

Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

House Bill 203
Ways and Means

(Delegate Cardin, *et al.*)

Budget and Taxation

Sales and Use Tax - Exemptions - Veterans' Organizations

This bill exempts sales made to veterans' organizations that are organized under § 501(c)(4) of the Internal Revenue Code (IRC) from the State sales and use tax.

The bill takes effect July 1, 2010.

Fiscal Summary

State Effect: General fund and Transportation Trust Fund (TTF) revenues decrease beginning in FY 2011. The amount of the decrease depends on the number of veterans' organizations qualifying for the exemption and the amount of tax exempt purchases made by these organizations. The current sales tax exemption for veterans' organizations established under § 501(c)(19) has decreased State revenues by approximately \$100,000 annually. Expenditures are not affected.

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Current Law: Chapter 506 of 2009 extended the termination date for a State sales and use tax exemption for sales to specified veterans' organizations from June 30, 2009, to June 30, 2012. The exemption was first enacted by Chapters 217 and 218 of 2006, which provided for a three-year State sales and use tax exemption for sales made to a bona fide nationally organized and recognized veterans' organization or an auxiliary of the organization or its units, if the organization is qualified as tax exempt under § 501(c)(19) of the IRC.

The State sales and use tax rate is 6%. The tax does not apply to sales made by a bona fide religious organization if the sale is made for the general purposes of the organization. In addition, sales made by the following organizations are also exempt from the State sales and use tax including:

- a gift shop at a mental hospital operated by the Department of Health and Mental Hygiene;
- a hospital thrift shop operated by volunteers;
- specified vending facilities operated under the Maryland Vending Program for the Blind; and
- an elementary or secondary school or a nonprofit parent-teacher organization for the sale of magazine subscriptions in a fund-raising campaign.

Sales made to certain organizations are also exempt from the State sales and use tax as provided under § 11-204 of the Tax-General Article, including sales made to:

- tax-exempt cemetery companies;
- credit unions;
- nonprofit organizations;
- nonprofit senior citizens' organizations if the sale does not exceed \$500;
- a volunteer fire or ambulance company or rescue squad;
- a nonprofit parent-teacher association; and
- a nonprofit organization qualified as tax exempt under § 501(c)(4) of the IRC for the purpose of mitigating spills of oil or other substances occurring in United States coastal and tidal waters.

To qualify as a tax-exempt organization, the organization must file an application for an exemption certificate with the Comptroller. The Comptroller may treat the possession of an effective determination letter of status under § 501(c)(3) or (13) of the IRC from the Internal Revenue Service as evidence that an organization qualifies for the exemption.

The sales tax also does not apply to a sale of food if the proceeds are used to support a bona fide nationally organized and recognized veterans' organization or auxiliary.

Chapter 210 of 2006 provided a State sales and use tax exemption for sales made by bona fide churches, religious, or nonprofit organizations that are exempt from taxation under § 501(c)(3) of the IRC if the sales are made at an auction sale and the proceeds are used to carry on the exempt purposes of the church or organization. Chapter 210 limited the exemption to that portion of the sale price that qualifies for a deduction under the federal income tax as a charitable contribution.

Background: The sales and use tax is the State's second largest source of general fund revenue accounting for \$3.5 billion in fiscal 2010 and \$3.7 billion in fiscal 2011, according to the December 2009 revenue forecast. In addition, TTF is projected to receive \$0.2 billion in sales and use tax revenues in both fiscal 2010 and 2011. **Exhibit 1** shows the sales and use tax rates in surrounding states and the District of Columbia.

Exhibit 1
Sales and Use Tax Rates in Maryland and Surrounding States

Delaware	0%
District of Columbia	5.75%
Maryland	6%
Pennsylvania	6% plus 1% in certain local jurisdictions 0% sales tax on clothing
Virginia	5%; 2.5% for food, both rates include 1% for local jurisdictions
West Virginia	6%

Tax-exempt Veterans' Organizations

Generally, § 501(c)(19) of the IRC applies to posts or organizations of past or present members of the U.S. armed forces. Organizations must meet the following qualifications for exempt status: (1) the post or organization must be organized in the United States or any of its possessions; (2) at least 75% of the members are past or present members of the U.S. armed forces and that at least 97.5% of all members of the organization are past or present members of the U.S. armed forces; cadets (including only students in college or university ROTC programs or at armed services academies); or spouses, widows, widowers, ancestors, or lineal descendants; and (3) no part of net earnings benefit any private shareholder or individual.

In addition, a qualified veterans' organization also must be operated exclusively for one or more of the following purposes: (1) to promote the social welfare of the community; (2) to assist disabled and needy war veterans and members of the armed forces and their dependents and the widows and orphans of deceased veterans; (3) to provide entertainment, care, and assistance to hospitalized veterans or members of the armed forces; (4) to carry on programs to perpetuate the memory of deceased veterans and members of the armed forces and to comfort their survivors; (5) to conduct programs for

religious, charitable, scientific, literary, or educational purposes; (6) to sponsor or participate in activities of a patriotic nature; (7) to provide insurance benefits for its members or dependents of its members or both; (8) to provide social and recreational activities for its members. The American Legion and the Veterans of Foreign Wars are examples of groups that may qualify for exempt status.

Generally, § 501(c)(4) of the IRC applies to civic leagues and social welfare organizations. In order to qualify, these organizations must be nonprofit and the organization's net earnings must be devoted only to charitable, educational, or recreational purposes. Civic associations and volunteer fire companies are considered to be social welfare organizations. Some veterans' organizations are also tax exempt under this section of the IRC.

Veterans' organizations originally were tax exempt under IRC § 501(c)(4) as social welfare organizations. However, when some groups began providing insurance benefits to members, the IRC was amended so the income derived from these activities would not be taxed as unrelated business income. As a result, the IRC was amended in 1972 to include a category of tax exempt organization specifically for veterans' organizations.

Many of these organizations in Maryland have reclassified under § 501(c)(19). However, representatives of the Jewish War Veterans have indicated that several of the smaller organizations in Maryland have remained classified under § 501(c)(4) while providing similar services as the organizations classified under § 501(c)(19). Therefore the bill would only apply to veterans' organizations that did not reclassify under § 501(c)(19) such as the Jewish War Veterans and the Military Order of the Purple Heart.

The following is a list of veterans' organizations represented in Maryland: American Ex-Prisoners of War, American Legion, Amvets, Catholic War Veterans, Disabled American Veterans, Fleet Reserve Association, Jewish War Veterans, Marine Corps League, Maryland Military Officers Association of America, Military Order of the Purple Heart, Pearl Harbor Survivors Association, Polish Legion of American Veterans, Veterans of Foreign Wars, Vietnam Veterans of America, Korean War Veterans Association, Black Veterans of All Wars, and Colonial Chapter of the Paralyzed Veterans of America.

State Fiscal Effect: General fund and TTF revenues decrease beginning in fiscal 2011. The amount of the decrease depends on the number of veterans' organizations qualifying for the exemption pursuant to the bill and the amount of tax exempt purchases made by these organizations, neither of which can be reliably estimated.

There are approximately 490 veterans' posts/organizations located in Maryland of which 105 have been issued a sales tax exemption certificate.

The *Tax Expenditures Report for Fiscal Year 2010* estimates the current exemption, which applies to veterans' organizations organized under § 501(c)(19), is worth approximately \$100,000 in fiscal 2010. The bill will increase the revenue loss associated with the exemption by expanding the exemption to veterans' organization organized under § 501(c)(4). The Jewish War Veterans report seven active posts in Maryland, and about 700 members. As noted, the current exemption for veterans organizations organized under § 501(c)(19) expires June 30, 2012.

Chapter 10 of 2008 altered the distribution of sales and use tax revenues by requiring that, for fiscal 2009 through 2013, 5.3% of revenues be distributed to TTF. Beginning in fiscal 2014, the amount distributed to TTF increases to 6.5%. As a point of reference, State sales tax revenues would decrease by \$6,000 for each \$100,000 of tax exempt purchases made by qualified organizations. General funds would decrease by 94.7% (\$5,682) of the total decrease and TTF revenue would decrease by 5.3% (\$318).

Additional Information

Prior Introductions: Senate Bill 898 of 2009 passed the Senate and received a hearing in the House Ways and Means Committee. No further action was taken.

Cross File: SB 237 (Senator Zirkin) - Budget and Taxation.

Information Source(s): Comptroller's Office, Department of Veterans Affairs, Department of Legislative Services

Fiscal Note History: First Reader - February 4, 2010
ncs/hlb

Analysis by: Michael Sanelli

Direct Inquiries to:
(410) 946-5510
(301) 970-5510