DEPARTMENT OF TAXATION
2010 Fiscal Impact Statement

1. Patron Daniel W. Marshall, III

2. Bill Number HB 545
House of Origin:
X **Introduced**
____ **Substitute**
____ **Engrossed**

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

3. Committee House Finance

4. Title Individual Income Tax; Retail Sales and Use Tax; Machinery and Tools Tax; Recycled Materials

5. Summary/Purpose:

This bill would permit the use of the special depreciation allowance under § 168(k) of the Internal Revenue Code ("IRC") for qualified items used in the production, processing, manufacturing, refining, retrieval, transportation or conversion of recycled building materials into articles of tangible personal property for resale. The bill would also provide an exemption from the Retail Sales and Use Tax, beginning July 1, 2010 and ending July 1, 2020 for recycled building materials used in the production, processing, manufacturing, refining, retrieval, transportation or conversion of such materials into articles of tangible personal property for resale, where such industrial materials either enter into production or become a component part of the finished product. In addition, the bill would create a separate classification consisting of machinery and tools used directly in the production, processing, manufacturing, refining, retrieval, transportation or conversion of recycled building materials into articles of tangible personal property for purposes of the machinery and tools tax. Finally, this bill would authorize local governments to provide for local incentives addressing the economic conditions within their localities, in order to stimulate real property improvements and new job creation for a qualified business firm.

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:

<u>Administrative Costs Impact</u>

TAX considers implementation of this bill as routine and does not require additional funding.

Revenue Impact

This bill would result in a revenue loss, the amount of which is unknown. There is no data available on the number of firms or volume of business in Virginia engaged in the production, processing, manufacturing, refining, retrieval, transportation or conversion of recycled building material into articles of tangible personal property.

The corporate income tax provisions would result in an unknown loss to the General Fund, as the amount of qualifying tangible personal property in the Commonwealth is unknown. While the exact types of property that would qualify for "bonus depreciation" allowed under § 168(k) of the Internal Revenue Code (IRC) under this bill is unknown, it was estimated that when Virginia deconformed from the extension of § 168(k) of the IRC, Virginia avoided a potential revenue loss of approximately $116.44 million in Fiscal Year 2010, $8.37 million in Fiscal Year 2011, $23.43 million in Fiscal Year 2012, $19.75 million in Fiscal Year 2013, $16.36 million in Fiscal Year 2014, $11.64 million in Fiscal Year 2015, and $7.54 million in Fiscal Year 2016. These estimates do not consider the percent of Virginia tangible personal property purchased and used in the production, processing, manufacturing refining, retrieval, transportation or conversion of recycled building materials. Therefore, these numbers would represent an upper limit.

The sales and use tax provisions would have no impact on state revenues, as tangible personal property used in the production of goods for resale are exempt from the tax. The machinery and tools tax provisions would reduce local revenues by an unknown amount, depending on whether localities elect to reduce the tax rate on qualifying property.

9. Specific agency or political subdivisions affected:

TAX
All localities

10. Technical amendment necessary: Yes.

As the Retail Sales and Use Tax exemption proposed in this bill overlaps the current exemption for tangible personal property purchased for resale and for industrial materials purchased for future processing, manufacturing, refining, or conversion into articles of tangible personal property for resale, it is not necessary. Accordingly, TAX suggests the following amendment:

Page 3, Line 141,

Strike: Lines 141 through 144.

11. Other comments:

Income Tax

Virginia's conformity to the Internal Revenue Code ("IRC") is currently fixed to the IRC as it existed on December 31, 2008. Since that date, Congress has enacted one significant measure that would affect income taxation in Virginia, the American Recovery and

Reinvestment Act of 2009, which provides a variety of monetary provisions for states and localities to help improve the economy and tax relief for individuals and families.

Virginia does not adopt federal bonus depreciation allowed for certain assets under IRC § 168(k). In addition, Virginia's fixed-date conformity does not include any bonus depreciation that is allowed under IRC § 168(l) (cellulosic biofuel plan property), IRC § 168(m) (reuse and recycling property), IRC § 1400L (New York Liberty Zone property), and IRC § 1400N (Gulf Opportunity Zone property).

This bill would permit the use of the special depreciation allowance under § 168(k) of the IRC for qualified items used in the production, processing, manufacturing, refining, retrieval, transportation or conversion of recycled building materials into articles of tangible personal property for resale.

<u>Retail Sales and Use Tax</u>

Under current law, industrial materials for future processing, manufacturing, refining, or conversion into articles of tangible personal property for resale, where the materials enter into the production of or become a component part of the finished product are exempt from the Retail Sales and Use Tax. Other production items and items of tangible personal property used indirectly in production activities are taxable. In order to claim an exemption, the business must be manufacturing or processing products for sale or resale and the production must be industrial.

This bill would also provide an exemption from the Retail Sales and Use Tax for recycled building materials used in the production, processing, manufacturing, refining, retrieval, transportation or conversion of such materials into articles of tangible personal property for resale, where such industrial materials either enter into production or become a component part of the finished product. The exemption would be available beginning July 1, 2010 and sunset on July 1, 2020. The Retail Sales and Use Tax exemption provided by this bill would overlap the current exemptions for tangible personal property purchased for resale and for industrial materials purchased for future processing, manufacturing, refining, or conversion into articles of tangible personal property for resale.

<u>Machinery and Tools Tax</u>

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 exceed that imposed on other classes of tangible personal property.

As established in a 1950 opinion of the Tax Commissioner, machinery and tools used in the manufacturing business are those machinery and tools (1) actually and directly used in manufacturing processes and (2) those machinery and tools used in the manufacturing business that are necessary in the particular manufacturing business and are used in connection with operation of machinery that is actually and directly used in manufacturing processes.

This bill would create a separate classification consisting of machinery and tools used directly in the production, processing, manufacturing, refining, retrieval, transportation or conversion of recycled building materials into articles of tangible personal property for purposes of the machinery and tools tax. Local governing bodies would be authorized to levy a tax on this class of property at a different rate from the tax levied on other machinery and tools, but the rate could not exceed that applicable generally to machinery and tools.

Certified Recycling Equipment

Under current law, certified recycling equipment, facilities, or devices constitute a separate class of property and localities are authorized to exempt or partially exempt such property. "Certified recycling equipment" is currently defined as machinery and equipment certified by the Department of Waste Management as integral to the recycling process. These items must be for use primarily for abating or preventing pollution of the atmosphere or waters of the state, and used in manufacturing facilities or plant units that manufacture, process, compound, or produce for sale recyclable items of tangible personal property at fixed locations in the state.

The exemption is determined by applying the local tax rate to the value of equipment, facilities or devices and subtracting such amount from the total real property tax due on the realty to which such equipment, facilities or devices are attached. If such equipment, facilities or devices are taxable as machinery and tools, the subtraction is from the total machinery and tools tax due on such equipment, facilities or devices.

This bill would change the definition of "certified recycling equipment" to equipment certified by DEQ, rather than the Department of Waste Management, as integral to the recycling process and would provide that machinery and equipment used in the production, processing, manufacturing, refining, retrieval, transportation or conversion of recycled building materials into articles of tangible personal property for resale, where such industrial materials either enter into production or become a component part of the finished product may constitute recycling equipment, facilities or devices, provided it is certified as such by DEQ. The bill would also require that DEQ promulgate regulations establishing criteria for recycling equipment, facilities, or devices.

Job Creation Incentives

This bill would authorize local governments to provide for local incentives addressing the economic conditions within their localities, in order to stimulate real property improvements and new job creation for a qualified business firm. Local incentives could include reduction of permit fees, reduction of user fees, reduction of business, professional and occupational license taxes, partial exemptions from taxation of substantially rehabilitated real estate and adoption of local enterprise zone development taxation programs. The bill would also render qualified business firms eligible for an enterprise zone job creation grant, an enterprise zone real property investment grant, and a major business facility job tax credit. In addition, the bill would allow for regulatory flexibility, including but not limited to: 1) special zoning districts; 2) permit process reform, exemptions from local ordinances, and public incentives.

The effective date of this bill is not specified.

cc : Secretary of Finance

Date: 2/2/2010 KP
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