DEPARTMENT OF TAXATION
2020 Fiscal Impact Statement

1. Patron Emmett W. Hanger, Jr.

2. Bill Number SB 590

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

3. Committee Passed House and Senate

4. Title Tax Incentives for Machinery and Equipment Used for Advanced Recycling

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

5. Summary/Purpose:

This bill would extend the sunset date for the Recyclable Materials Processing Equipment Tax Credit from January 1, 2020 to January 1, 2025. This bill would also expand the credit by making the purchase of machinery and equipment used in advanced recycling eligible for the credit.

This bill would provide that machinery, tools, and materials used in advanced recycling would be exempt from sales tax if the preponderance of their use is in advanced recycling. The bill would further add business primarily engaged in advanced recycling to the list of industries whose machinery and tools are to be segregated and classified as separate from all other classes of property and taxed at a rate no higher than that levied on other classes of personal property.

The provisions of this bill regarding the Recyclable Materials Processing Equipment Tax Credit would be effective for taxable years beginning on and after January 1, 2020. The provisions of this bill regarding the classification of advanced recycling machinery and equipment as qualifying as "machinery and tools" for personal property tax purposes would be effective for taxable years beginning on and after January 1, 2021. If this bill is enacted during the 2020 Regular Session, the provisions of this bill regarding the sales tax exemption for the purchase of advanced recycling machinery and equipment would become effective July 1, 2020.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Preliminary. (See Line 8.)

8. Fiscal implications:

<u>Administrative Costs</u>

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2021. It is unknown to what extent taxpayers would qualify and claim the tax incentives this bill would provide.

The Recyclable Materials Processing Equipment Tax Credit is currently subject to a $2 million credit cap and is oversubscribed. Therefore, taxpayers claiming the credit for Taxable Year 2015 through Taxable Year 2018 received a prorated credit as follows:

Taxable Year	Amount Requested	Amount Granted	Proration Factor
2015	$3,233,219	$2 million	61.86 percent
2016	$3,458,237	$2 million	57.83 percent
2017	$3,405,512	$2 million	58.73 percent
2018	$5,741,141	$2 million	34.84 percent

This bill would not increase the annual credit cap. Therefore, expanding this credit to more taxpayers would not result in a revenue impact.

The sales tax exemption proposed by this bill would have an unknown negative state and local revenue impact. In addition, the classification of advanced recycling machinery and equipment as qualifying as “machinery and tools” for personal property tax purposes would have an unknown impact on localities.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia Department of Environmental Quality
Localities

10. Technical amendment necessary: No.

11. Other comments:

Recyclable Material Processing Equipment Tax Credit

The Recyclable Materials Processing Equipment Tax Credit is an individual and corporate income tax credit for purchases made during the taxable year of machinery and equipment used predominantly in or on the premises of manufacturing facilities or plant units that manufacture, process, compound or produce items of tangible personal property from recyclable materials within Virginia for sale.

The amount of the credit is equal to 20 percent of a taxpayer’s qualifying expenditures, and cannot exceed 40 percent of its Virginia income tax liability for the year. The credit is nonrefundable and nontransferable. Credits in excess of a taxpayer’s income tax liability may be carried forward for up to 10 taxable years.

The credit is subject to an annual credit cap of $2 million.

Sales Tax Exemption

All retail sales of tangible personal property in the Commonwealth are subject to the Retail Sales and Use Tax unless specifically exempted. Although there is currently no exemption specifically for advanced recycling machinery, tools, and equipment, Virginia law provides a broad exemption from the tax for certain tangible personal property when used or consumed by an industrial manufacturer or processor of products for sale or resale. The exemption extends to:

- Industrial materials for future processing, manufacturing, refining or conversion into tangible personal property for resale, where the materials enter into the production of or become a component part of the finished product;

- Industrial materials coated upon or impregnated into the product being processed, manufactured, refined or converted for resale;

- Machinery or tools, and their repair and replacement parts, fuel, power, energy or supplies used directly in processing, manufacturing, refining, mining or converting products for sale or resale; and

- Materials containers, labels, sacks, cans, boxes, drums or bags for future use for packaging tangible personal property for shipment or sale.

- The exemption applies only to those items for direct use in producing products for sale or resale. Other production items and items of tangible personal property used indirectly in production activities are deemed subject to the tax. If an otherwise exempt item of tangible personal property is put to use in two different activities, one of which is an immediate part of the industrial production process and the other of which is not, the sales and use tax applies in full when the preponderance of the item's use (fifty percent or more) is in non-exempt activities. The item is totally exempt from tax if the preponderance of its use is in exempt production activities.

The manufacturing exemption is limited to processes deemed "industrial in nature," which include those businesses classified in codes 10 through 14 and 20 through 39 published in the Standard Industrial Classification ("SIC") Manual. Plants, factories, or mills, and other operations where production activities generally are carried on for the wholesale market, rather than for direct sale to domestic consumers are considered "industrial in nature." Furthermore, the determination of whether an operation is 'industrial in nature' must be made without regard to factors relating principally to size, such as the size of the plant or the finished product inventory, the capital investment amount, the degree of mechanization, or the number of employees.

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 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. 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. All 37 cities levying the tax use original cost as a basis of assessment except Falls Church. Of the 92 counties imposing the tax, 88 use original cost. Rappahannock County does not impose the tax. Seventy-four of the towns base their assessment on original cost, while the remainder use fair market value or depreciated cost.

Sunset Dates for Income Tax Credits and Sales Tax Exemptions

Section 3-5.14 of the Appropriation Act provides that the General Assembly may not advance the sunset date for any existing income tax credit or sales tax exemption beyond June 30, 2022. Any new income tax credit or sales tax exemption enacted by the General Assembly prior to the 2021 Session must have a sunset date not later than June 30, 2022. This requirement does not apply to sales tax exemptions related to nonprofit entities or to income tax credits or sales tax exemptions with sunset dates after June 30, 2022 that were enacted or advanced during the 2016 Session.

Proposed Legislation

Changes to the Recyclable Materials Processing Equipment Tax Credit

This bill would extend the sunset date for the Recyclable Materials Processing Equipment Tax Credit from January 1, 2020 to January 1, 2025. This bill would expand the credit by making the purchase of machinery and equipment used in advanced recycling eligible for the credit.

"Advanced recycling" would be defined as the operation of a single-stream or multi-stream recycling plants that convert waste materials into new materials for resale by processing them and breaking them down into their raw constituents. This includes the operation of a materials recovery facility or materials reclamation facility that receives, separates, and prepares recyclable materials for sale to end-user manufactures.

Sales Tax Changes

This bill would also provide that machinery, tools, and materials used in advanced recycling would be exempt from sales tax if the preponderance of their use is in advanced recycling.

Machinery and Tools Tax Changes

The bill would further add business primarily engaged in advanced recycling to the list of industries whose machinery and tools are to be segregated and classified as separate from all other classes of property and taxed at a rate no higher than that levied on other classes of personal property.

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cc : Secretary of Finance

Date: 2/27/2020 RWC
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