DEPARTMENT OF TAXATION
2007 Fiscal Impact Statement

1. Patron Christopher B. Saxman

2. Bill Number HB 2181

House of Origin:

_____ **Introduced**

_____ **Substitute**

_____ **Engrossed**

Second House:

__X__ **In Committee**

_____ **Substitute**

_____ **Enrolled**

3. Committee Senate Finance

4. Title Machinery and Tools Tax

5. Summary/Purpose:

This bill would make the following changes to the local machinery and tools tax:

- Require localities to consider independent appraisals submitted by taxpayers.
- Codify TAX's administrative rulings that idle machinery and tools are to be classified as intangible personal property not subject to local taxation.
- Codify TAX's definition of idle machinery and tools that provides that machinery and tools are idled if they have not been used for at least one year prior to tax day and there is no reasonable prospect that they will be used during the tax year.
- Expand the definition of "idle machinery and tools" to include machinery and tools identified by the taxpayer on or before April 1 as machinery and tools that the taxpayer intends to withdraw from service not later than the next tax day and as to which there is no reasonable prospect that such machinery and tools will be returned to use during the tax year.
- Require TAX to issue guidelines and advisory opinions regarding idle machinery and tools.

The bill also contains an enactment clause stating that its provisions are not intended to be a legislative statement concerning the correct classification and taxation of idle machinery and tools applicable to any prior tax year.

The bill contains an emergency enactment clause stating that it would take effect January 1, 2007.

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

7. Budget amendment necessary: No.

8. Fiscal implications:

Administrative Costs

As the role of TAX would be limited to issuing guidelines and advisory opinions, TAX would incur minimal costs implementing this bill.

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, this bill would decrease 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 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 generally considered intangible personal property because they are not used in the manufacturing business. Some localities, however, consider idle machinery and tools to be subject to tax as salvage, scrap or spare parts.

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 one year 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.

Senate Bill 260 and House Bill 1290 (2006)

The 2006 General Assembly passed Senate Bill 260 and House Bill 1290, which would have codified the administrative rulings holding that idle machinery and tools are classified as intangible personal property not subject to local taxation. These bills would also have defined "idle machinery and tools" as 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. Governor Kaine vetoed them and announced that he would convene a working group to address these issues.

Governor's Working Group

The Governor's working group was co-chaired by the Secretary of Commerce and Trade and the Tax Commissioner. Local governments were represented by the Virginia Municipal League, the Virginia Association of Counties, the Treasurers Association and the Commissioners of Revenue Association, as well as tax administrators from several localities. Manufacturers were represented by the Virginia Manufacturers Association, representatives of several different manufacturers, and tax practitioners. The group met on September 19, 2006, October 27, 2006 and December 15, 2006 and agreed to seek the support of their members for a legislative proposal to clarify the local taxation of machinery and tools.

Proposal

This bill represents the recommendation of the Governor's working group. 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 codify TAX's administrative rulings holding that idle machinery and tools are to be classified as intangible personal property not subject to local taxation. This bill would also codify the definition of idle machinery and tools established by the Tax Commissioner in 1950 that provides that machinery and tools are idled if they have been discontinued in use continuously for at least one year prior to any tax day and there is no reasonable prospect that such machinery and tools will be returned to use during the tax year.

This bill would also provide an additional definition of "idle machinery and tools" for machinery and tools that, on and after January 1, 2007, are specifically identified in writing by the taxpayer on or before April 1 as machinery and tools that the taxpayer intends to withdraw from service not later than the next tax day and as to which there is no reasonable prospect that such machinery and tools will be returned to use during the tax year. The alternate definition is intended to provide a clear cut procedure for machinery and tools to be classified as idle. The nine months notice is intended to give localities sufficient time to adjust their budgets to compensate for revenue loss.

The bill would require taxpayers to notify the locality in writing on or before the next return due date without extension in the event that any machinery and tools defined as idle under this definition are returned to use. Such machinery and tools would be subject to tax in the same manner as if they had been in use on tax day of the year in which such return to use occurs. Interest would apply, but if the taxpayer provides timely written notice of return to use, no penalty would be levied.

The bill contains an emergency enactment clause stating that it would take effect January 1, 2007. The bill also contains an enactment clause stating that its provisions are not intended to be a legislative statement concerning the correct classification and taxation of idle machinery and tools applicable to any prior tax year.

The bill requires TAX to issue guidelines for the use of local governments in applying the provisions of the proposal related to idle machinery and tools on or before January 1, 2008. In preparing such guidelines, TAX would not be subject to the provisions of the Administrative Process Act for guidelines promulgated on or before January 1, 2008, but would be required to cooperate with and seek the counsel of local officials and interested groups. After January 1, 2008, the guidelines would be accorded the weight of a regulation under § 58.1-205 and any amendments to the guidelines would be subject to the Administrative Process Act.

This bill would also authorize TAX to issue advisory written opinions regarding idle machinery and tools and the guidelines required by this bill.

Similar Legislation

House Bill 1937 would create a new classification of intangible personal property for idle equipment, hardware or software, of a research and development, technology, high technology, or nanotechnology business.

Senate Bill 1151 is identical to this bill.

cc : Secretary of Finance

Date: 2/7/2007 JEM
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