



# Tax Exemptions in Virginia

*A nonbinding  
interpretation*

*VAAO July 2014*

# The U.S. Constitution and Taxation

*Former Supreme Court Justice Oliver Wendell Holmes, Jr. said,*

*“Taxes are what we pay for civilized society.”*

# Goldfarb v. Virginia State Bar (1975)

*The court looked to the broad range of activities engaged in by both for profit and not-for-profit organizations. The court noted that in the fields of education, hospitals, child care, nurseries and research, not for profits generate significant earnings and purchase goods and services in competitive markets. The court determined that not-for-profit organizations are NOT totally and automatically exempt from all types of taxes.*

# Constitution of Virginia

*The Taxation and Finance section of the Virginia Constitution of 1861 defines the basic elements of taxation in Virginia, and are still applied today.*

*They are:*

- Taxation shall be uniform and equal throughout the Commonwealth*
- All property shall be taxed in proportion to its value as prescribed by law*

# Article 10 – Constitution of Virginia

*Article 10 is the taxation and finance section of the Constitution of Virginia as revised in 1971.*

*Section 1 – Taxable property; uniformity; classification and segregation*

*The General Assembly has the responsibility of defining and classifying all taxable property in Virginia. The GA also segregates property for either state and/or local taxation.*

# Constitution of Virginia

*Article 10 Section 2: Assessments must be at fair market value*

*Article 10 Section 3: Taxes or assessments upon abutting property owners*

*Article 10 Section 4: Property segregated for local taxation*

- *Real estate*
- *Coal and other minerals*
- *Tangible personal property*

# Constitution of Virginia

## *Article 10 Section 6: Exempt property*

*Property exempted from state and local taxation:*

- *Property owned by the state or local government*
- *Real estate and personal property owned by and exclusively occupied or used by a church or religious body for religious worship or for minister's residence*

# Exempted

## *Properties of the Commonwealth*

*All property owned by the Commonwealth or political subdivision is exempted from taxation. The Supreme Court has ruled that “taxes are not to be assessed against the state or its subdivisions unless the right to tax is made plain.”*

# Other Categories of Exemptions

*The following types of property may be considered partially or fully tax exempt based on circumstances:*

- *Religious, historical, cultural, public use*
- *Land with limited use due to perpetual flooding*
- *Anyone determined by the General Assembly to be bearing an extraordinary tax burden*
- *Household goods, personal effects or tangible farm equipment*

# 2014 General Assembly Changes

*The 2014 General Assembly amended 58.1-3504(A) by adding the following types of equipment as exempted household goods; Electronic communications and processing devices and equipment including but not limited to cell phones and tablet and personal computers, including peripheral equipment such as printers*

# Real and Personal Property Exemptions

## *Property Exemption by Classification or Designation*

*58.1-3600 – contains the most commonly used sections for property tax exemptions, exemption by classification and exemption by designation. In order for either of these exemptions to apply, all properties must meet the requirements of the exemption.*

# Classification

*58.1-3606 covers property exempted by classification. Refers back to Article X of the Constitution, which lists classes of real and personal property exempt from taxation:*

- *Property owned by the Commonwealth or political subdivision*
- *Property owned by churches or religious bodies*

# Classification

- *Nonprofit private or public cemeteries*
- *Libraries or educational institutions*
- *Property of the YMCA*
- *Public park or playgrounds*
- *Benevolent and charitable organizations*
- *Not-for-profit museum property*
- *58.1-3610 - 3617 contains other exempt organizations i.e., Boys & Girls Clubs, SPCA, 4-H Clubs, Red Cross, Volunteer fire and rescue squads, etc.*

# Designation

*58.1-3607 covers property exempt from taxation by designation. Exempts real and personal property of specifically named organizations, corporations and associations. Prior to 2004 these exempt entities were listed in the Code (58.1-3650.1 thru 58.1-3650.1001) according to the General Assembly approval date, not alphabetically. The exemption may not be limited to certain types of property or may require certain uses to maintain exemption.*

# Real and Personal Property Exemptions

*The use of specific terms in the Code is important in interpreting eligibility for exemption:*

- *“And” is important - when a statement includes “and”, the property must meet ALL of the requirements in order to be exempt.*
- *“Exclusively” is not absolute – Although the Code may state that the property must be used “exclusively” for some purpose to be exempt, the Supreme Court has ruled that it has never been considered as an absolute term.*

# “Exclusively” is Not Absolute

*Richmond v. United Givers Fund of Richmond, Henrico & Chesterfield (1964)*

*The Court ruled that in the case of independent physicians located on hospital property, consideration should be given to the fact that the property, although not used exclusively for nonprofit, is still being used to meet the hospital’s charitable purposes and is still located in the actual hospital.*

*City of Richmond v Richmond Memorial Hospital, 202 Va. At 91, 116 S.E.2d at 82*

## “Exclusively” is Not Absolute

- *May not tax the hospital because they provide space to independent doctor’s offices on hospital grounds*
- *May impose an allocation of real estate tax on the hospital’s space rented to independent doctors; especially when the hospital lists the rentals as UBIT on Form 990*

# Real and Personal Property Exemptions

*Property owned by an organization exempted by classification or designation becomes taxable when:*

- *The property becomes a source of revenue  
(a church rents out the minister's residence)*
- *The property is not used or occupied for the purposes stated in the exemption*

# Real and Personal Property Exemptions

## *Dominant Purpose Controls*

*The Supreme Court has applied a dominant purpose test in the rule of statutory construction. This means that when determining whether the property in question is exempt, the dominant purpose in the use of the property is the controlling factor.*

# Real and Personal Property Exemptions

## *Liberal Interpretation for*

### *Property Held before July 1, 1971*

*The Supreme Court has consistently applied a liberal interpretation to those property tax exemptions if the property was owned before July 1, 1971. If there is any doubt as to whether the property is exempt, then such doubt is resolved in favor of the one claiming the exemption (City of Richmond v. United Givers Fund of Richmond, Henrico and Chesterfield, Inc. 1964)*

# Real and Personal Property Exemptions

## *Strict Interpretation after July 1, 1971*

*The Supreme Court has ruled when addressing doubts concerning tax exemptions for properties acquired after July 1, 1971, that the interpretation shall be strictly construed. If there is any doubt as to whether the property is exempted, such doubt shall be resolved against the one claiming the exemption.*

*Westminster Canterbury of Hampton Roads, Inc. v. City of Virginia Beach (1989)*

# Churches and Religious Bodies

## Church Properties

*Church properties exempted from taxation are those used for worship, as minister residences or other ancillary purposes, as well as certain motor vehicles.*

*In accordance with a Virginia Attorney General Opinion (08/23/1976), the exemption would apply even though the minister is not ordained. The exemption does not include real property used for purposes other than religious worship or minister residence*

*See also VAG opinion 12/19/1973*

# Churches and Religious Bodies

- *Formerly, buildings with land they actually occupy and personal property owned by churches or religious bodies were exempt from local taxes when exclusively occupied or used either for religious worship or for the residence of the minister of the church or religious body*
- *Adjacent land reasonably necessary for the convenient use of any such building were also exempt from state and local tax*

# Churches and Religious Bodies

- *Local commissioners of the revenue had interpreted this provision to exempt, for example, church buildings, as well as attached parking lots.*
- *Vacant lots or lots not attached to the church building were not exempt (prior to 7/1/14)*

# Churches and Religious Bodies

## *Motor Vehicles Owned by the Church*

*58.1-3617*

*Motor vehicles owned or leased by churches and used predominantly for church purposes, are classified as property used by its owner for religious purposes and are, therefore, exempt from taxation.*

# 2014 General Assembly Changes

*The 2014 General Assembly expanded the definition of real property designated as tax exempt. 58.1-3606(2) was amended as follows:*

***“Real property exclusively used for religious worship shall also include the following: (a) property used for outdoor worship activities; (b) property used for ancillary and accessory purposes as allowed under the local zoning ordinance, the dominant purpose of which is to support or augment the principal religious worship use; and (c) property used as required by federal, state or local law.”***

# Churches and Religious Bodies

*Real property exclusively used for religious worship shall also include the following:*

- 1) Property used primarily for outdoor worship activities*
- 2) Property whose use is reasonably connected to and supportive of the principal religious worship use*

# Churches and Religious Bodies

- *Real property exclusively used for religious worship shall also include the following:*
- *Vacant lots used primarily for open air or tent services, even if the property is occasionally used for other purposes, are exempt*
- *Exempts unattached lots, if reasonably connected to and supportive of the principal religious worship use, such as land used for church retreats and other such activities.*

# Churches and Religious Bodies

## *Sales Taxes Applicable to Meals and Accommodations for Churches 97-38*

*The Tax Commissioner ruled that there is no authority to grant any church an exemption from sales tax for meals and lodgings*

*See the following for churches & not-for-profits  
PD 88-14, 89-176, 99-254, 91-28*

# Local Meals, Food & Beverage Taxes

- *However, the GA did grant an exemption on the local level for those entities from collecting taxes*
- *Before July 1, 2014, nonprofit entities were exempt from collecting the tax on fundraising sales only if they had no more than three such sales per year*

# Local Meals, Food & Beverage Taxes

- *In 2014, the General Assembly through HB 1099 amended 58.1-3833 & 3840 to exempt nonprofit churches or other religious bodies; or educational, charitable, fraternal, or benevolent organizations from collecting tax on the first \$100,000 of sales **AFTER** the first three sales*

# Local Meals, Food & Beverage Taxes

- ***WHO ARE EXEMPTED? -  
Volunteer fire departments and  
rescue squads; nonprofit churches  
or other religious bodies; or  
educational, charitable, fraternal,  
or benevolent organizations***

# Local Meals, Food & Beverage Taxes

- *The first three times per calendar year and, beginning with the fourth time, on the first \$100,000 of gross receipts per calendar year from sales of meals (excluding gross receipts from the first three times)*
- *As a fundraising activity, the gross proceeds of which are to be used by such organization*

# Local Meals, Food & Beverage Taxes

- *There is no guidance or definition for “fundraising activity”*
- *Could it include nonprofit entities that file monthly F&B such as the Moose Lodge, American Legion, FOP, Yacht Club?*
- *How about the entity who handles the beer sales at the block party on Saturday nights?*

# Local Meals, Food & Beverage Taxes

- *First thoughts are that if the entity is filing a regular F&B return then it would not qualify*
- *However, we are not totally sure*
- *Oh! By the way, churches that serve meals for their members as a regular part of their religious observances are exempt*

# Hospital Entities

*Facilities owned by an exempt hospital  
(as exempted in 58.1-3606(5)),*

*Are they also exempt from local taxation?*

# Definition of a Hospital

- *Section 32.1-123 defines a “hospital” subject to such regulation as:*
  - *any facility . . . in which the primary function is the provision of diagnosis, of treatment, and of medical and nursing services, surgical or nonsurgical, for two or more nonrelated individuals, including hospitals known by varying nomenclature or designation such as sanatoriums, sanitariums and general, acute, rehabilitation, chronic disease, short-term, long-term, outpatient surgical, and inpatient or outpatient maternity hospitals*

# Nursing Homes

- *Means any facility or any identifiable component of any facility licensed pursuant to Virginia Code § 32.1-137*
- *Primary function is the provision, on a continuing basis, of nursing services and health-related services for the treatment and inpatient care of two or more nonrelated individuals, including facilities known by varying nomenclature or designation such as convalescent homes, skilled nursing facilities or skilled care facilities, intermediate care facilities, extended care facilities and nursing or nursing care facilities*

# Nursing Home is NOT a “Hospital”

*AG 86-87 Va. AG 332, 334 (1987) - Not “Hospital” Exempt from Property Taxation Under § 58.1-3606(A)(5)*

- *The term “hospital” in § 58.1-3606(A)(5) does not encompass nursing homes, even utilizing a liberal rule of construction*
- *The terms “hospital” and “nursing home” clearly refer to two distinct classes, as illustrated by the Virginia licensing and inspection definitions*
- *The AG found no basis to exempt nursing homes from property taxation under § 58.1-3606(A)(5)*

# Doctor Offices

- *Section 32.1-124 specifically excludes from such regulation of hospitals*
  - *An office of one or more physicians or surgeons unless such office is used principally for performing surgery*
  - *It is clear that a hospital and a physician's office are treated as two distinct classes.*
  - *Under strict rules of construction, a facility that is a physician's office is not tax exempt unless it is used “principally for performing surgery.”*

# Medical Centers

## *Opinion of the AG 1998 Va. AG 138, 139*

- *Found no express constitutional or statutory tax exemption for a “medical center.”*
- *Thus, for a medical center to receive the benefit of the § 58.1-3606(A)(5) exemption, it must fall within the meaning of a “hospital.”*
- *In so determining, the statutory definition of a hospital is relevant*

# Licensure of Medical Facilities

- *§ 32.1-137. Certification of medical care facilities under Title XVIII of Social Security Act.*
  - *The Board shall constitute the sole agency of the Commonwealth to enter into contracts with the United States government for the certification of medical care facilities under Title XVIII of the United States Social Security Act and any amendments thereto and with the Virginia Department of Medical Assistance Services for the certification of medical care facilities under Title XIX of the United States Social Security Act and any amendments thereto.*

# Rehabilitation Facilities

- *A place for the performance of medically supervised, prescribed rehabilitation (the same type of service a hospital performs)*
- *Each location should be licensed by the State in order to gain the designation of a rehabilitation facility*
- *Ask the question, “Does the rehab facility have a current and a separate VA regulatory license as hospital type of facility?”*
- *Otherwise, you can hang a sign on a gym and call it Good Health and Rehab Unit; but it is still a gym until the State puts them under their regulatory authority*

# Real and Personal Property Exemptions



# Tax Relief for the Elderly and Disabled

*58.1-3210 et. seq. provides that localities may adopt an ordinance allowing property tax relief for elderly and totally disabled persons, in the form of a tax deferral or exemption.*

*The 2011 GA repealed 58.1-3211 and provided localities the authority to determine what, if any, income and net worth restriction would be enforced. The 2014 GA further clarified its intent by reenacting and amending 58.1-3210, 58.1-3211.1 and 58.1-3212 of the Code of Virginia.*

# 2014 General Assembly Changes

## *Changes to 58.1-3210, 3211.1 and 3212*

- *Eligible dwellings include those held by revocable and irrevocable trusts*
- *Income calculation should exclude “those relatives living in the dwelling and providing bona fide caregiving services to the owner whether such relatives are compensated or not” [emphasis added]*

# 2014 General Assembly Changes

## *Changes to 58.1-3210, 3211.1 and 3212*

- *At the locality's option, the same income exclusion may be extended to non-relatives providing bona fide caregiving services to the owner whether such non-relatives are compensated or not [emphasis added]*
- *What are “bona fide caregiving services”?!?*

# Tax Relief for the Elderly and Disabled

## *Eligibility Requirements*

- *Dwelling must be used as the principal residence of the owners*
- *In the event a relative moves in as a caregiver and that relative is an owner of the residence (on the deed), then the relative's income is included in the income calculation*
- *If net worth limits are imposed by local ordinance, then eligibility calculations will be based on net worth as of December 31<sup>st</sup> of the preceding calendar year*
- *A citizen may not be required to live in a locality for a minimum time to be eligible*

# Tax Relief for the Elderly and Disabled

## ***58.1-3214***

***Persons qualifying for the exemption and residing in hospitals, nursing homes or other facilities for physical and mental care for extended periods shall continue to be eligible so long as the real estate is not used by, or leased to others, for consideration.***

***What happens if Mrs. Elderberry moves in with her son because she can no longer live alone?***

# Military Personnel and Spouses

## *Personal Property Exemption for Active Duty Military Personnel*

*As of 11/11/11, military spouses were granted the exemption from personal property tax previously afforded only to the active duty service member.*

# Military Personnel and Spouses

## *PP Exemption for Military (cont.)*

- *The exemption is only allowed for:*
  - *members of the armed forces*
    - *(Army, Navy, Air Force, Marines and Coast Guard)*
  - *commissioned corps of the National Oceanic and Atmospheric Administration (NOAA)*
  - *commissioned corps of the Public Health Service*

*And their spouses*

# Military Personnel and Spouses

## *PP Exemption for Military (cont.)*

- *The exemption is only granted if the service member & spouse have the same home of record and it is other than Virginia.*
- *The vehicle may be titled in the service member's name, jointly or just the spouse's name to qualify for the exemption. A vehicle jointly titled with ANY other relative (parents, siblings, children, etc.) is not eligible for the exemption.*

# Real and Personal Property Exemptions

## *Other Exempt Property*

*In addition to those properties identified by classification and designation, the Code also provides for other types of exempt properties:*

- *Solar energy equipment, facilities or devices (2015)*
- *Certified storm water management developments*
- *Equipment certified to recycle solar energy*
- *Environmental restoration sites*

*These exemptions require a local ordinance enacting the exemption*

# Exemption - Solar Energy

- *Exemption for pollution control equipment, facilities, or devices. (58.1-3660)*
  - *Certified pollution control equipment and facilities, as defined herein, are hereby declared to be a separate class of property and shall constitute a classification for local taxation separate from other such classification of real or personal property and such property. Certified pollution control equipment and facilities shall be exempt from state and local taxation pursuant to Article X, Section 6 (d) of the Constitution of Virginia.*

# Exemption - Solar Energy

*As of January 1, 2015, the definition of Equipment, facilities, or devices is expanded to include solar energy equipment.*

- Exempts from personal property tax business-owned or business-operated solar energy equipment, facilities, or devices that collect, generate, transfer or store thermal or electric energy*
- 58.1-3660 concerns itself with a business exemption while 58.1-3661 is tailored to the individual as a local option*

# Exemption - Solar Energy

*Per 58.1-3660, as of January 1, 2015, exempt property will include “solar energy equipment, facilities, or devices owned or operated by a business that collect, generate, transfer, or store thermal or electric energy whether or not such property has been certified to the Department of Taxation by a state certifying authority.”*

# Exemption - Solar Energy

- ***58.1-3660 (cont.)***

***“For solar photovoltaic (electric energy) systems, this exemption applies only to projects equaling 20 megawatts or less, as measured in alternating current (AC) generation capacity. Such property shall not include the land on which such equipment or facilities are located.”***

# Exemption - Solar Energy

*Per 58.1-3661, "Certified solar energy equipment, facilities or devices" means any property, including real or personal property, equipment, facilities, or devices, certified by the local certifying authority to be designed and used primarily for the purpose of providing for the collection and use of incident solar energy for water heating, space heating or cooling or other application which would otherwise require a conventional source of energy such as petroleum products, natural gas, or electricity.*

# Exemption - Solar Energy

*The changes to 58.1-3611 become effective January 1, 2015.*

*~Specifically excludes any property exempt under 58.1-3660.*

*~This is still a local option exemption.*

# Certified Pollution Control Equipment

- *Declared to be a separate class of property*
- *Shall constitute a classification for local taxation separate from other such classification of real or personal property*
- *Certified pollution control equipment and facilities shall be exempt from state and local taxation pursuant to Article X, Section 6 (d) of the Constitution of Virginia*

# Certified Pollution Control Equipment

- *Shall include, but is not limited to, any equipment used to*
  - *Grind, chip or mulch trees, tree stumps, underbrush, and other vegetative cover for reuse as:*
    - *mulch*
    - *compost*
    - *landfill gas*
    - *synthetic or natural gas recovered from waste or other fuel, and*

# Certified Pollution Control Equipment

- *Equipment used in collecting, processing, and distributing, or generating electricity from landfill gas or synthetic or natural gas recovered from waste, whether or not such property has been certified to the Department of Taxation by a state certifying authority*
- *Shall not include the land on which such equipment or facilities are located*

# Installation Costs

- *As opined in County of Chesterfield v. BBC Brown Boveri, 238 Va. 97, 380 S.E.2d 890 (1989) which states in part,*  
  
*“that no legal basis exists which allows a single piece of property to be subject to more than one ad valorem tax apportioned according to its use.”*

# Installation Costs

- *Taxpayer desires a proration of costs by installation costs or use.*
- *We must also rely on the meaning of “used in manufacturing” as opined by the Tax Commissioner in PD 04-39,*  
*“This machinery is directly used in the manufacturing process and as such is subject to the M&T tax. There is no provision in the County’s ordinance for a partial exemption for machinery and tools that are used directly in the manufacturing process and used in another capacity.”*

# Installation Costs

- *Installation cost is necessary for the construction and operation of the machinery and tools*
- *If installation costs are not specifically identified, it would not be proper to allocate those costs as a percentage of total cost*
- *If the installation costs of exempt pollution control equipment cannot be specifically identified, we are unable to exempt as part of the exempt certified pollution control equipment*

# Installation Costs

- *When the purchase contract is silent as to cost allocation or assignment to the project,*
- *Be alert to subsequent submissions of installation cost allocations*
  - *If generated by manufacturer's engineers, especially if they didn't perform the installation*
  - *If costs were not submitted with the items submitted to the DEQ*

# Installation Costs

- *The Code of Virginia and the laws are strictly construed as it applies to exemptions*
- *Rely on the guidance provided by the DEQ Section F, guidance on processing applications as follows:*
  - “...DEQ may grant certification for only that portion of the machine that performs air pollution abatement or prevention functions and it is the applicant’s responsibility to itemize those components of the machine which perform the air pollution abatement or prevention function.”

# Real and Personal Property Exemptions

## *Property Exempted by Local Classification or Designation after January 1, 2003*

*The 2002 General Assembly amended Article X Section 6(a)(6) and removed the requirement that only the GA approve exemptions by classification or designation. The change allows the local governing body to adopt a local ordinance to approve the exemptions. As a result of the change, the GA added 58.1-3651 to the Code of Virginia enacting the change.*

# Locally Authorized Exemptions

*The Code change requires local organizations seeking the exemption to receive approval from the local governing body through enactment of a local ordinance.*

*The local government must consider the following prior to approving the exemption:*

- *Is the organization already exempt through 501(C) of the Internal Revenue Code of 1954?*
- *Does the organization provide services to the common good?*
- *What is the revenue impact?*

# Real and Personal Property Exemptions

## *Locally Authorized Exemptions, cont.*

*Locally authorized exemptions must be strictly construed when there is doubt about the exemption.*

*Any exemption previously granted by the GA prior to January 1, 2003 remains valid.*

# Intangible Personal Property



# Intangible Personal Property

## *Intangible Property*

*Property can be tangible or intangible. Tangible property has historically been defined as property that has value measured in accordance with its actual physical presence. It includes both personal and real property. Intangible property has historically been defined as something of value but that has no real physical presence. It is based on evidence of ownership rather than physical character.*

# Intangible Personal Property

## *Code of Virginia*

*The General Assembly has exercised its constitutionally established authority related to intangible property in 58.1-1100, et al.*

- *Intangible personal property, including capital of a trade or business of any person, firm or corporation, except for merchant's capital as defined in 58.1-3510, which might be subject to local taxation, is hereby segregated for state taxation only.*

# Intangible Personal Property

## *Code of Virginia*

*Originally this code section did not create an exemption, it simply restricted local taxation and explicitly permitted state taxation. Through 1982, the state tax rate on intangible property was 30% per \$100 of actual value. In 1983, the tax rate was reduced to zero for everything except inventory. In 1985, the tax on inventory was also reduced to zero. These actions effectively make intangible personal property exempt from taxation.*

# Virginia Administrative Code

*The VA Administrative Code (VAC) is the body of regulations issued by TAX to assist in the interpretation and enforcement of tax laws in the Commonwealth.*

*Sections 23VAC10-340-10 through 23VAC10-34-190 pertain to intangible property.*

# Types of Intangible Property

*58.1-1101 establishes the types of intangible property.*

- *Money, bonds, stock shares and accounts receivable*
- *Application software – computer instructions in any form, designed to be read by a computer and to enable it to perform specific operations with data or information stored by the computer. Software that is designed to solve a particular problem or perform functions such as word processing, accounting, spreadsheet or database analysis or inventory management. Examples- CAD software, Word, Excel*

# Operational Software

*In comparison to application software, operational software is a system that actually permits a computer to function. Operational software is taxable as personal property, as it is required for the actual operation of the computer hardware. Examples – DOS, Windows*

*•Intangible property continued:*

*Manufacturing, mining, water-well drilling, radio or television broadcasting, dairy, dry cleaning or laundry businesses*

# Intangible Personal Property

## *Types of Intangible property, cont.*

*•The Code specifies that “the capital 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), mining, water well drilling, radio or television broadcasting, dairy, dry cleaners or laundry businesses is intangible property.*

# Intangible Personal Property

## *Types of Intangible property, cont.*

- *Machinery and tools, motor vehicles and delivery equipment of such businesses shall not be defined as intangible personal property...and shall be taxed locally as tangible personal property.” 58.1-1101(A)(2)*

# Manufacturing

*When you are classifying property of a manufacturer as intangible you are in essence determining that the property is not machinery and tools. The most challenging components of the decision are determining what constitutes the manufacturing process and then whether the business in question is, in fact, a manufacturer.*

## *American Woodmark Corp v. City of Winchester (1995)*

- *City contended that since no manufacturing occurred at the facility within the city, the property in question was not used in the manufacturing process.*
- *City's secondary argument – if the equipment is in fact part of the manufacturing process it should be classified as machinery and tools and taxable locally*

## *American Woodmark Corp v. City of Winchester (1995)*

- *Company contended it was a manufacturer and that all property, including that in Winchester was used in the manufacturing business and should be classified intangible*
- *Remember that statutes imposing taxes are to be construed most strongly against the government, and in favor of the citizen*

# Manufacturing

*American Woodmark Corp v. City of Winchester, cont.*

*Both the trial court and Supreme Court agreed with the company. Supreme Court stated, “.... We find no language to construe 58.1-1101(A)(2) as requiring that a manufacturer maintain a manufacturing facility with the City’s boundaries...or that the manufacturer’s capital, which is personal property....be used directly in the manufacturing process.”*

# Manufacturing

## *Coca-Cola v. Botetourt (2000)*

*In 1997 Coca-Cola sued Clifton Forge, arguing that vending machines were erroneously assessed because the machines were part of the manufacturing process and thus intangible. Circuit Court of Clifton Forge agreed with the company. The company next filed suit against Botetourt County with the same argument. The Circuit Court of Botetourt ruled against the company.*

# Manufacturing

## *Coca-Cola v. Botetourt (2000)*

*Supreme Court ruled against the company stating “....the evidence indicates that the sales equipment in question was not used in manufacturing but merely selling the finished product....in a separate business.”*

# Manufacturing

*The Daily Press v. The City of Newport News (2003)*

*The case dealt with where the manufacturing process begins for a newspaper. The city contended the process begins with the compilation of the news itself. The newspaper argued that the process consists solely of the act of putting ink to paper. The local court agreed with the city. The Supreme Court ruled that the newspaper manufactures newspapers, not news. It opined that only the machinery and tools that physically altered raw material to a finished product should be assessed as M&T.*

# Manufacturing

- *In BBC Brown Boveri, the Court held that after it is determined that a taxpayer is engaged in a manufacturing activity, the taxpayer's manufacturing activities must meet the test of substantiality. "When a party is engaged in both manufacturing and non-manufacturing activities, it will nonetheless be classified as a manufacturer for tax purposes if the manufacturing portion of its business is substantial."*

# Manufacturing

*The Court offered several measures to be used in making the determination of a manufacturer.*

*These are:*

- *(1) the manufacturing component's financial receipts or proportion of total corporate income;*
- *(2) the percentage that manufacturing equipment, inventory, etc., comprises of the total capital investment;*

# Manufacturing

*The Court offered several measures to be used in making the determination of a manufacturer.*

*These are:*

- *(3) the number of employees working in the manufacturing component as compared with the total number of employees; or*
- *(4) the ratio of manufacturing activities to the entire business.*

# Manufacturing

- *Pursuant to Title 23 VAC 10-500-520(C), to be considered substantial, the manufacturing component of a business must not be de minimis, merely trivial, or only incidental to its principal business*

# Manufacturing

- *What needs to be considered:*
  - *Making a determination cannot be done in a vacuum*
  - *Companies exists in multiple localities*
  - *Types of work performed can vary*
  - *A locality possessing a manufacturing entity must be aware of the total volume of work performed by the entity as a whole*
  - *One manufacturing determination will impact all localities*

# Manufacturing

- *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.*

# Manufacturing

- *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.*
- *P.D. 04-39 (8/2/2004), TAX found that equipment and tools that did not directly transform or even touch the product being produced could be used directly in the manufacturing process*
- *Therefore, it is not whether a particular piece of machinery transforms a product, but whether such machinery or tool is used directly in a manufacturing process.*

That's All Folks . . .

***Christie Tompkins***

***Chief Deputy/Compliance Coordinator, CPA, MDCR***

***City of Fredericksburg***

***540-372-1004***

***crdeputy@fredericksburgva.gov***

***Paul Crepeau***

***Business Tax Specialist, CPA, MDCR***

***City of Suffolk***

***757-514-4259***

***pcrepeau@suffolkva.us***

**The End**

