

GUIDELINES FOR THE LOCAL TAXATION OF IDLE MACHINERY AND TOOLS

January 1, 2008

House Bill 2181 and Senate Bill 1151 (Chapters 191 and 159, *Acts of Assembly 2007*) provide for the uniform statewide classification and taxation of idle machinery and tools on a prospective basis, effective January 1, 2007. Nothing in the new law or in these guidelines is intended to be a statement concerning the correct classification and taxation of idle machinery and tools applicable to any tax year beginning prior to January 1, 2007.

These guidelines are published by the Department of Taxation ("TAX") to provide guidance to taxpayers and local governments regarding the new law. TAX has worked with affected taxpayers and local governments to develop these guidelines. After January 1, 2008, these guidelines will be accorded the weight of a regulation under *Code of Va. § 58.1-205* and any amendments to the guidelines will be subject to the Administrative Process Act. These guidelines are available in an electronic format on TAX's web site, www.tax.virginia.gov.

Background

Machinery and Tools Tax

Machinery and tools used in a manufacturing, mining, water well drilling, processing or reprocessing, radio or television broadcasting, dairy, dry cleaning or laundry business are segregated as a class of tangible personal property and subject to local taxation only. The tax rate imposed on machinery and tools by the locality may not exceed that imposed on the general class of tangible personal property in the locality. (Source: *Code of Va. § 58.1-3507*)

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 apply a tax rate to intangible personal property. Localities are prohibited from taxing intangible personal property.

Certain personal property, while tangible in fact, has been designated in the Code of Virginia 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 that is not machinery and tools 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

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considered to be intangible personal property. (Source: *Code of Va.* § 58.1-1100 and 1101)

TAX's 1950 Opinion

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.

The opinion 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. 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

Effective Date

House Bill 2181 and Senate Bill 1151 contain an emergency enactment clause providing that they are effective as of January 1, 2007. Additionally, the new law contains an enactment clause stating that its provisions, other than a provision allowing taxpayers to submit independent appraisals to the local assessing officer, are intended to provide uniform statewide statutory classification and taxation for idle machinery and tools on a prospective basis. This enactment clause states that these provisions are not intended to be either declaratory of existing law or a change from existing law concerning the classification and taxation of idle machinery and tools applicable to any tax year commencing prior to January 1, 2007. Accordingly, these Guidelines are not intended to be applicable to any tax year commencing prior to January 1, 2007

Independent Appraisals

The new law requires any commissioner of the revenue, director of finance, or any other officer of any county, city, or town performing any or all of the duties of a commissioner of the revenue to consider, upon the written request of the taxpayer, any bona fide, independent appraisal submitted by the taxpayer when valuing machinery and tools for purposes of the machinery and tools tax. (Source: *Code of Va.* § 58.1-3507 B)

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For the purposes of these Guidelines, a bona fide, independent appraisal is a good faith opinion of value determined by a third party appraiser with no affiliation with the taxpayer and no vested interest in the value of the property. The opinion of value by the appraiser must be unbiased and objective. An appraisal conducted by any third-party on a contingency basis is not a bona fide, independent appraisal.

The locality may take into account the relevant education, professional credentials, experience, licenses or certificates held, and other appropriate factors when considering the appraiser's opinion of value.

Fair Market Value

Article X, §§ 1 and 2 of the *Constitution of Virginia* provide that all property, unless specifically exempted within the provisions of the *Constitution*, shall be taxed at a uniform rate among classes, and that "all assessments of real estate and tangible personal property shall be at their fair market value to be ascertained as prescribed by general law." The Virginia Supreme Court has defined fair market value as the "sales price when offered for sale by one who desires, but is not obliged, to sell it, and is bought by one who is under no necessity of having it." *Keswick Club, L.P. v. County of Albemarle*, 273 Va. 128, 136, 639 S.E.2d 243, 247 (2007), quoting *Tuckahoe Women's Club v. City of Richmond*, 119 Va. 734, 737, 101 S.E.2d 571, 574 (1958).

The Virginia Supreme Court has consistently stated that

"[t]he 'fair market standard', as required by the Constitution, has been the subject of countless decisions, editorials and articles. It has had the consideration of the General Assembly, the courts, the State Corporation Commission and numerous study commissions. All recognize that assessment of property is not an exact science. The value of land, buildings and tangible personal property is dependent upon many factors which cannot be prescribed by any general rule.... The courts, in trying to resolve this problem, while recognizing the general custom of undervaluing property and the difficulty of enforcing the standard of true value, have sought to enforce equality in the burden of taxation by insisting upon uniformity in the mode of assessment and in the rate of taxation." *Norfolk and Western Ry. Co. v. Commonwealth*, 211 Va. 692, 694-695, 179 S.E.2d 623, 625 (1971); See also *Southern Ry. Co. v. Commonwealth*, 211 Va. 210, 176 S.E.2d 578 (1970); *Washington Bank v. Washington Co.*, 176 Va. 216, 10 S.E.2d 515 (1940); *Skyline Swannanoa, Inc. v. Nelson County*, 186 Va. 878, 44 S.E.2d 437 (1947); *Green v. Louisville and Interurban R.R. Co.*, 244 U.S. 499, 37 S. Ct. 673 (1917).

Code of Va. § 58.1-3103 requires that each commissioner of the revenue, director of finance, or any other officer of any county, city, or town performing any or all of the duties of a commissioner of the revenue to "ascertain and assess, at fair market value, all subjects of taxation in his county or city." *Code of Va.* § 58.1-3503 allows for

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differing methods of valuation to determine the fair market value of tangible personal property, “so long as each method used is uniform within each category, is consistent with requirements of this section and may reasonably be expected to determine actual fair market value as determined by the commissioner of revenue or other assessing official.”

During administrative appeals of machinery and tools tax, assessments are deemed *prima facie* correct. (Source: *Code of Va.* § 58.1-3983.1 (B)(4))

Idle Machinery and Tools to be Classified as Intangible Personal Property

The new law codifies TAX’s administrative rulings holding that idle machinery and tools are to be classified as intangible personal property not subject to local taxation. (Source: *Code of Va.* § 58.1-3507 A) As idle machinery and tools are classified as intangible personal property, they should not be subject to local taxation as salvage, surplus, spare parts or other non-active “uses.”

Basic Definition for Idle Machinery and Tools

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. (Source: *Code of Va.* § 58.1-3507 D) Once machinery and tools are considered idle, they shall be considered idle until such time as they are returned to service. In the event that such machinery and tools are returned to use, they shall not be subject to tax until the next tax year.

Alternate Definition for Machinery and Tools to be Considered Idle

The new law also provides 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. (Source: *Code of Va.* § 58.1-3507 D) Once machinery and tools are considered idle, they shall be considered idle until such time as they are returned to service.

Taxpayers using the alternate definition to have machinery and tools considered idle must follow any procedures that the locality establishes for notifying it by April 1 of the current tax year that specific machinery or tools will be withdrawn from service before tax day of the next tax year. If not, the locality may refuse to treat the machinery or tools as idle. If the locality has not established procedures for this notification, the taxpayer must provide written notification to the commissioner of the revenue or other

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assessing official by April 1 of the current tax year. The notification must contain the following information:

- Taxpayer's legal name and any trade name;
- Taxpayer's contact information, including address and phone number;
- Taxpayer's federal employer identification number;
- Specific identification of the machinery and tools that will be withdrawn from service before tax day of the next tax year;
- A statement that the machinery and tools will be withdrawn from service prior to tax day of the next tax year and that there is no reasonable prospect of them being returned to use during the next tax year; and
- Location of the idle machinery and tools.

Taxpayers using the alternate definition of idle machinery and tools are required to notify the commissioner of the revenue or other assessing official in writing on or before the next return due date without extension in the event that the machinery and tools are returned to use. Such machinery and tools are then subject to tax in accordance with the procedures provided in *Code of Va. § 58.1-3903* in the same manner as if they had been in use on tax day of the year that the return to use occurs. Any interest otherwise payable pursuant to applicable law or ordinance shall apply to such taxes paid after the due date, without regard to the fault of the taxpayer or lack thereof. Notwithstanding the provisions of *Code of Va. § 58.1-3903*, if the taxpayer has provided timely written notice of return to use, no penalty shall be levied with respect to any tax liability arising as a result of the return to use of machinery and tools classified as idle and actually idle prior to such return to use. (Source: *Code of Va. § 58.1-3507 E*)

Examples

Example 1. On tax day, January 1, 2007, Manufacturer owns machinery and tools that have been idle on and after January 1, 2006. There is no reasonable prospect that the machinery will be returned to use by January 1, 2008. For tax year 2007, the machinery is considered idle and will not be subject to the machinery and tools tax.

Example 2. Same facts as Example 1. Manufacturer unexpectedly returns the machinery to use on June 1, 2007. As there was no reasonable prospect that the machinery would be returned to use by January 1, 2008 and the machinery was considered idle on tax day of 2007, it is not subject to tax, penalty or interest for tax year 2007. The machinery will be subject to the machinery and tools tax in tax year 2008.

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Example 3. On tax day, January 1, 2008, Manufacturer owns machinery that is currently in use. Manufacturer intends to withdraw the machinery from service before January 1, 2009. There is no reasonable prospect that the machinery will be returned to use by January 1, 2010. Manufacturer properly notifies its local assessing official on or before April 1, 2008. For tax year 2009, the machinery will be considered idle and will not be subject to the machinery and tools tax unless the machinery is returned to use during the tax year. If the machinery is returned to use during the tax year, the Manufacturer is liable for the tax for tax year 2009 and interest on the tax. If, on or before the due date without extension for its 2010 machinery and tools tax due date, the Manufacturer notifies the locality that the machinery has been returned to use, it is not subject to a penalty for tax year 2009.

Example 4. Same facts as Example 3. Manufacturer does not notify the locality that the machinery has been returned to use before the tax return due date for taxable year 2010. The machinery is subject to the machinery and tools tax for taxable year 2009 and Manufacturer is liable for any interest on the tax. Manufacturer is also subject to a penalty.

Tax Commissioner's Authority to Issue Guidelines and Advisory Opinions

The new law requires TAX to promulgate guidelines for the use of local governments in applying the provisions of the new law related to idle machinery and tools prior to January 1, 2008. In preparing these guidelines, TAX is not subject to the provisions of the Administrative Process Act (*Code of Va. § 2.2-4000 et seq.*) for guidelines promulgated on or before January 1, 2008, but is required to cooperate with and seek the counsel of local officials and interested groups. After January 1, 2008, such guidelines shall be accorded the weight of a regulation under *Code of Va. § 58.1-205* and any amendments to these guidelines shall be subject to the Administrative Process Act. The new law also authorizes TAX to issue advisory written opinions in specific cases to interpret the provisions of the new law related to idle machinery and tools and the guidelines. However, TAX shall not be required to interpret any local ordinance. The guidelines and opinions shall not be applicable as an interpretation of any other tax law. (Source: *Code of Va. § 58.1-3507 F and G*)

Recordkeeping

Commissioners of the revenue are authorized to require taxpayers or their agents or any person, firm or officer of a company or corporation to furnish information relating to tangible or intangible personal property of any and all taxpayers and require such persons to furnish access to books of account or other papers and records for the purpose of verifying the tax returns of such taxpayers and procuring the information necessary to make a complete assessment of any taxpayer's tangible and intangible personal property for the current tax year and the three preceding tax years. (Source: *Code of Va. § 58.1-3109*)

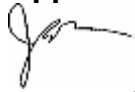
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Any person who refuses to (i) furnish to the commissioner of the revenue access to books of account or other papers and records, (ii) furnish information to the commissioner of the revenue relating to the assessment of taxes, (iii) answer under oath questions touching any person's tax liability, or (iv) exhibit to the commissioner of the revenue any subject of taxation liable to assessment by the commissioner of the revenue, is guilty of a Class 3 misdemeanor. Each day's refusal to furnish such access or information constitutes a separate offense. No person other than the taxpayer shall be convicted of this offense unless he has willfully failed to comply with a summons properly issued under *Code of Va. § 58.1-3110*. (Source: *Code of Va. § 58.1-3111*)

Additional Information

These guidelines and advisory opinions and ruling concerning the machinery and tools tax are available on-line in the Tax Policy Library section of TAX's web site, located at www.tax.virginia.gov.

Approved:



Janie E. Bowen
Tax Commissioner

January 1, 2008