

# DEPARTMENT OF TAXATION

## 2019 Fiscal Impact Statement

1. **Patron** Kathy J. Byron

3. **Committee** House Finance

4. **Title** Machinery and Tools Tax; Definition of Original Total Capitalized Cost

2. **Bill Number** HB 2640

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

**5. Summary/Purpose:**

This bill would add the definition of “original total capitalized cost” to state law regarding to the local taxation of machinery and tools. The definition would make a distinction between machinery and tools acquired in an “arm’s-length transaction,” and those that are not. It further defines when a transaction would be presumed to be an arm’s-length transaction.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

**6. Budget amendment necessary:** No

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

**8. Fiscal implications:**

Administrative Costs

Since this bill addresses a local tax issue, there would be no state administrative costs as a result of the bill. It could, however, result in unknown administrative costs to localities.

Revenue Impact

This bill would have no impact on state revenues but may affect local revenues due to the definition of original capitalized cost.

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

All localities

**10. Technical amendment necessary:** No

## 11. Other comments:

### Machinery and Tools Tax

Article X, § 2 of the Constitution of Virginia provides that all assessments of real estate and tangible property are to be at their fair market value. Article X, § 1 of the Constitution provides that all taxes shall be uniform upon the same class of subjects within the territorial limits of the authority levying the 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 be higher than that imposed on other classes of tangible personal property.

Under current law, localities are required to value machinery and tools, other than manufacturers' energy conservation equipment, by means of depreciated cost or a percentage or percentages of original total capitalized cost excluding capitalized interest. According to the Weldon Cooper Center for Public Service, in Fiscal Year 2016, 37 cities, 91 counties, and 81 towns impose a machinery and tools tax. Most localities assess machinery and tools on the basis of original cost, fair market value, or book value. Frequently, a sliding scale is used, with the effective tax rate varying according to the age of the property. Thirty-six cities use original cost as a basis of assessment. Of the 91 counties imposing the tax, 87 use original cost. Seventy-two of the towns base their assessment on original cost, while the remainder use fair market value or depreciated cost.

### Intangible Personal Property

Under current law, intangible personal property is a separate class of property segregated for taxation by the Commonwealth. The Commonwealth does not currently tax intangible personal property and localities are prohibited from taxing intangible personal property. Certain personal property, while tangible in fact, has been designated as intangible and thus 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.

### Affiliated Group

Under current law, an "affiliated group" is defined as:

1. One or more chains of corporations subject to inclusion connected through stock ownership with a common parent corporation which is a corporation subject to inclusion if:

a. Stock possessing at least eighty percent of the voting power of all classes of stock and at least eighty percent of each class of the nonvoting stock of each of the corporations subject to inclusion, except the common parent corporation, is owned directly by one or more of the other corporations subject to inclusion; and

b. The common parent corporation directly owns stock possessing at least eighty percent of the voting power of all classes of stock and at least eighty percent of each class of the nonvoting stock of at least one of the other subject to inclusion corporations. As used in this subdivision, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends; the phrase "corporation subject to inclusion" means any corporation within the affiliated group irrespective of the state or country of its incorporation; and the term "receipts" includes gross receipts and gross income.

2. Two or more corporations if five or fewer persons who are individuals, estates or trusts own stock possessing:

a. At least eighty percent of the total combined voting power of all classes of stock entitled to vote or at least eighty percent of the total value of shares of all classes of the stock of each corporation; and

b. More than fifty percent of the total combined voting power of all classes of stock entitled to vote or more than fifty percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.

When one or more of the corporations subject to inclusion, including the common parent corporation, is a nonstock corporation, the term "stock" as used in this subdivision shall refer to the nonstock corporation membership or membership voting rights, as is appropriate to the context.

3. Two or more entities if such entities satisfy the requirements in subdivision 1 or 2 of this definition as if they were corporations and the ownership interests therein were stock.

### Proposal

This bill would add the definition of "original total capitalized cost" to state law regarding to the local taxation of machinery and tools. The definition would make a distinction between machinery and tools acquired in an "arm's-length transaction," and those that are not. It further defines when a transaction will be presumed to be an arm's-length transaction.

If the machinery and tools were acquired in an arm's-length transaction, the original total capitalized cost would be the cost of the machinery and tools when acquired by the current owner plus any amount added by the current owner to extend the useful life of the machinery and tools. If the current owner acquired the machinery and tools from anyone other than a member of the current owner's affiliated group, then the acquisition would be presumed to be a bona fide, arm's-length transaction unless the contrary could be shown.

If the machinery and tools were not acquired in an arm's-length transaction, the original capitalized cost would be the prior owner's original total capitalized cost. If the current

owner acquired the machinery and tools from a member of the current owner's affiliated group, then the acquisition would be presumed not to be an arm's-length transaction unless the contrary could be shown.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

cc : Secretary of Finance

Date: 1/19/2019 SK  
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