

**DEPARTMENT OF TAXATION
2011 Fiscal Impact Statement**

1. **Patron** Harry R. Purkey

2. **Bill Number** HB 1636

3. **Committee** House Finance

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

4. **Title** Machinery and Tools Tax

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would reclassify as intangible personal property and exempt from state and local taxation, i) machinery and tools used for business purposes, for the first three years after being brought into the Commonwealth for the first time, and ii) machinery and tools purchased on and after July 1, 2011, for the first three years following the date of purchase. The bill would also reclassify as intangible personal property, machinery and tools that have been in use for at least 10 years and are located in a locality in which the assessed value of the machinery and tools is greater than one percent of the original cost when it was purchased new. The bill would not apply to motor vehicles that are taxed as personal property or machinery and tools or machinery and tools held as inventory for sale.

This is a recommendation of the Governor's Economic Development and Jobs Creation Commission.

The effective date of this bill is not specified.

6. **Budget amendment necessary:** No.

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

8. Fiscal implications:

Administrative Costs Impact

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

Revenue Impact

This bill would have no impact on state revenues. As this bill would exempt certain machinery and tools from local taxation, this bill would have an unknown negative impact on local revenues. A random sample of 8 localities that draw a large share of revenue

from the Machinery and Tools Tax performed by Fiscal Analytics for the Virginia Municipal League concluded that the bill would reduce the tax base for the Machinery and Tools Tax by approximately 50%. Using this analysis, the bill would potentially have a negative revenue impact on localities of approximately \$106.9 million annually. According to the Auditor of Public Account's Comparative Report of Local Government Revenues and Expenditures, local revenues from the machinery and tools tax totaled \$205.9 million in Fiscal Year 2007, \$200.3 million in Fiscal Year 2008, and \$213.7 million in Fiscal Year 2009.

9. Specific agency or political subdivisions affected:

All localities

10. Technical amendment necessary: No.

11. Other comments:

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.

Intangible Personal Property

Under current law, intangible personal property is a separate class of property segregated for taxation by the Commonwealth. Localities are prohibited from taxing intangible personal property.

Certain personal property, while tangible in fact, has been designated as intangible and has been 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. The 1950 opinion of the Tax Commissioner also established TAX's longstanding policy that idled machinery and tools are generally considered intangible personal property because they are not used in the

manufacturing business. The opinion stated that in order to be considered “idle,” machinery and tools must be in “prolonged and indefinite” disuse, not seasonal or occasional disuse, such that the machinery and tools are stored or storage of the machinery and tools would be proper if it were practicable to place the machinery and tools into storage. The opinion stated 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.

House Bill 2181 and Senate Bill 1151 (2007)

House Bill 2181 and Senate Bill 1151 (*Acts of Assembly 2007*, Chapters 191 and 159) provided for the uniform statewide classification and taxation of idle machinery and tools on a prospective basis, effective January 1, 2007. The law codified TAX’s administrative rulings holding that idle machinery and tools are to be classified as intangible personal property not subject to local taxation. The law also codified TAX’s administrative rulings that machinery and tools are to be considered idled if they (1) have been discontinued in use continuously for at least one continuous year prior to any tax day, (2) are not in use on the tax day and (3) no reasonable prospect exists that such machinery and tools will be returned to use during the tax year.

The law also provided an alternate rule for determining that machinery and tools are to be considered idle. The alternate rule requires that on and after January 1, 2007, the machinery and tools (1) be specifically identified in writing by the taxpayer to the commissioner of the revenue or other assessing official on or before April 1 of the current tax year as machinery and tools that will be withdrawn from service before tax day of the next tax year, (2) are not in use on the tax day, and (3) which have no reasonable prospect of being returned to use during the next tax year.

Governor's Economic Development and Jobs Creation Commission

This is a recommendation of the Governor's Economic Development and Jobs Creation Commission. The Commission’s final report contained 50 specific recommendations and identified the BPOL and Machinery and Tools as taxes that placed certain businesses at a competitive disadvantage.

The Commission found that the Machinery and Tools Tax hinders manufacturing in Virginia because, as manufacturers invest in new technologies and equipment, their taxes increase. Several of Virginia’s competitive states have repealed their Machinery and Tools Taxes, including Alabama, Kentucky, North Carolina, South Carolina and Georgia. The Commission determined that Virginia must offer manufacturers a competitive tax environment which will result in job creation and larger capital investment. While the Commission determined that a complete repeal of the Machinery and Tools Tax is in the best interest of both manufacturers and the Commonwealth, the Commission developed this proposal to avoid creating a financial hardship for local governments. This proposal is calculated to motivate industry to purchase new equipment and tools, transfer machinery and tools from out-of-state to Virginia and/or restart idled machinery and tools.

Proposal

This bill would reclassify as intangible personal property and exempt from state and local taxation, i) machinery and tools used for business purposes, for the first three years after being brought into the Commonwealth for the first time, and ii) machinery and tools purchased on and after July 1, 2011, for the first three years following the date of purchase. The bill would also reclassify as intangible personal property, machinery and tools that have been in use for at least 10 years and are located in a locality in which the assessed value of the machinery and tools is greater than one percent of the original cost when it was purchased new. The bill would not apply to motor vehicles that are taxed as personal property or machinery and tools or machinery and tools held as inventory for sale.

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cc : Secretary of Finance

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