DEPARTMENT OF TAXATION
2006 Fiscal Impact Statement

1. Patron Christopher B. Saxman

2. Bill Number HB 1290

House of Origin:
_____ **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **In Committee**
_____ **Substitute**
__X__ **Enrolled**

3. Committee Passed House and Senate

4. Title Machinery and Tools Tax; Valuation

5. Summary/Purpose:

This bill would provide that when valuing machinery and tools for purposes of the local machinery and tools tax, the locality must, upon written request of the taxpayer, consider any bona fide, independent appraisal submitted by the taxpayer. This bill would also define “idle machinery and tools," which are exempt from local taxation, to be machinery and tools that have not been used for at least three continuous months immediately prior to the date they are returnable for taxation, provided that there is no reasonable prospect that they will return to active use within one year after such date. Additionally, this bill would require the Department of Taxation to convene a working group consisting of local government and industry representatives to consider and report to the Tax Commissioner concerning (1) a uniform method of assessing machinery and tools; (2) uniform criteria for evaluating claims of technological obsolescence; (3) proposed guidelines establishing minimum standards for appraisals of machinery and tools; and (4) a uniform method for classification of idled machinery and tools.

The effective date of this bill is not specified.

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

7. Budget amendment necessary: No.

8. Fiscal implications:

Revenue Impact

This bill would have no impact on state revenues. The revenue impact on localities is unknown. To the extent that localities adjust assessments after considering independent appraisals submitted by taxpayers, this bill would impact local revenues. To the extent that this bill allows additional equipment to be exempted from the machinery and tools tax by decreasing from one year to three months the length of time equipment must be idled in order to be classified as intangible personal property, this bill would decrease local revenues.

Administrative Costs

As the role of the Department of Taxation would be limited to convening the working group studying the assessment of machinery and tools and would not include the provision of staffing for the drafting of its report, the Department of Taxation would not incur any costs implementing this bill.

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 cost, 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 cost, while the remainder use fair market value or depreciated cost.

Intangible Personal Property

Under current law, intangible personal property is a separate class of property segregated for taxation by the Commonwealth. The Commonwealth does not currently tax intangible personal property. Localities are prohibited from taxing intangible personal property. Certain personal property, while tangible in fact, has been designated as intangible and thus exempted from state and local taxation. For example, tangible personal property used in manufacturing, mining, water well drilling, radio or television broadcasting, dairy, dry cleaning or laundry businesses has been designated as exempt intangible personal property.

In the case of a manufacturing business, all personal property except machinery and tools, motor vehicles and delivery equipment used in the manufacturing business are considered to be intangible personal property. Additionally, idled machinery and tools are considered intangible personal property because they are not used in the manufacturing business. As established in a 1950 opinion of the Tax Commissioner, it has been TAX's longstanding policy that, as a general rule, machinery and tools may be considered idle if they have been discontinued in use for as long a period as <u>one year</u> prior to the date they are returnable for taxation, provided there is no reasonable prospect that they will return to an active state within at least one year after such date.

<u>Proposal</u>

This bill would provide that when valuing machinery and tools for purposes of the local machinery and tools tax, the locality must, upon written request of the taxpayer, consider any bona fide, independent appraisal submitted by the taxpayer.

This bill would also expand the definition of "idle machinery and tools" that has been in place for 56 years to include machinery and tools that have not been used for at least <u>three continuous months</u> immediately prior to the date they are returnable for taxation, provided that there is no reasonable prospect that they will return to active use within one year after such date.

This bill would also require the Department of Taxation to convene a working group consisting of representatives of the Virginia Manufacturers Association, the Virginia Poultry Federation, the Printing Industries of Virginia, the Virginia Chamber of Commerce, the Virginia Association of Counties, the Virginia Municipal League, and the Commissioners of the Revenue Association of Virginia, to consider and report in writing to the Tax Commissioner not later than November 1, 2006, as to (1) the feasibility of, and fiscal impacts upon local governments associated with, transitioning to a uniform method of assessment of machinery and tools, and potential assessment methods suitable for uniform statewide application; (2) the feasibility of, and fiscal impacts upon local governments associated with, adopting uniform criteria for evaluating and applying claims of technological obsolescence; (3) proposed guidelines establishing minimum standards for appraisals of machinery and tools submitted to localities; and (4) the feasibility of, and fiscal impact upon local governments associated with, implementing a uniform method for classification of machinery and tools that are idle or stored as capital, and potential classification criteria suitable for uniform statewide application. The report of the working group would be submitted in writing to the Tax Commissioner, with copies to the Chairman of the House Finance Committee and the Chairman of the Senate Finance Committee no later than November 1, 2006.

<u>Similar Legislation</u>

Senate Bill 260 would accomplish the same purpose as this bill. Additionally, Senate Bill 260 would provide a local real and personal property tax exemption for certified pollution control equipment and facilities placed in service on or after July 1, 2006 that consist of equipment used in collecting, processing and distributing or generating electricity from landfill gas or synthetic or natural gas recovered from waste, including equipment used to grind, chip or mulch trees, tree stumps, underbrush and other vegetative cover for reuse as landfill gas or synthetic or natural gas recovered from waste. The Senate Bill 260 working group would also consider the feasibility the feasibility of, and fiscal impacts upon local governments associated with, exemption from local taxation of new investments in certified pollution control equipment and facilities.

cc : Secretary of Finance

Date: 03/22/2006 JEM