

**DEPARTMENT OF TAXATION
2017 Fiscal Impact Statement**

1. **Patron** Ryan T. McDougle
3. **Committee** House Finance
4. **Title** BPOL Tax; Defense Production Businesses

2. **Bill Number** SB 1274
House of Origin:
 Introduced
 Substitute
 Engrossed
- Second House:**
 X **In Committee**
 Substitute
 Enrolled

5. Summary/Purpose:

This bill would clarify that the manufacturing exemption from the Business, Professional, and Occupational License (“BPOL”) fee and tax extends to a manufacturer who is also a defense production business selling manufacturing, rebuilding, repair, and maintenance services at the place of manufacture i) to the United States or ii) for which consent of the United States is required.

Under current law, localities may not impose a BPOL fee or tax on a manufacturer for the privilege of manufacturing and selling goods, wares and merchandise at wholesale at the place of manufacture. *Virginia Code* § 58.1-3853 defines a “defense production business” as a “business engaged in the design, development, or production of materials, components, or equipment required to meet the needs of national defense.”

The effective date of this bill is not specified.

6. **Budget amendment necessary:** No.
7. **Fiscal Impact.** Not Available (See Line 8.)
8. **Fiscal implications:**

To the extent that localities have determined that manufacturers who are also defense production businesses selling manufacturing, rebuilding, repair, and maintenance services at the place of manufacture to the United States, or for which consent of the United States is required, are not selling goods at wholesale and impose the BPOL tax on such sales, this bill would result in a decrease in local revenues. This bill would have no impact on state revenues.

9. Specific agency or political subdivisions affected:

All localities that impose a BPOL tax or fee.

10. Technical amendment necessary: No.

11. Other comments:

Under current law, localities are authorized to impose license taxes upon local businesses. The 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 BPOL tax is currently imposed in all 39 cities, 48 of the 95 counties, and many of the towns of the Commonwealth.

The measure or basis of the BPOL tax generally is the gross receipts of the business. However, current law allows localities to assess the BPOL tax on either gross receipts or the Virginia taxable income of a 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 or 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.

BPOL Tax Manufacturing Exemption

Virginia localities are prohibited from imposing a license fee or tax on a manufacturer for the privilege of manufacturing and selling goods, wares and merchandise at wholesale at the place of manufacture. The Supreme Court of Virginia has developed a test involving three essential elements in determining whether a manufacturing activity is being undertaken. These elements are: (1) original material, referred to as raw material; (2) a process whereby the original material is changed; and (3) a resulting product, which by reason of being subject to such processing, is different from the original material.

The Department recently issued Public Document ("P.D.") 16-118 (June 13, 2016), in which the Tax Commissioner determined that a taxpayer with contracts to rebuild weapon

systems for the federal government was engaged in manufacturing activity. However, the Tax Commissioner also determined that in order to be a manufacturer for BPOL tax and to qualify for the exemption, the business must be i) conducting substantial manufacturing activities, and ii) selling goods, wares, or merchandise at wholesale.

In that case, federal regulations provide that the title of all materials purchased by the taxpayer vested in the federal government when the materials were delivered to the taxpayer and the taxpayer never owned the work in progress or finished goods. The Department determined that, based on these facts and the wording of the contract between the taxpayer and the federal government, the taxpayer could not show that it sold goods at wholesale. Accordingly, even though the taxpayer was engaging in manufacturing activities, the taxpayer did not qualify for the manufacturing exemption from the BPOL tax.

Proposal

This bill would clarify that the manufacturing exemption from the Business, Professional, and Occupational License (“BPOL”) fee and tax extends to a manufacturer who is also a defense production business selling manufacturing, rebuilding, repair, and maintenance services i) to the United States or ii) for which consent of the United States is required.

The effective date of this bill is not specified.

Similar Legislation

House Bill 1889 is identical to this bill, but would not require that the sale take place at the place of manufacture in order to qualify for the exemption.

House Bill 1626 would require localities that impose a requirement that peddlers and itinerant merchants subject to the BPOL Tax display their license on their vehicle or temporary place of business to supply those peddlers and merchants with a decal, sticker, or adhesive label that satisfies the display requirement.

cc : Secretary of Finance

Date: 2/3/2017 VB
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