DEPARTMENT OF TAXATION
2014 Fiscal Impact Statement

1. Patron James M. LeMunyon

2. Bill Number HB 435

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

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

3. Committee House Finance

4. Title Business, Professional, and Occupational License Tax; Machinery and Tools Tax; Merchants' Capital Tax; Limits on Rates

5. Summary/Purpose:

This bill would provide that a locality may not increase the Machinery and Tools Tax or Business Tangible Personal Property Tax rate or assessment ratio on machinery and tools used in a business higher than the rate and assessment ratio that was applicable on January 1, 2014. The bill also would provide that a locality may not increase the rate or assessment ratio for the Merchants' Capital Tax rate or the Business, Professional and Occupational License ("BPOL") tax or fee rate at a rate or assessment ratio higher than that which was applicable on January 1, 2014. The bill also provides that any locality that elects to impose the BPOL tax on Virginia taxable income may not thereafter impose the tax on gross receipts.

Additionally, effective for taxable years beginning on or after January 1, 2014, but before January 1, 2019, the bill would allow a business to claim a refundable individual or corporate income tax credit in an amount equal to 33 percent of the i) tax paid on machinery and tools used in a business, ii) local BPOL tax or fee, iii) Merchants' Capital Tax, and iv) coal severance license tax paid by the business during the taxable year. Businesses would be required to add back any taxes or fees for which the credit is allowed to the extent that such taxes or fees were subtracted or deducted as a business expense in computing federal adjusted gross income.

Currently, the tax rate imposed on machinery and tools may not exceed that imposed on the general class of tangible personal property. The *Va. Code* limits the rates that localities may impose for the BPOL tax and fee. The maximum rates for the BPOL fee are determined by the population of the locality and the maximum rates for the BPOL tax are determined by the type of business. Localities that imposed a higher rate structure on January 1, 1978 are allowed to continue to impose the tax at those rates. Localities that impose the Merchants' Capital Tax are prohibited from imposing a BPOL tax on merchants. Additionally, the tax must be imposed at a rate that does not exceed the rate or ratio that was in effect in that locality on January 1, 1978.

The effective date of this bill is not specified.

6. **Budget amendment necessary:** Yes.
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7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)
7a. Expenditure Impact:

Fiscal Year	***Dollars***	***Positions***	***Fund***
2013-14	$0	0	GF
2014-15	$480,000	8	GF
2015-16	$570,000	8	GF
2016-17	$580,000	8	GF
2017-18	$590,000	8	GF
2018-19	$600,000	8	GF
2019-20	$620,000	8	GF

8. **Fiscal implications:**

Administrative Costs

The Department would incur administrative costs of approximately $480,000 in Fiscal Year 2015, $570,000 in Fiscal Year 2016, $580,000 in Fiscal Year 2017, $590,000 in Fiscal Year 2018, $600,000 in Fiscal Year 2019, and $620,000 in Fiscal Year 2020. The administrative expenses would include costs for 8 full time employees to administer the compliance and audit program for the refundable credit beginning in Fiscal Year 2015.

Revenue Impact

This bill would allow a business to claim the refundable income tax credit for taxable years beginning on or after January 1, 2014. The credit would sunset on December 31, 2018. This could potentially result in a revenue decrease to the General Fund of approximately $300 million for Fiscal Year 2016, Fiscal Year 2017, and Fiscal Year 2018. There also could be an unknown minimal revenue loss in Fiscal Year 2014 as some individual taxpayers may request the credit in that fiscal year.

To the extent that localities may not increase the rates of the Machinery and Tools Tax or Business Tangible Personal Property Tax on business machinery and tools, the Merchants' Capital Tax, or the BPOL tax or fee in excess of the rate imposed on January 1, 2014, this bill would have an unknown revenue impact on localities. In Fiscal Year 2012, localities generated approximately $683.1 million from the BPOL tax and fee, $11.4 million from the Merchants' Capital Tax, and $204.6 million from the Machinery and Tools Tax.

9. **Specific agency or political subdivisions affected:**

All localities

10. **Technical amendment necessary:** No.

11. Other comments:

Refundable Tax Credits

A taxpayer who claims a refundable tax credit may receive a refund payment from the Department equal to the net excess of their refundable tax credit over their tax liability. The majority of Virginia's tax credits are nonrefundable. Only the Agriculture Best Management Practices Tax Credit for individuals, the Research and Development Expenses Tax Credit, the Coalfield Employment Enhancement Tax Credit, the Virginia Coal Employment and Production Incentive Tax Credit, and the Motion Picture Production Tax Credit are refundable in Virginia.

BPOL Tax

The Business, Professional and Occupational License (BPOL) tax is a tax on businesses for the privilege of engaging in business at a definite place of business within a Virginia locality. The measure or basis of the BPOL tax may either be the gross receipts or the Virginia taxable income of the business. Under current BPOL law, any locality may charge a license fee in an amount not to exceed:

- $50 for any locality with a population of 25,000 and greater
- $30 for any locality with a population smaller than 25,000

The locality may not assess a license tax on gross receipts upon which it charges a license fee. Additionally, the locality may not impose a license tax on a business with gross receipts:

- less than $100,000 in any locality with a population greater than 50,000
- less than $50,000 in any locality with a population of 25,000 but no more than 50,000.

Any business with gross receipts in excess of these thresholds may be subject to license tax at a rate not to exceed the rates set forth below:

- Contracting - sixteen cents per $100 of gross receipts
- Retail sales - twenty cents per $100 of gross receipts
- Financial, real estate and professional services - fifty eight cents per $100 of gross receipts
- Repair, personal and business services, and all other businesses - thirty six cents per $100 of gross receipts.

Localities that imposed a higher rate structure on January 1, 1978 are allowed to continue to impose the tax at those rates.

Machinery and Tools 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 exceed that imposed on the general class 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.

Tangible Personal Property Tax

Under current law, tangible personal property is classified under a number of separate classifications for valuation purposes as well as for rate purposes. Tangible personal property employed in a trade or business is a separate classification of property can be taxed at a rate not to exceed the general rate imposed on tangible personal property. Additionally, localities may value property within the separate classifications provided for valuation purposes differently, so long as each method used is uniform within each category, is consistent with the specified requirements for each separate classification, and may reasonably be expected to determine actual fair market value as determined by the commissioner of the revenue or other assessing official. Tangible personal property employed in a trade or business is also a separate classification of property for valuation purposes and such property must be valued by means of a percentage or percentages of original cost.

Merchants' Capital Tax

The Merchants' Capital Tax is a local option property tax imposed on the inventory, daily rental passenger cars, and all other personal property of merchants except for tangible personal property not for sale as merchandise. As of 2008, the tax was imposed in 46 counties and 7 towns. Localities that impose the tax are prohibited from imposing a BPOL tax on merchants. Additionally, the tax must be imposed at a rate that does not exceed the rate or ratio that was in effect in that locality on January 1, 1978.

Proposal

This bill would provide that a locality may not increase the Machinery and Tools Tax or Business Tangible Personal Property Tax rate or assessment ratio on machinery and tools used in a business higher than the rate and assessment ratio that was applicable on January 1, 2014. The bill also would provide that a locality may not increase the rate or assessment ratio for the Merchants' Capital Tax rate or the Business, Professional and Occupational License ("BPOL") tax or fee rate at a rate or assessment ratio higher than that which was applicable on January 1, 2014. The bill also provides that any locality that elects to impose the BPOL tax on Virginia taxable income may not thereafter impose the tax on gross receipts.

Additionally, effective for taxable years beginning on or after January 1, 2014, but before January 1, 2019, the bill would allow a business to claim a refundable individual or corporate income tax credit in an amount equal to 33 percent of the i) tax paid on machinery and tools used in a business, ii) local BPOL tax or fee, iii) Merchants' Capital Tax, and iv) coal severance license tax paid by the business during the taxable year. The credit would not be allowed for any interest or penalty, including any penalty deemed under law as part of the tax due. To claim the credit, a taxpayer would be required to attach evidence of the payment of the taxes or fees for which the credit is being claimed to his tax return.

If the amount of the credit exceeds the total amount of individual income tax or corporate income tax imposed upon the business for the taxable year, the excess amount of credit would be required to be refunded by the Tax Commissioner for 100 percent of the face value of the excess amount of credit.

Credits granted to a partnership, limited liability company, or electing small business corporation would be required to be allocated to the individual partners, members, or shareholders in proportion to their ownership or interest in such business entities.

Effective for taxable years beginning on or after January 1, 2014, businesses would be required to add back any taxes or fees for which the credit is allowed to the extent that such taxes or fees were subtracted or deducted as a business expense in computing federal adjusted gross income.

The bill would require the Department of Taxation to develop and publish guidelines implementing the provisions of the bill.

The effective date of this bill is not specified.

Similar Legislation

House Bill 371 would require localities to impose the BPOL tax on the Virginia taxable income or net income of a business, rather than on gross receipts beginning in license year 2015.

House Bill 434 would prohibit a locality from increasing the rate of its business machinery and tools tax, merchants' capital tax, and BPOL tax and fees above the locality's rates in effect as of January 1, 2014.

House Bill 497 would allow taxpayers to appeal or request a written ruling from the Tax Commissioner regarding the classification of his business for BPOL tax purposes, regardless of whether the locality has conducted an audit or issued an assessment.

Senate Bill 112 would require the General Assembly to appropriate an amount sufficient to pay on behalf of taxpayers the total amount of BPOL Tax and Machinery and Tools Tax owed to a locality beginning in any calendar year in which the unemployment rate of the locality in the most recent calendar year for which data is available is equal to or greater than twice the statewide average unemployment rate.

cc : Secretary of Finance