

DEPARTMENT OF TAXATION

Fiscal Impact Statement

1. **Patron** Vivian Watts

3. **Committee** House Finance

4. **Title** Taxation in the Commonwealth

2. **Bill Number** HB 978

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

The Department of Taxation ("the Department") understands that the Patron intends to introduce a substitute. This Fiscal Impact Statement is based upon the substitute.

This bill would impose the Retail Sales and Use Tax ("RSUT") on digital personal property delivered electronically, digital services, and several personal and professional services.

The bill would provide for RSUT exemptions for other enumerated services including certain health care services, veterinary services, professional services, Internet access services, and services provided by a person who does not receive more than \$2,500 per year in gross receipts for performance of such services. The bill would also exempt services purchased by nonprofit organizations and services purchased by a homeowners' association or by a landlord for the benefit of his tenant.

The bill would also repeal the service exemptions currently provided for the sale of custom programs and modification of prewritten programs and impose the Communications Sales and Use Tax ("CSUT") on prepaid calling services.

The bill would also exempt food purchased for human consumption and essential personal hygiene products from all state, local, and regional sales taxes. Under current law, food purchased for human consumption and essential personal hygiene products are subject only to the 1 percent local option sales tax.

General Fund revenues generated by imposing the state RSUT on taxable services and digital personal property that are not otherwise dedicated to transportation and education purposes would be distributed to localities on the basis of high-need student population, with the exception of revenue generated by the state RSUT on delivery services which would be distributed to transportation funds based on the location of the service.

Current law provides that most personal and professional services, digital products delivered electronically where no tangible personal property was offered as part of the sale, custom software, modifications to pre-written software, and digital subscription and streaming services are exempt from RSUT. Current law also provides that maintenance

contracts and warranties, the terms of which provide for both repair or replacement parts and repair labor, are subject to tax upon one-half of the total charge for such contracts only.

If enacted during the regular session of the 2026 General Assembly, this bill would become effective July 1, 2026.

6. Budget amendment necessary: Yes.

Items: Page 1: Revenue Estimates
261 and 263, Department of Taxation

7. Fiscal Impact Estimates are: Preliminary. (See Line 8.)

7a. Expenditure Impact:

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Positions</i>	<i>Fund</i>
2026-27	\$117,455	0	GF
2027-28	\$412,200	4	GF
2028-29	\$409,044	4	GF
2029-30	\$416,841	4	GF
2030-31	\$424,794	4	GF
2031-32	\$432,906	4	GF

8. Fiscal implications:

Administrative Costs

The Department requests a delayed effective date of January 1, 2027, due to the system changes required by this legislation and resource commitments associated with the Integrated Revenue Management System (IRMS) replacement project. Changes needed to implement this bill would impact work in progress for the first rollout of the new system scheduled for September 2026. For more information on the new system implementation releases, see the [2025 Status Report on the Replacement of the Integrated Revenue Management System](#) (IRMS).

The Department would incur estimated expenditures as shown above. Such costs would primarily consist of costs associated with four FTEs to ensure compliance with the taxation of services and digital personal property and the related distribution requirements. Changes would also be required to the Department's forms and systems.

Revenue Impact

The table below shows the overall estimated revenue impact of all changes proposed by the legislation:

Total Impact of the Legislation (in millions)

	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031	FY 2032
Digital Products and Services*	\$1,595.8	\$1,803.6	\$1,868.5	\$1,936.6	\$2,007.2	\$2,079.0
Other Taxable Services	\$1,184.1	\$1,341.2	\$1,392.6	\$1,446.1	\$1,501.7	\$1,559.5
Food/Personal Hygiene Products Exemption	(\$290.3)	(\$325.0)	(\$334.4)	(\$344.8)	(\$356.5)	(\$366.5)
Total Impact	\$2,489.5	\$2,819.8	\$2,926.8	\$3,037.9	\$3,152.4	\$3,272.0

* Includes services and digital services (Software application services, computer-related services, website hosting and design, data storage, digital downloads and streaming)

The table below shows the net impact to individual funds:

	2027	2028	2029	2030	2031	2032
General Fund	\$ 1,582.5	\$ 1,793.6	\$ 1,859.3	\$ 1,927.8	\$ 1,999.0	\$ 2,072.0
GF-New Locality Education Transfers	\$ 926.5	\$ 1,051.4	\$ 1,089.6	\$ 1,129.5	\$ 1,170.9	\$ 1,213.3
School-age pop. (60%)	\$ 555.9	\$ 630.8	\$ 653.8	\$ 677.7	\$ 702.5	\$ 728.0
High-need student pop. (40%)	\$ 370.6	\$ 420.6	\$ 435.9	\$ 451.8	\$ 468.4	\$ 485.3
GF-Restricted (Including Transfers)	\$ 656.0	\$ 742.2	\$ 769.6	\$ 798.3	\$ 828.1	\$ 858.7
Non-general Fund	\$ 907.0	\$ 1,026.2	\$ 1,067.5	\$ 1,110.1	\$ 1,153.5	\$ 1,200.0
Transportation	\$ 463.5	\$ 521.9	\$ 541.8	\$ 562.5	\$ 584.0	\$ 606.2
CTF funds (Delivery SUT)	\$ 30.9	\$ 32.6	\$ 34.3	\$ 36.1	\$ 38.0	\$ 40.0
Local Option	\$ 190.3	\$ 218.7	\$ 229.4	\$ 240.1	\$ 250.2	\$ 262.6
Other	\$ 253.2	\$ 285.6	\$ 296.3	\$ 307.6	\$ 319.3	\$ 331.3
WMATA funds (Delivery SUT)	\$ 11.0	\$ 11.6	\$ 12.2	\$ 12.8	\$ 13.5	\$ 14.2
TOTAL	\$ 2,489.5	\$ 2,819.8	\$ 2,926.8	\$ 3,038.0	\$ 3,152.5	\$ 3,272.0

The positive impact to state funds reflects the combined impact of extending the RSUT to digital property and select services. The exclusion of maintenance and cleaning for fleet vehicles and specified memberships from the sales tax base by the substitute may reduce the overall positive revenue gain by an unknown amount. The impact to localities reflects the positive impact to the local option sales tax generated by extending the RSUT to digital property and services, and the offsetting reduction in local revenues from exempting food purchased for human consumption and essential personal hygiene products from the local option sales tax.

Any impact on the CSUT from this bill is expected to be minimal.

9. Specific agency or political subdivisions affected:

Department of Taxation

All localities

10. Technical amendment necessary: No.

11. Other comments:

Retail Sales and Use Tax

Since the Retail Sales and Use Tax was first imposed in 1966, it has been limited to sales of tangible personal property and a few services in connection with the sale of tangible personal property. Specifically, current law provides an exemption from sales tax for the following services:

- Professional, insurance, or personal service transactions which involve sales as inconsequential elements for which no separate charges are made
- Services rendered by repairmen for which a separate charge is made
- Amounts separately charged for labor or services rendered in installing, applying, remodeling, or repairing property sold or rented,
- Transportation charges separately stated
- Separately stated charges for alterations to apparel, clothing and garments
- Charges for gift wrapping services performed by a nonprofit organization

Additionally, custom programs and amounts separately charged for labor or services rendered in connection with the modification of prewritten programs are also exempt from the tax.

Maintenance contracts and warranties, the terms of which provide for both repair or replacement parts and repair labor, are subject to tax upon one-half of the total charge for such contracts only. The current 50 percent taxability rule provides ease of administration for sellers of such contracts as it may be difficult or impossible to determine, at the time of sale, the value of any tangible personal property or taxable service that may accrue to the purchaser during the life of the contract.

Communications Sales and Use Tax

The Communications Sales and Use Tax is levied on the customers of communications services at a rate of five percent. The sale or recharge of a prepaid calling service is currently exempt from the tax. Digital products delivered electronically, such as software, downloaded music, ringtones, and reading materials are also exempt. Revenue from CSUT, after deductions for telephone relay service and franchise fees, is allocated amongst the localities of the Commonwealth based on each locality's pro rata distribution from CSUT revenues in 2010.

Digital Downloads and Streaming

Services not involving an exchange of tangible personal property which provide access to or use of the Internet and any other related electronic communication service, including software, data, content and other information services delivered electronically via the

Internet, are currently exempt from RSUT and CSUT. This exemption currently extends to streaming services.

Food Purchased for Human Consumption and Essential Personal Hygiene Products

Food purchased for human consumption and essential personal hygiene products are subject only to the 1 percent local option sales tax. These items are not subject to the state sales tax, the regional sales tax levied in transportation districts, or the additional local sales tax levied in some localities to pay for school construction.

“Food purchased for human consumption” has the same meaning as “food” defined in the Food Stamp Act of 1977, as amended, and federal regulations adopted pursuant to that Act, except it does not include seeds and plants which produce food for human consumption. “Food purchased for human consumption” does not include food sold by any retail establishment where the gross receipts derived from the sale of food prepared by such retail establishment for immediate consumption on or off the premises of the retail establishment constitutes more than 80 percent of the total gross receipts of that retail establishment, including but not limited to motor fuel purchases, regardless of whether such prepared food is consumed on the premises of that retail establishment.

“Essential personal hygiene products” means (i) nondurable incontinence products such as diapers, disposable undergarments, pads, and bed sheets and (ii) menstrual cups and pads, pantyliners, sanitary napkins, tampons, and other products used to absorb or contain menstrual flow.

Proposal

Retail Sales and Use Tax

This bill imposes RSUT on digital personal property, defined in the bill as a digital product, delivered electronically including software, digital audio and audiovisual products, reading materials, and other data or applications, that the purchaser owns or has the ability to continually access whether by downloading, streaming, or otherwise accessing the content, without having to pay an additional subscription or usage fee to the seller after paying the initial purchase price.

The bill would make the following services subject to RSUT:

- Admissions;
- Charges for recreation,
- Fitness, or sports facilities;
- Nonmedical personal services or counseling;
- Dry cleaning and laundry services;
- Shoe and garment alteration;
- Companion animal care;
- Residential home repair or maintenance services when paid for directly by a resident or homeowner;

- Landscaping, or cleaning services when paid for directly by a resident or homeowner;
- Vehicle and engine repair, except for maintenance and cleaning of vehicles that are rented or part of a commercial fleet;
- Repairs or alterations to tangible personal property;
- Storage of tangible personal property;
- Delivery or shipping services;
- Separately billed travel, event, and aesthetic planning services; and
- Digital services.

The bill would define “digital services” as including (i) software application services, (ii) computer-related services, (iii) website hosting and design, (iv) data storage, and (v) digital subscription services. The bill would define “digital subscription services” as a service, including audio and visual streaming services, that for a fee allows the user to access and use software, reading materials, or other digital data or applications for a defined period of time, and which products the user does not own or have permanent access to outside of such period of time.

The bill would exempt certain services from RSUT, including:

- Health care services that must be performed by a person licensed or certified by the Department of Health Professions or any expense that is considered an expense for medical care under § 213 of the Internal Revenue Code;
- Veterinary services;
- Professional services, including education or training and other professional services as they are defined in § 2.2-4301 of the Code of Virginia.
- Internet access services;
- Services provided by a person who does not receive more than \$2,500 per year in gross receipts for performance of such services;
- Services purchased by a nonprofit organization; and
- Services purchased by a homeowners' association or by a landlord for the benefit of his tenant.
- Payment card payment facilitation services, including credit card interchange fees paid by merchants.

The bill would also repeal the service exemptions currently provided for the sale of custom programs and modification of prewritten programs.

The bill would eliminate the current provision for application of the tax to only one-half of the total charge for maintenance contracts and warranties, the terms of which provide for both repair or replacement parts and repair labor.

The bill would also exempt food purchased for human consumption and essential personal hygiene products from all state, local, and regional sales taxes.

The bill would clarify that non-performing loans or other accounts receivable do not constitute tangible personal property.

The bill would state that a person acting as a common carrier, motor carrier, air carrier, or third-party logistics provider, or performing fulfillment services will not be deemed to be required to register and collect or remit any RSUT on delivery, shipping, freight, transportation, or similar services, provided that the delivery, shipping, freight, transportation, or similar service is furnished as part of a retail sale by another dealer and such dealer shall be responsible for all tax collection and remittance obligations for that sale.

With the exception of revenue generated by the state RSUT on delivery services, General Fund revenues generated by imposing the state RSUT on taxable services and digital personal property that are not otherwise dedicated to transportation and education purposes would be distributed to localities on the basis of high-need student population. Revenue generated by the imposition of RSUT on delivery services in the Northern Virginia Transportation District would be distributed to the Washington Metropolitan Area Transit Authority and all other revenue generated by such tax on delivery services would be distributed to the Commonwealth Transportation Fund. "High-need student population" would be defined as the number of students in a locality who are (1) identified students, as defined in 42 U.S.C. § 1759a or any successor provision; (2) participants in a program of special education established pursuant to Article 2 (§ 22.1-213 et seq.) of Chapter 13 of Title 22.1; or (3) English language learners.

Communications Sales and Use Tax

The bill would also impose CSUT on prepaid calling services. "Digital personal property" would be defined as digital products delivered electronically, including software, digital audio and audiovisual products, reading materials, and other data or applications, that the purchaser owns or has the ability to continually access, whether by downloading, streaming, or otherwise accessing the content, without having to pay an additional subscription or usage fee to the seller after paying the initial purchase price. "Digital subscription services" would be defined as a service, including audio and visual streaming services, which for a fee allows the user to access and use software, reading materials, or other digital data or applications for a defined period of time, and which products the user does not own or have permanent access to outside of such period of time.

If enacted during the regular session of the 2026 General Assembly, this bill would become effective July 1, 2026.

cc : Secretary of Finance

Date: 02/07/2026 AB
HB978F161