

Recyclable Materials Processing Equipment Tax Credit Guidelines

Introduction

During the 2015 Session, the Virginia General Assembly enacted House Bill 1554 (2015 *Acts of Assembly*, Chapter 49) and Senate Bill 1205 (2015 *Acts of Assembly*, Chapter 94), which made several changes to the Recyclable Materials Processing Equipment Tax Credit. These changes include increasing the amount of the credit, imposing an annual credit cap, and amending certain credit qualification requirements. This legislation requires the Department of Taxation (“the Department”), in consultation with the Department of Environmental Quality (“DEQ”), to adopt guidelines to implement the provisions of such legislation.

These guidelines are published by the Department to provide guidance to taxpayers regarding the Recyclable Materials Processing Equipment Tax Credit. These guidelines are not rules or regulations subject to the provisions of the Administrative Process Act (*Va. Code* § 2.2-4000 et seq.) and are being published in accordance with the Tax Commissioner’s general authority to supervise the administration of the tax laws of the Commonwealth pursuant to *Va. Code* § 58.1-202. As necessary, additional information will be published and posted on the Department’s website, www.tax.virginia.gov.

These guidelines represent the Department’s interpretation of the relevant laws. They do not constitute formal rulemaking and hence do not have the force and effect of law or regulation. In the event that the final determination of any court holds that any provision of these guidelines is contrary to law, taxpayers who follow these guidelines will be treated as relying on erroneous written advice for purposes of waiving penalty and interest under *Va. Code* §§ 58.1-105, 58.1-1835, and 58.1-1845. To the extent there is a question regarding the application of these guidelines, taxpayers are encouraged to write to the Department and seek a written response to their question.

Legislative History

During the 1990 Session, the Virginia General Assembly enacted Senate Bill 101 (1990 *Acts of Assembly*, Chapter 709), which established the Recyclable Materials Processing Equipment Tax Credit, effective for taxable years beginning on or after January 1, 1991. This is an individual and corporate income tax credit for certain taxpayers that purchase machinery and equipment used on the premises of a manufacturing facility or plant unit which manufactures, processes, compounds, or produces items of tangible personal property from recyclable materials within Virginia for sale. The credit amount that may be claimed cannot exceed 40 percent of the taxpayer’s Virginia income tax liability for the taxable year in which the credit is being claimed. Prior to claiming the credit, the taxpayer must receive certification from DEQ that the equipment meets the credit requirements.

Originally, the Department of Waste Management was responsible for certifying that machinery or equipment is integral to the recycling process. In 1996, House Bill 297 (1996 *Acts of Assembly*, Chapter 837) transferred the responsibility for certifying machinery and equipment to DEQ. This legislation also extended the credit carryover period from five years to ten years.

In 2003, the provision that allowed individuals to claim the Recyclable Materials Processing Equipment Tax Credit expired. As a result, only corporations were entitled to claim new credits during Taxable Years 2003 through 2007. In 2007, House Bill 3044 (2007 *Acts of Assembly*, Chapter 529) and Senate Bill 870 (2007 *Acts of Assembly*, Chapter 593) reinstated the credit for individuals, effective for taxable years beginning on or after January 1, 2008.

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Changes Effective for Taxable Year 2015 and After

Effective for Taxable Year 2015 and thereafter, taxpayers may claim the credit for purchases made during the taxable year for machinery and equipment used *predominantly* in or on the premises of manufacturing facilities or plant units which manufacture, process, compound, or produce items of tangible personal property from recyclable materials within Virginia for sale. For such taxable years, the amount of the credit is increased to 20 percent of a taxpayer's qualifying expenditures.

Prior to Taxable Year 2015, the credit was allowed only for qualifying purchases that were used *exclusively* in or on the premises of manufacturing facilities or plant units which manufacture, process, compound, or produce items of tangible personal property from recyclable materials within Virginia for sale. For such taxable years, the credit was equal to 10 percent of a taxpayer's qualifying expenditures.

Effective for Taxable Year 2015 and thereafter, no taxpayer may claim the credit for machinery or equipment unless such machinery or equipment manufactures, processes, compounds, or produces items of tangible personal property from recyclable materials. Prior to Taxable Year 2015, the law required that the machinery or equipment be used on the premises of a manufacturing facility that manufactures, processes, compounds, or produces items of tangible personal property from recyclable materials, but there was no explicit requirement regarding how a taxpayer used such machinery or equipment on the premises.

Also effective for Taxable Year 2015 and thereafter, no taxpayer may be denied the credit based solely on another person's use of the tangible personal property produced by the taxpayer, provided that the tangible personal property was sold by the taxpayer to an unaffiliated person in an arm's-length sale. Prior to Taxable Year 2015, there was no specific requirement preventing a taxpayer from being denied the credit based solely on another person's use of the tangible personal property produced by the taxpayer. For purposes of determining whether such property was sold to an unaffiliated person, an "affiliated person" means a "related person" as defined for purposes of Internal Revenue Code ("IRC") § 267.

Annual Credit Cap

Effective for Taxable Year 2015 and thereafter, the credit is capped at \$2 million per fiscal year. If the total amount of all approved credits exceeds the \$2 million credit cap for credits, each taxpayer will be granted a pro rata amount of credits as determined by the Department. The amount of the prorated credit will be determined by multiplying the amount of approved credits requested by an eligible taxpayer for the taxable year by a fraction, the numerator of which is the \$2 million credit cap, and denominator of which is the total amount of approved credits requested by all eligible taxpayers for such taxable year.

Prior to Taxable Year 2015, the Recyclable Materials Processing Equipment Tax Credit was uncapped and, therefore, the proration of approved credits was unnecessary.

Determining the Purchase Price Paid

For Taxable Year 2015 and thereafter, the amount of the Recyclable Materials Processing Equipment Tax Credit is equal to 20 percent of the purchase price paid during the taxable year for machinery or equipment that qualifies for the credit. Prior to Taxable Year 2015, the amount of the credit was equal to 10 percent of the purchase price paid during the taxable year for such

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machinery or equipment. For purposes of determining the credit amount, the “purchase price paid” consists of:

- The amount actually paid for machinery or equipment that qualifies for the credit in the year of the purchase; or
- For capitalized machinery or equipment that qualifies for the credit, an amount equal to the original total capitalized cost of such machinery or equipment minus any capitalized interest related to such machinery or equipment.

Original Total Capitalized Cost

Under federal law, a taxpayer is generally required to capitalize the purchase price of a new asset if such asset has a useful life that extends beyond the current taxable year. See IRC § 263; Treasury Regulations (Treas. Reg.) §§ 1.263(a)-1. A taxpayer with an asset that must be capitalized may also capitalize certain costs incurred to acquire or produce such asset. See Treas. Reg. § 1.263(a)-2. Costs that may be capitalized in addition to the cost of a capitalized asset include, but are not limited to, certain transportation and installation expenses. For more information regarding capitalization, see IRS Publication 535.

For purposes of the Recyclable Materials Processing Equipment Tax Credit, “original total capitalized costs” include both the purchase price of machinery or equipment that is capitalized for federal income tax purposes, and any capitalized costs incurred in the year of purchase to acquire or produce such machinery or equipment. “Original total capitalized costs” do not include costs that are incurred in a year other than the year of purchase or costs that are not capitalized. When determining the purchase price paid for machinery or equipment, subtract any capitalized interest related to the purchase from the original total capitalized cost of such machinery or equipment.

Example 1:

In Taxable Year 2016, Taxpayer A purchased an item of equipment that qualifies for the Recyclable Materials Processing Equipment Tax Credit for \$10,000 that Taxpayer A intends to capitalize. When transporting and installing such equipment, Taxpayer A incurred \$2,000 of installation costs in the year of purchase that it intends to capitalize and \$1,000 of additional costs related to such equipment in the year of purchase that may not be capitalized under federal law. When determining the amount of the credit, Taxpayer A may include the \$10,000 cost of purchasing the equipment and \$2,000 of capitalized installation costs. When determining the amount of the credit, Taxpayer A may not include the \$1,000 in additional costs that may not be capitalized.

Example 2:

Assume the same facts as in Example 1. In Taxable Year 2017, Taxpayer A also incurs \$2,000 in costs that it intends to capitalize that are related to maintaining the equipment that qualified for the Recyclable Materials Processing Equipment Tax Credit for Taxable Year 2015. Although the maintenance costs were capitalized costs related to an item of equipment that qualified for the credit, Taxpayer A may not use the maintenance costs to claim the credit because such costs were incurred in a year after the year Taxpayer A purchased such equipment.

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Capital Leases

Leased machinery and equipment does not generally qualify for the Recyclable Materials Processing Equipment Tax Credit. However, if a taxpayer is required to capitalize the value of leased machinery or equipment for federal income tax purposes in the first year the relevant lease is effective (a “capitalized lease”), the amount actually capitalized and any capitalized costs incurred in such year to acquire or produce such asset are considered “original total capitalized costs” for purposes of the credit. A lease of machinery or equipment is required to be treated as a capitalized lease if:

- The lease transfers ownership of the leased machinery or equipment at the end of the lease term;
- There is an option to purchase the leased machinery or equipment at a bargain price at the end of the lease term;
- The lease term equals or exceeds 75 percent of the estimated economic life of the leased machinery or equipment; or
- The present value at the beginning of the lease term of the minimum lease payments equals or exceeds 90 percent of the fair market value of the leased machinery or equipment.

No leased machinery or equipment may qualify for the credit if such machinery or equipment was not capitalized in the first year the relevant lease was effective. In addition, no capitalized interest related to the leased machinery or equipment may qualify for the credit.

Claiming the Credit

When a Taxpayer May Claim the Credit

A taxpayer may claim the Recyclable Materials Processing Equipment Tax Credit only for the taxable year in which such taxpayer purchases qualifying machinery or equipment. If such machinery or equipment does not qualify for the credit in the year of purchase, the taxpayer may not claim the credit for a later taxable year when the machinery or equipment meets the credit requirements. A taxpayer that does not qualify for the credit in the taxable year of purchase or that fails to meet the application deadlines may neither claim the credit for the year of purchase nor claim original or carryover credits for years following the year of purchase.

In Public Document (“P.D”) 04-190 (10/20/2004), the Department addressed a situation where a taxpayer purchased otherwise qualifying equipment in one year, but did not produce a sufficient quantity of recycled materials for DEQ to certify the machinery and equipment as integral to the recycling process for several years. In such case, the Department provided that a taxpayer that did not qualify for the credit in the year of purchase may later amend its tax return for the taxable year of purchase and claim the credit, as long as the amended return is filed within the three-year statute of limitations. The Department also provided that a taxpayer that did not claim the credit on an amended return within the three-year statute of limitations may amend its tax returns for the taxable years following the year of purchase to claim carryover credits that would have been available if the credit had been claimed for the year of purchase as long as

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such returns are filed within three-year statute of limitations. The Department issued similar guidance in P.D. 10-136 (7/12/2010) and P.D. 10-227 (9/29/2010).

This guidance was issued prior to the imposition of an annual credit cap, which requires the establishment of deadlines in order to allocate credits. Accordingly, for machinery or equipment purchased in taxable years beginning on or after January 1, 2015, these Guidelines supersede such rules set forth in P.D. 04-190, P.D. 10-136, and P.D. 10-227 as applied to the Recyclable Materials Processing Equipment Tax Credit. For machinery or equipment purchased in taxable years beginning before January 1, 2015, such rules remain in effect and a taxpayer may claim credits from such purchases on an amended return, as long as the amended return is filed within the three-year statute of limitations.

Certification by DEQ

Prior to claiming the Recyclable Materials Processing Equipment Tax Credit, a taxpayer first must receive written certification from DEQ stating that the machinery or equipment is integral to the recycling process. When determining whether an item of machinery or equipment is integral to the recycling process, DEQ will determine whether the machinery or equipment is being 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. DEQ will also determine whether the machinery or equipment is being used to manufacturer, process, compound, or produce items of tangible personal property from recyclable materials. See *Va. Code* § 58.1-439.7(A)(2) and 9 VAC 15-30-10 *et seq.*

To apply for certification, a taxpayer is required to submit a completed application (Form DEQ50-11S) to DEQ by March 1 of the year following the year it purchased the machinery or equipment. This is similar to the process required prior to Taxable Year 2015, except that taxpayers must now apply to DEQ by the March 1 deadline. No taxpayer may claim the credit unless it has received written certification from DEQ stating that the machinery or equipment is integral to the recycling process. More information regarding DEQ's certification process is available on DEQ's website located at www.deq.virginia.gov.

Submission of the Credit Application to the Department

Once a taxpayer receives written certification from DEQ stating that the machinery or equipment is integral to the recycling process, such taxpayer must then apply to the Department for an allocation of credits. To apply for an allocation of credits, a completed application (Form RMC), the certification received from DEQ, and any other required documentation must be submitted to the Department by June 1 of the year following the year the machinery or equipment was purchased. Form RMC is available on the Department's website at www.tax.virginia.gov. No taxpayer that submits a credit application to the Department after June 1 will be eligible to receive an allocation of credits. The Department will review all applications for completeness and notify taxpayers of any errors by August 1. If any additional information is required, it must be provided to the Department no later than August 15 to be considered for the credit. All eligible taxpayers will be notified as to the amount of credits that they may claim by September 1. Such deadlines apply to applications submitted for Taxable Year 2016 and thereafter.

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Filing Requirements

Upon receiving notification of the credit amount from the Department, the taxpayer must claim the credit on its Virginia income tax return. In the event that a taxpayer does not receive notification of the allowable credit amount before its Virginia income tax return is due, the taxpayer may file the return during the extension period, or it may file the original return without claiming the credit and then file an amended tax return once notification of the allowable credit amount is received.

Carryover Credits

Any tax credit not used for the taxable years in which the purchase price on recycling machinery and equipment was paid may be carried over for credit against the taxpayer's income taxes in the ten succeeding taxable years until the total credit amount is used. Carryover credits earned and claimed on returns prior to Taxable Year 2015 are not subject to the \$2 million annual cap or any of the other changes imposed by the 2015 legislation.

Additional Information

These guidelines are available online under the Laws, Rules and Decisions section of the Department's website, located at <http://www.policylibrary.tax.virginia.gov>. For additional information, please contact the Department at (804) 786-2992.

Approved:



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Tax Commissioner