

Rulings of the Tax Commissioner

Document Number: 14-12
Tax Type: Machinery Tools Tax
Brief Description: Taxation of Machinery and Tools/Idle Equipment/ Exemptions
Topics: Exemptions; Local Taxes Discussion; Manufacturing; Property Subject to Tax; Records>Returns/Payments; Taxpayers' Remedies
Date Issued: 01/27/2014

January 27, 2014

Re: Appeal of Final Local Determination

Taxpayer: *****

Locality Assessing Tax: *****

Machinery and Tools Tax

Dear *****:

This final state determination is issued upon the application for correction filed by you on behalf of ***** (the "Taxpayer") with the Department of Taxation. You appeal the assessments of Machinery and Tools (M&T) tax issued to the Taxpayer by the ***** (the "County") for the 2008 through 2010 tax years.

The M&T tax is imposed and administered by local officials. *Virginia Code* § 58.1-3983.1 authorizes the Department to issue determinations on taxpayer appeals of machinery and tools tax assessments. On appeal, the machinery and tools tax assessment is deemed *prima facie* correct, *i.e.*, the local assessment will stand unless the taxpayer proves it is incorrect.

The following determination is based on the facts presented to the Department summarized below. The *Code of Virginia* sections and public documents cited are available on-line in the Laws, Rules and Decisions section of the Department's web site, located at www.tax.virginia.gov.

FACTS

The Taxpayer, a manufacturer located in the County, filed amended M&T tax returns for the 2008 through 2010 tax years. It requested the removal of certain equipment included on the original returns as machinery and tools. The County declined to remove all of the equipment.

The Taxpayer filed an appeal with the County. The County agreed to remove some

machinery and tools from the assessment, but upheld its assessment of the equipment at issue. The Taxpayer appeals the County's final determination, contending that certain equipment at issue was not subject to the M&T tax because it was not used in the manufacturing process, idle, or exempt pollution control equipment.

ANALYSIS

Taxation of Machinery and Tools

All tangible personal property, unless declared intangible under the provisions of *Va. Code* § 58.1-1100 *et seq.*, is reserved for local taxation by Article X § 4 of the Constitution of Virginia. Included in the category of tangible property that is declared intangible and subject to state taxation only is "[c]apital which is personal property, tangible in fact, used in manufacturing (including, but not limited to, furniture, fixtures, office equipment and computer equipment used in corporate headquarters)" See *Va. Code* § 58.1-1101 A 2.

The machinery and tools, motor vehicles and delivery equipment of a manufacturing business are not defined as intangible personal property. Such property is to be taxed locally as tangible personal property. Virginia has elected to create a separate classification of tangible personal property for machinery and tools used in manufacturing. *Virginia Code* § 58.1-3507A also provides:

Machinery and tools . . . used in a manufacturing . . . business shall be listed and are hereby segregated as a class of tangible personal property separate from all other classes of property and shall be subject to local taxation only.

Used in Manufacturing

In *City of Winchester v. American Woodmark*, 250 Va. 451, 458, 464 S.E.2d 148, 152 (1995), the Virginia Supreme Court (the "Court") stated, "Since 1950, the Tax Commissioner has opined that the phrase 'machinery and tools' contained in *Va. Code* § 58.1-1101 A 2 and its precursors, means machinery used in the actual process of manufacturing." The Court also cited previous opinions of the Attorney General in deriving the meaning of "used in manufacturing."

In *The Daily Press, Inc. v. County of Newport News*, 265 Va. 304, 576 S.E.2d 430 (2003), the Court amplified the principles set forth in *American Woodmark*:

The principle gleaned from *American Woodmark* can be simply stated: personal property that may be essential to the overall operations of a

manufacturing business is not 'machinery and tools' subject to local taxation unless the property is actually and directly used in the manufacturing process where new materials are transformed into a substantially different product or the property is connected with the operation of machinery actually and directly used in the manufacturing process. 265 Va. 304, 311.

The Attorney General has consistently opined that "machinery and tools" used in a particular manufacturing business are the machinery and tools that are necessary in the particular manufacturing business and which are used in connection with the operation of machinery that is actually and directly used in the manufacturing process. *Id.*, citing 1985-1986 Att'y. Gen. Ann. Rep. 316 at 317; see also 1987-1988 Att'y. Gen. Ann. Rep. 590. *Id.*

This language does not imply that each piece of machinery or each tool used directly in the manufacturing process must be directly connected to the complete transformation of a material into something substantially different in character. In Public Document (P.D.) 04-39 (8/2/2004), the Department found equipment and tools that did not directly transform or even touch the product being produced could be used directly in the manufacturing process. The question, therefore, is not whether a particular piece of machinery transforms a product, but whether such machinery or tool is used directly in a manufacturing process.

Coal Silo

The Taxpayer contends that the coal silo was not used in connection with any machinery used in its manufacturing process. The County determined that the coal silo was an integral part used in manufacturing the product.

Machinery and tools used in a pre-production process not directly used in manufacturing are considered intangible property not subject to the M&T tax. See *Daily Press, Inc.* and P.D. 06-79 (8/23/2006). The silo was used to store raw coal. The coal was loaded by a bucket loader on to a conveyor belt where it was used to fire up an industrial kiln. The silo was not connected to any machinery used in the production process. The raw coal could be placed on a pile on the ground in lieu of using the silo.

Fire Safety Equipment

The Taxpayer contends that certain fire safety equipment was not used in connection with any machinery used in its manufacturing process. The County determined that the fire safety equipment consisted of integral parts used in manufacturing the product.

Machinery that is integrated or built into equipment directly used in the

manufacturing process is classified as machinery and tools. See P.D. 10-26 (3/31/2010). The fire safety equipment was used to monitor the oxygen and temperature levels in the coal silo. When the temperature levels exceed certain thresholds, the equipment will introduce carbon dioxide to smother any fires. The fire safety equipment was built into the kiln system. Without this equipment, the kiln which was used in manufacturing could not be operated safely.

Idle Equipment

Under *Va. Code* § 58.1-3507 A, idle machinery and tools are not subject to the M&T tax. *Virginia Code* § 58.1-3507 D provides two tests for determining whether machinery and tools may be classified as idle. Under the statute, machinery and tools will be considered idle if:

1. The machinery and tools have been discontinued in use continuously for at least one year, prior to any tax day, such machinery and tools are not in use on the tax day, and no reasonable prospect exists that the machinery and tools will be returned to use during the tax year; or
2. On or after January 1, 2007, a taxpayer provides a written statement to the locality, on or before April 1, identifying the machinery and tools that a taxpayer intends to remove from service no later than the next tax day, the machinery and tools are not in use on the tax day, and no reasonable prospect exists that the machinery and tools will be returned to use during the next tax year.

The first test and second test are referred to as the one-year test and the notification test, respectively. See Public Document (P.D.) 11-84 (6/2/2011) and P.D. 12-177 (11/5/2012). The Taxpayer contends that the portable mixer was idle machinery for the 2010 tax year and that a roll press was idle machinery for the 2008 through 2010 tax years. The County concluded that the equipment at issue were not idle because the Taxpayer never gave written notice that the equipment was being removed from service. The Taxpayer acknowledges that written notice was not given to the County, but argues that the one-year test is applicable to the portable mixer and roll press machine.

In its initial appeal, the Taxpayer asserted that the portable mixer was disassembled and out of service when it arrived at the County facility and has remained idle throughout the 2008 through 2010 tax years. Subsequently, in conjunction with requests for documentation by the Department, information has been provided indicating the portable mixer was rented to an independent third party in 2008 and was not transferred to the Taxpayer until October 2008. Based on this information, the Taxpayer is amending its claim that the portable mixer was idle only in 2010. It argues that there was no reasonable expectation that it would be returned to service during 2010 because of the economic downturn in 2008.

The Taxpayer has also provided documentation that appears to show a roll press machine has been out of service since 2005. The Taxpayer asserts that it became too costly to operate the machine because of increased maintenance costs and poor operational performance.

Tax Day

In its amended appeal, the Taxpayer contends that a portable mixer was not subject to the M&T tax for the 2008 tax year because it was not located in the County as of the 2008 tax day. Under *Va. Code* § 58.1-3511 A, the situs for the assessment and taxation of machinery and tools is in all cases the locality in which the property is physically located on the tax day. *Virginia Code* § 58.1-3515 provides that the tax day is January 1 of each year. The portable mixer was purchased by a Taxpayer related entity in 2006 and was shipped to ***** (State A). The related entity leased the mixer to an unrelated company located in ***** (County A) from May 2008 through October 2008. It was then transferred to the Taxpayer and moved to the Taxpayer's facility located in the County.

The evidence appears to indicate that the portable mixer was not situated at the Taxpayer's facility on January 1, 2008. This raises a question as to how the mixer could have been reported on the Taxpayer's original property tax return. The County's ordinance requires returns to be filed by April 15, but the information provided indicates the Taxpayer did not receive the property until October 2008. Such apparent inconsistencies raise doubts regarding the accuracy and reliability of the Taxpayer's accounting records.

Pollution Control Exemption

Under *Va. Code* § 58.1-3660, certified pollution control equipment and facilities are defined to be a separate class of real or personal property for purposes of local taxation. For tax years beginning on or after January 1, 2011, *Va. Code* § 58.1-3660 A exempts such property from local taxation. See Chapter 671, 2009 *Acts of Assembly*. Prior to the legislative change, the governing body of any locality was authorized to exempt or partially exempt certified pollution control equipment and facilities from local taxation.

For tax years prior to January 1, 2011, pollution control equipment was only exempt to the extent permitted by local ordinance. Such ordinances would govern how a locality would respond to a refund request by a taxpayer. If a locality did not have an ordinance exempting or partially exempting pollution control equipment property from local taxation, no exemption would be granted and no refund of property tax would be required.

Because the tax years at issue are prior to January 1, 2011, and the County did not have an ordinance exempting pollution control equipment, the County contends that the Taxpayer's pollution control equipment was not exempt from the M&T tax. The

Taxpayer argues that the pollution control equipment was exempt from the M&T tax because it was not used in manufacturing.

The pollution control equipment at issue was certified to abate or control atmospheric pollution or contamination. In P.D. 08-88, the Department held that pollution control equipment not used in manufacturing is not machinery and tools. However, a determination as to whether pollution control equipment was connected with the operation of machinery actually and entirely used in the manufacturing process is a factual matter. See P.D. 11-110 (6/17/2011) and 1987-1988 Op. Va. Att'y Gen. 590. Pollution control equipment is used in the manufacturing process when the waste product captured by the equipment is recycled and reused in the manufacturing process. See P.D. 11-110 and P.D. 04-39 (8/2/2004). In this case, it is not clear whether any waste captured by the Taxpayer's pollution control equipment is used in the manufacturing process.

DETERMINATION

The Department has met with the Taxpayer and the County, and has considered all of the evidence provided in this case. Based on the information provided, the coal silo was not used in manufacturing and, as such, was intangible property subject to state taxation only. The fire suppression equipment, however, was used in the manufacturing process for the purpose of safely operating the machinery and, therefore, was subject to the M&T tax.

Regarding the portable mixer, the County should verify the mixer was listed on the Taxpayer's original 2008 property tax return before considering the Taxpayer's request for an adjustment to the assessment. While the evidence appears to show the portable mixer was not physically present in the County as of the 2008 tax day, documentation may be needed to determine why the mixer was listed as property on January 1, 2008 when it was not received until October 2008.

The information provided also appears to demonstrate that the portable mixer was idle for one-year prior to the tax day for the 2010 tax year. Likewise, it appears the roll press machine has been idle since 2005 and would be considered to be idle for the 2008 through 2010 tax years. If the County is satisfied with the documentation provided, the equipment would qualify as idle machinery under *Va. Code* § 58.1-3507 D.

Finally, the Department is unable to determine if the pollution control equipment was used in the Taxpayer's manufacturing process based on the documentation provided. The pollution control equipment would be considered used in manufacturing if the waste product removed by the equipment is used in the manufacturing process. The County, having examined the subject equipment, should make a determination based on the principles set forth in this determination.

Accordingly, I am remanding this case back to the County with instruction to consider the documentation that the Taxpayer can produce concerning the portable mixer, roll press machine, and pollution control equipment. If additional documentation is required, it should be provided directly to the County within 30 days of any request. If the Taxpayer is unable to provide adequate documentation, the County must adjust the assessments based on the information available and issue refunds accordingly. If you have any questions about this determination, you may contact ***** in the Office of Tax Policy, Appeals and Rulings at *****.

Sincerely,

Craig M. Burns
Tax Commissioner

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