DEPARTMENT OF TAXATION
2006 Fiscal Impact Statement

1. Patron Christopher B. Saxman

2. Bill Number HB 1290

House of Origin:
- X **Introduced**
- ____ **Substitute**
- ____ **Engrossed**

Second House:
- ____ **In Committee**
- ____ **Substitute**
- ____ **Enrolled**

3. Committee House Finance

4. Title Machinery and Tools Tax; Valuation

5. Summary/Purpose:

This bill would provide that if the owner of machinery and tools depreciates their value for federal income taxation purposes, localities must value the machinery or tools at their depreciated basis for federal income tax purposes.

Under current law, localities are required to value machinery and tools, other than manufacturers' energy conservation equipment, by means of depreciated cost or a percentage or percentages of original total capitalized cost excluding capitalized interest.

This bill would be effective for tax years beginning on or after January 1, 2007.

6. Fiscal Impact Estimates are: Not available. (See Line 8.)

7. Budget amendment necessary: No.

8. Fiscal implications:

This bill would have no impact on state revenues. The revenue impact on localities is unknown. To the extent that assessments determined using the methods required by this bill differ from assessments determined under currently authorized methods, this bill would impact local revenues.

9. Specific agency or political subdivisions affected:

All localities.

10. Technical amendment necessary: No.

11. Other comments:

Machinery and Tools Tax

Article X, § 2 of the *Constitution of Virginia* provides that all assessments of real estate and tangible property are to be at their fair market value. Article X, § 1 of the *Constitution* provides that all taxes shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax.

Generally, machinery and tools used in manufacturing, mining, water well drilling, processing or reprocessing, radio and television broadcasting, dairy, dry cleaning or a laundry business are segregated as a separate class of tangible personal property and are subject to local taxation only. The tax rate imposed on machinery and tools may not be higher than that imposed on other classes of tangible personal property.

Under current law, localities are required to value machinery and tools, other than manufacturers' energy conservation equipment, by means of depreciated cost or a percentage or percentages of original total capitalized cost excluding capitalized interest. Most localities assess machinery and tools on the basis of original costs, fair market value, or book value. Frequently, a sliding scale is used, with the effective tax rate varying according to the age of the property. All cities except Lexington and Staunton use original cost as a basis of assessment. Of the 94 counties imposing the tax, 88 use original cost. Rappahannock County does not impose the tax. Eighty-two of the towns base their assessment on original costs, while the remainder use fair market value or depreciated costs.

Federal Income Tax Depreciation

The *Internal Revenue Code* (*IRC*) allows taxpayers to deduct a reasonable allowance for the exhaustion, wear and tear of property used in a trade or business. The Modified Accelerated Cost Recovery System (MACRS) applies to tangible personal property generally placed in service after 1986. Under MACRS, the cost of property is recovered over a 3, 5, 7, 10, 15, 20, 27.5, 31.5 or 39 year period, depending on the type of property. The Accelerated Cost Recovery System (ACRS) applies to property placed in service after 1980 and before 1987. Under ACRS, the cost of property is recovered over a 3, 5, 10, 15, 18 or 19 year period, depending on the type of property. Under MACRS or ACRS, taxpayers may use the straight line method, the declining balance method, the sum of the years digits methods, or other consistent methods.

The basis of property is usually its cost. Cost is the amount paid in cash, debt obligations, or other property and services. Cost also includes amounts paid for sales tax, freight, installation and testing, excise taxes, capitalized legal and accounting fees, revenue stamps and recording fees. Under the uniform capitalization rules, all direct costs and an allocable part of most indirect costs incurred due to production and resale activities must be capitalized. Capitalized costs are included in the basis of property rather than deducted. Basis may be decreased by the *IRC* § 179 deduction, the deduction for clean-fuel vehicles, the credit for qualified electric vehicles, the investment credit and the tax credit or refund for buying a diesel powered highway vehicle.

Proposal

This bill would provide that if the owner of machinery and tools depreciates their value for federal income taxation purposes, localities must value the machinery or tools at their depreciated basis for federal income tax purposes as of the assessment date, as reflected on the income tax return of the owner filed for the period that includes the assessment date.

This bill would provide that if requested by the locality, the owner of the machinery or tools would need to report information regarding the depreciated basis of the machinery or tools for federal income tax purposes.

The proposed valuation requirement would not apply to the separate classifications for machinery and tools used in harvesting forest products and for heavy construction machinery.

Other Legislation

Senate Bill 258 would provide that if the owner of machinery and tools depreciates their value for federal income taxation purposes, localities must value machinery or tools placed in service on or after July 1, 2006 at their depreciated basis for federal income tax purposes. Additionally, localities would be required to value machinery or tools placed in service prior to July 1, 2006 partially based on the method currently used in the locality and partially based on their depreciated basis for federal income tax purposes on a sliding scale until the first tax year in which the assessment date is on or after July 1, 2010, when the machinery or tools would be valued at their depreciated basis for federal income tax purposes.

cc : Secretary of Finance

Date: 01/23/2006 JEM