23 VAC 10-210-693 will not be applicable to “task orders,” “work orders,” or “statements of work” entered into on and after July 1, 2006. Instead, TAX will make the taxability determination as if the underlying contract was a qualifying ID/IQ (Indefinite Delivery/Indefinite Quantity) contract. Because under a qualifying ID/IQ contract it is impossible to determine the “true object” of the contract, TAX has determined that under a qualifying ID/IQ contract the “true object” analysis is to be applied at the “task order” level. Under this change in policy, if the “true object” of the “task order,” “work order,” or “statement of work” is for the provision of services, the contractor must pay tax on all tangible personal property purchased in fulfilling the contract. If the “true object” of the “task order,” “work order,” or “statement of work” is the conveyance of tangible personal property to the government entity, the contractor may purchase the tangible personal property exempt of the tax for resale and subsequently sell the property to the government entity without collecting tax on the sale because sales to government entities are exempt. TAX’s policy with respect to the application of the “true object” test to ID/IQ contracts may be found in Public Document (PD) 01-6 (1/4/2001), PD 04-53 (8/18/2004), PD 05-16 (2/9/2005), and PD 05-93 (6/10/2005). The documents are available on-line in the Tax Policy Library section of TAX’s website, located at www.policylibrary.tax.virginia.gov.

TAX has been charged with promulgating regulations, with the assistance of the government contracting industry, to implement this change in policy. Such regulations will provide examples to illustrate when a government contractor makes a taxable use of an item in fulfilling a governmental contract, as well as when interim use of an item by a government contractor is incidental to a resale to the government entity. Emergency regulations implementing this change in policy will be issued on or before June 30, 2007.

If you have any questions regarding this Tax Bulletin, please contact TAX at: (804) 367-8037.