

DEPARTMENT OF TAXATION

2016 Fiscal Impact Statement

1. **Patron** James M. LeMunyon

3. **Committee** House Finance

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

2. **Bill Number** HB 217

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would provide that a locality may not increase the rate or assessment ratio of the Machinery and Tools Tax or Business Tangible Personal Property Tax on machinery and tools used in a business, the Merchants' Capital Tax, or the Business, Professional and Occupational License ("BPOL") tax or fee higher than the rate and assessment ratio that was applicable on January 1, 2016. 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.

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:

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, 2016, this bill would have an unknown revenue impact on localities. In Fiscal Year 2014, localities generated approximately \$674.3 million from the BPOL tax and fee, \$11.9 million from the Merchants' Capital Tax, and \$192.5 million from the Machinery and Tools Tax.

This bill would have no impact on state revenues.

9. Specific agency or political subdivisions affected:

All localities

10. Technical amendment necessary: No.

11. Other comments:

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. According to *Virginia Local Tax Rates, 2014*, published by the Weldon Cooper Center for Public Service, all 38 cities, 48 counties and 115 towns currently report imposing the BPOL tax or fee.

Legislation enacted in the 2011 Session of the General Assembly, House Bill 1437 (*Acts of Assembly 2011*, Chapter 685), allowed localities the option to impose the BPOL tax on either the gross receipts or the Virginia taxable income of a business, except for certain public service corporations. The BPOL tax on i) telephone and telegraph companies, ii) water companies, and iii) certain heat, light and power companies is required to be imposed on the gross receipts.. No locality currently imposes the BPOL tax on Virginia taxable income.

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. According to *Virginia Local Tax Rates, 2014*, published by the Weldon Cooper Center for Public Service, 37 cities, 93 counties and 87 towns currently report imposing the Machinery and Tools Tax.

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.

All localities impose a tangible personal property tax.

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. According to *Virginia Local Tax Rates, 2014*, published by the Weldon Cooper Center for Public Service, 44 counties and 10 towns currently report imposing the Merchants' Capital Tax. 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 rate or assessment ratio of the Machinery and Tools Tax or Business Tangible Personal Property Tax on machinery and tools used in a business, the Merchants' Capital Tax, or the Business, Professional and Occupational License ("BPOL") tax or fee higher than the rate and assessment ratio that was applicable on January 1, 2016. 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.

The effective date of this bill is not specified.

Similar Legislation

House Bill 545 and **Senate Bill 218** (similar) would exclude wages, salaries, and other benefits paid by a staffing firm to an independent contractor working on behalf of or for the benefit of the staffing firm's clients pursuant to a professional employer organization services or temporary help services contract from the gross receipts of the staffing firm for the purposes of the BPOL Tax.

cc : Secretary of Finance

Date: 1/15/2016 AM
DLAS File Name: HB217F161

**Commission on Local
Government**

**Estimate of Local Fiscal
Impact**

2016 General Assembly
Session

Bill: HB 217

Patron: LeMunyon
1/20/2016

Date:

In accordance with the provisions of §30-19.03 of the Code of Virginia, the staff of the Commission on Local Government offers the following analysis of the above-referenced legislation:

Bill Summary:

Machinery and tools, merchants' capital, and BPOL taxes; maximum rates established. Prohibits a locality from increasing its business machinery and tools tax, merchants' capital tax, and local license (BPOL) fees and taxes above the locality's rates in effect as of January 1, 2016.

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**Executive Summary:**

HB 217 prohibits the localities from increasing its business machinery and tools tax, merchants' capital tax, and local license (BPOL) fees and taxes above the locality's rate in effect as of January 1, 2016.

Localities have evaluated a negative fiscal impact of \$0.01 - \$13,200,000.00. The provisions of the bill will affect all local governments in some way. Localities that levy for M&T, merchant's capitals, BPOL will be prohibited from increasing the rate and if the localities do not have a new addition in this revenue category, they will lose revenue due to the depreciation of their assets i.e. M&T. Localities with no levy in this category will be prohibited to impose taxes in future. Localities also mentioned that this bill may increase Real Estate taxes as localities may not have another option to raise the revenue that provides the required services to citizen currently provided through taxes eliminated by this legislation.

Additional localities noted that removing the discretion of the locality does not allow for them to consider special circumstance or knowledge of business in their area.

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**Local Analysis:**

**Locality:** Augusta County

**Estimated Fiscal Impact:** \$190,815.00

The estimated fiscal impact figure of \$190,815 above is based on the increase of Augusta County's machinery and tool tax from \$1.90/\$100 to \$2.00/\$100 in 2015. If the current rates become the maximum rates allowable, localities will not be able to increase rates to gain additional revenue in the future. They would need to rely on assessments being stable in order to realize a flat revenue stream. Assessments do change with the market, growth and decline of values, and depreciation. If assessments are less, then the locality would not be able to adjust tax rates to maintain adequate revenues.

A similar argument could be made for BPOL taxes, except the "assessment" would be gross receipts. Augusta's BPOL rates have remained the same for many years, but we have seen a change in revenue due to the rise and decline of the gross receipts, mainly affected by the economy.

Augusta County does not have a merchant's capital tax.

This bill limits the ability of localities to earn revenue based on their own taxing powers. Will the Commonwealth of Virginia hold localities harmless in years when their revenue dips below the

revenue generated based on 1/1/16 rates? The implementation of a local income tax would be an administrative burden, require software changes, etc.

Also, 1/1/16 rates will be set during the FY17 budget process. Localities could choose to raise their rates effective 1/1/16 if the General Assembly passes the bill. This would set the bar higher if the 1/1/16 rates are set in stone going forward. I doubt this was part of their thought process when the bill was proposed.

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Locality: Chesapeake Public Schools **Estimated Fiscal Impact:** \$1.00
No plan to change

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**Locality:** City of Danville **Estimated Fiscal Impact:** \$0.01  
The rates for machinery and tools tax (approx. \$1.2m in revenue) and BPOL (approx. \$4.8m in revenue) have not been raised in many years and staff do not foresee changing these rates. We do not foresee any fiscal impact locking in the rates that have been decided by the locality.  
The City of Danville does not levy a Merchant's Capital Tax.

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Locality: City of Falls Church **Estimated Fiscal Impact:** \$1,000,000.00
This bill would create a financial gap by freezing the BPOL at the current rate given increased costs over time. Over the long term, it would create inequity among neighboring localities, increase competitiveness issues and not hold us revenue neutral.

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**Locality:** City of Harrisonburg **Estimated Fiscal Impact:** \$10,000.00  
The \$10,000 estimated fiscal impact reflects a \$0.01 increase in the City's current MandT tax rate. The City anticipates collecting \$2.1 million in MandT tax in FY 2016.  
The estimated fiscal impact for BPOL is not readily at hand. The City's BPOL rates are currently at the maximum allowed by state code except for the Repair, Personal and Human Services category. The City anticipates collecting \$6.6 in BPOL tax in FY 2016.  
Would be opposed this legislative change.

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Locality: City of Lynchburg **Estimated Fiscal Impact:** \$13,200,000.00
If you really just cap the rate there is no revenue impact but this is critical revenue for localities and if the General Assembly caps it then the next step is to eliminate it or begin to limit new additions.

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**Locality:** City of Martinsville **Estimated Fiscal Impact:** \$1.00  
No way to estimate the future with "what if". I cannot tell what will happen with businesses next week, let alone into the future. But, that being said, of course, if the locality is limited as to what rate they can charge in order to support services it would result in a loss of revenue. The locality knows what it's businesses can afford/withstand better than the far-removed state legislature. This would definitely tie our hands in providing for our citizens the services they are accustomed to and require.

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Locality: City of Norfolk

Estimated Fiscal Impact: \$14,000.00

Should the proposed legislation pass, localities would lose the authority to raise additional revenue beyond the established January 1, 2016 tax rates. Under current law, there is no state maximum tax rate for machinery and tools. The City of Norfolk taxes machinery and tools at a rate of \$4.25 per \$100 of assessed value which generates approximately \$5.7 million. The City of Norfolk's machinery and tools tax rate was last raised in FY 2008 by 25 cents, which generated approximately \$240,000 in additional revenue. Currently, a one-cent increase is worth \$14,000 to the City of Norfolk and a 25 cent increase is worth \$350,000. The proposed bill prevents further increases to the tax rate.

For the City of Norfolk, the business license (BPOL) tax rates are at the state maximum rates. Per state code, localities that impose the merchant's capital tax are prohibited from imposing a BPOL tax on merchants. As such, no fiscal impact to BPOL revenue is expected from the implementation of this bill.

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**Locality:** City of Virginia Beach

**Estimated Fiscal Impact:** \$1.00

The City is concerned about legislation that takes local control of local revenue away from City Council. There is no way to quantify this amount because the legislation prohibits the city from raising the rate, so any potential loss of revenue depends on how much the City Council may have adjusted the rates upward. To put BPOL revenue in perspective, BPOL is estimated at \$46.8 million in FY 2016. We currently do not collect revenue from the business machinery and tools tax because part of our economic development strategy is trying to relocate high tech manufacturers to the City.

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Locality: City of Winchester

Estimated Fiscal Impact: \$95,000.00

The \$95,000 is a 5% increase (standard for the City of Winchester) to our current FY 2016 budget (1.9M). This is a great concern, limiting our local authority to impose taxes as our Council sees the need arise.

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**Locality:** Henrico County

**Estimated Fiscal Impact:** \$21,000.00

For BPOL, this would have no future impact as Henrico has not intention of increasing its BPOL tax rate. The impact listed above is strictly for Machinery and Tools Tax. The impact is based on a relative growth percentage of 3.3 percent in assessments on the current base for machinery and tools tax. Henrico has interpreted this legislation to require depreciation schedules to be adjusted so to not increase the amount collected from prior years. This could prove to be at odds with the Constitution of Virginia as it requires property to be assessed at fair market value and Henrico's depreciation schedules are determined by a third party vendor.

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Locality: Rappahannock County

Estimated Fiscal Impact: \$0.01

We have no BPOL tax and our Machinery Tools and Merchants' Capital tax rates are 0

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**Locality:** Richmond County

**Estimated Fiscal Impact:** \$100,000.00

This impact to this bill will be felt over time, not just in the next budget year. The idea that those in Richmond continue to want to interfere with taxation at the local level is beyond frustrating. All this will do in the long

run is force Real Estate taxes to a higher level, of which they are already high across the state due to the limited resources many small localities have.

Localities have the same checks and balances as the State Government, it is called elections. Our elections are generally more contested than those at the state level. Let local governments act on their own. If they do wrong by the people, the people will certainly make that known in future elections.

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Locality: Spotsylvania County **Estimated Fiscal Impact:**
\$1.00

Prohibits future increases, but doesn't have an impact on revenue currently received.

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**Locality:** Town of Front Royal **Estimated Fiscal Impact:** \$150,000.00

The Town has historically kept our Machinery and Tools tax low to attract industry. The EPA has recently released our Superfund site (160 acres) for industrial redevelopment. Locking these taxes at current rates will keep the Town from generating additional future revenue from the site that we have worked to remediate over the past thirty years.

How will this impact establishing new BPOL classifications in the future?

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Locality: Wise County **Estimated Fiscal Impact:** \$0.01

Wise County will likely never raise the current rates but this bill would eliminate the discretion of the Board of Supervisors to ever do so.