

MANUFACTURING PROPERTY TAX ADJUSTMENT CREDIT

REPORT TO THE JOINT COMMITTEE ON GOVERNMENT AND FINANCE

July 1, 2020

Submitted by:

West Virginia State Tax Department
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State Tax Commissioner

MANUFACTURING PROPERTY TAX ADJUSTMENT CREDIT

This report is submitted to the Joint Committee on Government and Finance pursuant to the provisions of West Virginia Code §11-13Y-8(a), which requires in pertinent part:

“The Tax Commissioner shall provide to the Joint Committee on Government and Finance by the first day of July, two thousand eleven, and on the first day of July of each year thereafter, a report detailing the amount of credit claimed pursuant to this article. The report is to include the amount of credit claimed against the business franchise tax and the amount of credit claimed against the corporate net income tax.”

In conformity with the above requirement, the following report provides details on the Manufacturing Property Tax Adjustment Credit (Inventory Tax Credit) from Corporation Net Income Tax (CNIT) and Business Franchise Tax (BFT) returns in State Tax Department databases as of May 15, 2020.¹

Description of the Inventory Tax Credit

As with all other businesses, manufacturers are subject to both State and local taxes. State and local taxes may include tangible personal property taxes on manufacturing inventory other than finished goods inventory destined for export outside the State. Several tax reform studies have recommended repeal of manufacturing inventory property taxes. However, the tax on inventory is provided for in the West Virginia Constitution and generally benefits local governments. Thus, any change in the tax on inventory would require a Constitutional Amendment to be ratified by the State's electorate. The Manufacturing Property Tax Adjustment Credit enacted by Chapter 215, Acts of the Legislature, 2008 provides some tax relief to manufacturers without directly reducing revenue for local governments.

As codified in West Virginia Code §11-13Y-1 *et seq.*, eligible Taxpayers are allowed a tax credit in an amount equal to the West Virginia Property Tax paid by the Taxpayer on the value of manufacturing inventory of the eligible Taxpayer during the Corporation Net Income Tax or Business Franchise Tax year. The credit was effective for tax years beginning on or after January 1, 2009. Pertinent definitions related to the Manufacturing Property Tax Adjustment Credit included in the Statute are as follows:

"Eligible taxpayer" means any manufacturing business that is subject to the tax imposed under article twenty-three [§§11-23-1 *et seq.*] or twenty-four [§§11-24-1 *et seq.*] of this chapter, or both: *Provided*, That taxpayers owning property assessed by the Board of Public Works are not eligible taxpayers for purposes of this article. "Eligible taxpayer" also means and includes those members of an affiliated group of taxpayers engaged in a unitary business, in which one or more members of the affiliated group is a person subject to the tax imposed under article twenty-three or article twenty-four of this chapter, or both. Affiliates not engaged in the unitary business do not qualify as eligible taxpayers.

¹ The Business Franchise Tax was eliminated for taxable years beginning on and after January 1, 2015. For this reason, Inventory Tax Credit claims beyond calendar year 2014 are restricted to claims against the Corporation Net Income Tax.

"Manufacturing business" means any business primarily engaged in business activity classified as having a sector identifier, consisting of the first two digits of the six-digit North American Industry Classification System code number, of thirty-one, thirty-two or thirty-three that also paid ad valorem property tax on manufacturing inventory to one or more West Virginia counties during the taxable year.

"Manufacturing inventory" means and is limited to raw materials, goods in process and finished goods of a business primarily engaged in business activity classified as having a sector identifier, consisting of the first two digits of the six-digit North American Industry Classification System code number, of thirty-one, thirty-two or thirty-three.

"Pass-Through Entities" include Sub-Chapter S-corporations, partnerships and other business types treated in a similar manner.

"Tax year" or "taxable year" means the tax year of the taxpayer for federal income tax purposes.

"Taxpayer" means any person subject to the tax imposed under article twenty-three [§§11-23-1 et seq.] or twenty-four [§§11-24-1 et seq.] of this chapter, or both.

Data Notes

Taxpayers use a variety of taxable periods for purposes of filing income tax returns. For consistency, the Tax Years reported in this document reflect the year in which a Taxpayer's taxable year begins. For example, some Taxpayers are calendar year filers (*i.e.*, Tax Year 2019 began on January 1, 2019) while others are fiscal year filers² (*e.g.*, Tax Year 2019 began on July 1, 2019). Although the statutory due dates³ of tax returns for calendar year Taxpayers occurred before the analysis date (*i.e.*, May 15, 2020) of this report, many Taxpayers use an automatic six-month extension of time before filing final returns with credit claims. Most returns of fiscal year taxpayers would not be due until after the analysis date. Given that the majority of both calendar year and fiscal year 2019 returns had not yet been filed or fully processed by the Tax Department at the time of this analysis, Tax Year 2019 credit claims are omitted from this report. In addition, due to the complex nature of some tax returns, many Tax Year 2018 returns have yet to be fully processed.

In order to not misrepresent State inventory tax credit claims, statistical results for all taxable periods – particularly more recent Tax Years – do not include unprocessed returns and thus do not represent complete records of manufacturing inventory tax credit claims. Additionally, tax returns can generally be amended through the third year following the original due date of the

² Statutory due dates for fiscal year Taxpayers are on or before the 15th day of the third month following the close of the taxable year for Pass-Through Entities and Partnerships or the 15th day of the fourth month following the close of the taxable year for C-Corporations.

³ Tax Year 2019 due dates are March 15, 2020 for Pass-Through Entities treated as a partnership for federal and state income tax purpose and July 15, 2020 for C-Corporations and limited liability companies that elect to be treated as a corporation for federal and state income tax purposes. The West Virginia State Tax Department granted an extension to individuals and corporations whose annual income tax returns were due April 15, 2020 in response to the COVID-19 outbreak per Administrative Notice 2020-16.

return. It is important to note that credit claims for Tax Years 2016, 2017, and 2018 as provided in the tables and figures of this report may be subject to revision by the Taxpayer or upon audit by the Tax Department.

Manufacturing Property Tax Adjustment Credit Claimed

Table 1 and Figure A provide data collected from Inventory Tax Credit claims by tax and business type as reported on Corporation Net Income Tax and Business Franchise Tax returns for Tax Years 2009 through 2018. Business Franchise Tax returns are separated into those for Pass-Through Entities (PTEs) and C-Corporations (C-Corp). Appendix A provides changes in the claims of this credit between the June 30, 2019 and current reports for the most recent five taxable periods.

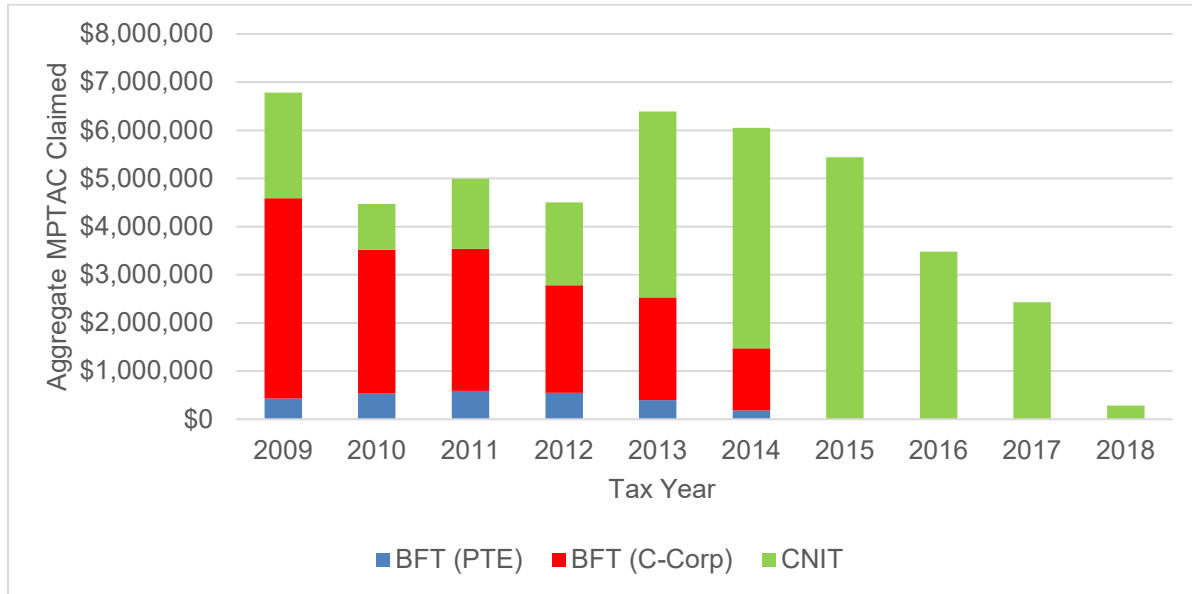
Table 1
State Inventory Tax Credit Claims by Tax and Business Type

Tax Year	BFT (PTE)		BFT (C-Corp)		CNIT		Total
2009	\$	432,473	\$	4,154,918	\$	2,196,430	\$ 6,783,821
2010	\$	536,322	\$	2,983,392	\$	950,770	\$ 4,470,484
2011	\$	588,395	\$	2,951,417	\$	1,458,096	\$ 4,997,908
2012	\$	549,663	\$	2,232,806	\$	1,722,414	\$ 4,504,883
2013	\$	394,511	\$	3,963,267	\$	2,029,910	\$ 6,387,688
2014	\$	181,249	\$	1,292,298	\$	4,576,216	\$ 6,049,763
2015	\$	(*)	\$	(*)	\$	5,442,592	\$ 5,442,592
2016	\$	(*)	\$	(*)	\$	3,481,413	\$ 3,481,413
2017	\$	(*)	\$	(*)	\$	2,431,865	\$ 2,431,865
2018	\$	(*)	\$	(*)	\$	286,448	\$ 286,448
Total	\$	2,682,613	\$	15,748,531	\$	26,405,721	\$ 44,836,865

(*) No inventory tax credit claims against BFT Liabilities effective with BFT termination on January 1, 2015.

Since the inception of the State Inventory Tax Credit program, roughly 80 taxpayers per year have claimed this credit from Tax Year 2009 through Tax Year 2018. Of all Inventory Tax Credit claimants, most are corporate taxpayers (66 claimants per year on average) while the remainder are Pass Through Entity taxpayers (24 claimants per year on average). The total number of inventory tax credit claimants declined by 62 percent between 2014 and 2015 largely due to the termination of the Business Franchise Tax on January 1, 2015. Between 2015 and 2017, the number of inventory tax credit claimants declined by 43 percent, largely due to both a decline in the manufacturing industry and subsequent reductions in Corporation Net Income Tax liabilities.

Figure A
State Manufacturing Inventory Tax Credit Claims by Tax and Business Type



Comparison of Manufacturing Inventory Taxes Paid with State Tax Credit Claims

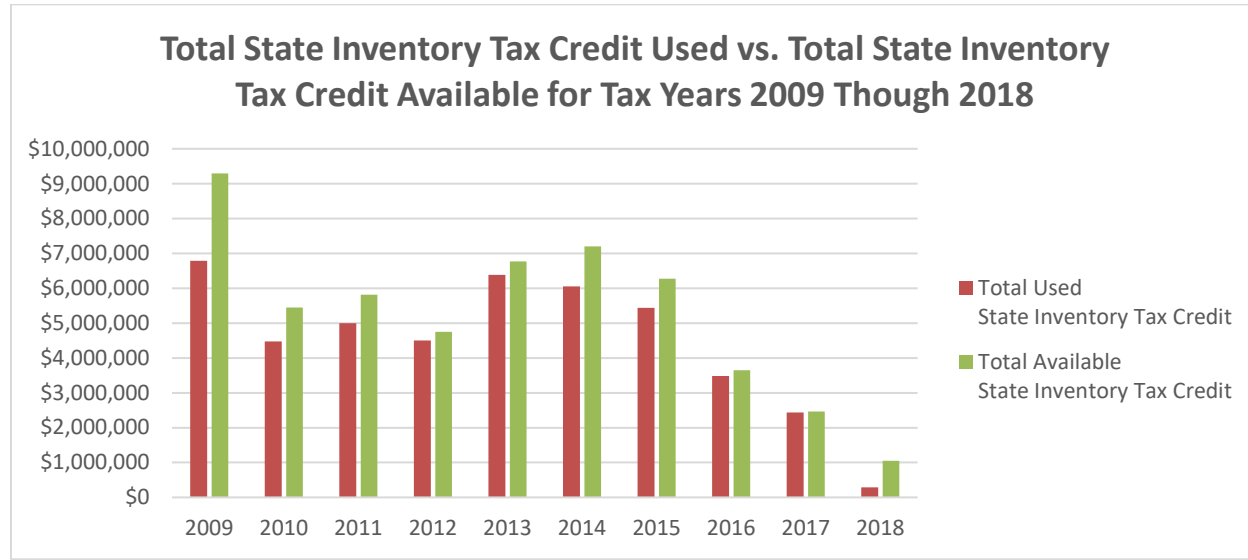
The inventory tax credit allows manufacturers an offset of up to 100 percent of local manufacturing inventory taxes paid against their combined pre-credit tax liability for State Corporation Net Income Tax and Business Franchise Tax. Statistical feedback from property tax assessment data for the ten-year period between Property Tax Year 2009 and Property Tax Year 2018 indicate an average of \$34 million per year in local inventory property taxes assessed to the manufacturing sector. By comparison, State tax credits based on inventory taxes paid averaged roughly \$5.1 million per year between 2009 and 2014 and slightly more than \$3.0 million per year between 2015 and 2017. The State tax credit effectively offset roughly 15 percent of the total local inventory tax paid in years when the State imposed both a Business Franchise Tax and a Corporation Net Income Tax on manufacturers. Following the elimination of the Business Franchise Tax, the tax credit program now effectively offsets closer to 10 percent of the local inventory tax paid by the manufacturing sector.

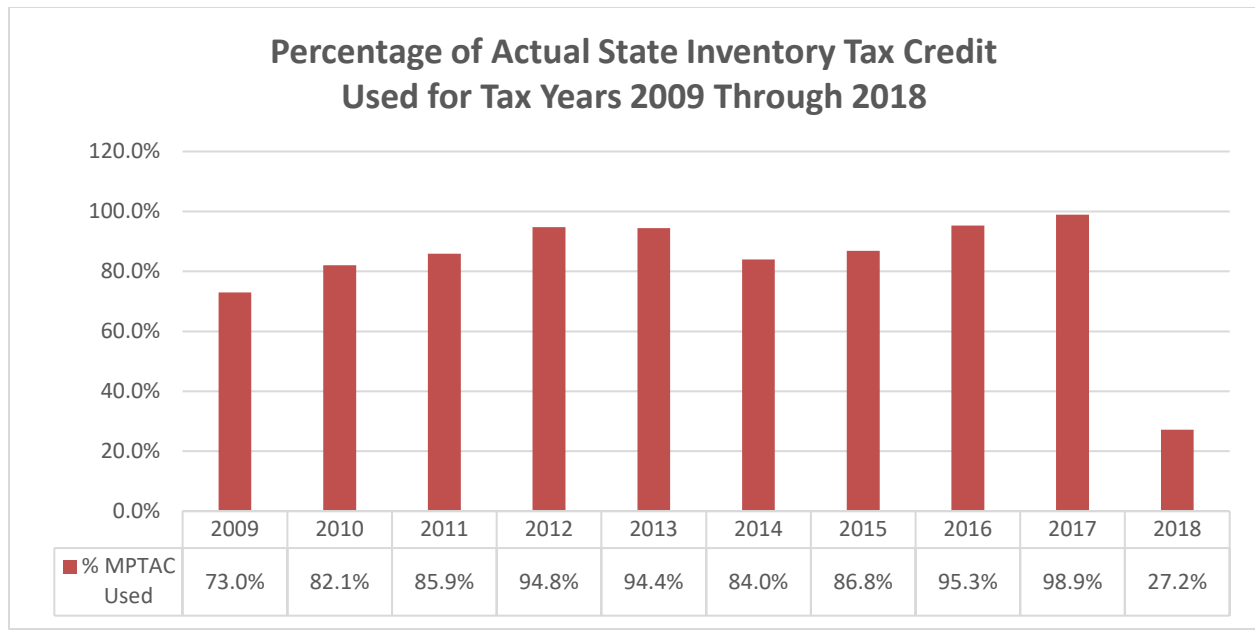
The lower level of actual tax credit claims is due to the fact that local property taxes imposed on manufacturing inventory tend to be greater in magnitude than State income taxes for many in the manufacturing sector. Based on statistical data published by the Internal Revenue Service's Statistics of Income Division, more than 40 percent of all U.S. manufacturing firms filing annual income tax returns report no net taxable income on their tax returns in any given year⁴. Federal taxable income is the starting point for the determination of the West Virginia Income Tax. These businesses would pay no West Virginia income taxes and therefore would not be able to claim any inventory tax credits. Businesses with taxable income would be able to claim the inventory

⁴ Internal Revenue Service SOI Tax Stats-Historical Table 14b.

tax credit. However, some of these Taxpayers would pay more in local inventory property taxes than in State income taxes and therefore be limited in the use of the inventory tax credit. West Virginia also offers manufacturing investment tax credits against income tax with the result of less tax liability remaining for offset by the inventory tax credit. The following section examines statistical use of the inventory tax credit for the subgroup of manufacturers with net taxable income and pre-credit State Corporation Net Income Tax liability.

Based on State inventory tax credit schedules filed for Tax Years 2013 to 2017 for companies with a pre-credit state tax liability, roughly 92 percent of reported available credit funds were claimed by Taxpayers. For comparison, the average amount of claimed to available credit was approximately 84 percent for Tax Years 2009 to 2012. As mentioned previously, Tax Years 2016 through 2019 are currently subject to revision as amended returns are filed and processed. The following graph compares the amount of credit available and amount of credit used between Tax Years 2009 through 2018. The second graph shows the percentage of credit utilization since the inception of the Manufacturing Property Tax Adjustment Credit. Although the total Inventory Tax Credit available decreased from \$7.2 million in Tax year 2014 to \$2.5 million in Tax Year 2017, the total credit utilization rate remains high at roughly 94 percent since 2015. Credit usage rates are significantly lower in tax year 2018 because many Corporation Return Income Tax returns have not been fully processed yet.





Manufacturing Inventory Personal Property Tax for Tax Year 2019

The basis for the credit is the West Virginia Property Tax paid by manufacturers on the value of manufacturing inventory. Manufacturing inventory is essentially raw materials, goods in process, and finished goods of a manufacturer. Based upon information from the West Virginia State Tax Department Property Tax Division, the total potential manufacturing inventory Personal Property Tax would range between \$29 million to \$33 million after application of the exemption provided by the Freeport Amendment (see Appendix B for the formal description of the exemption).⁵

⁵ These data are provided for illustration of Tax Year 2019 tax rates related to inventory property taxes in West Virginia. Rates of levy vary from year to year; rates of levy for other taxable periods are available online at <https://www.wvsao.gov/localgovernment/reports>.

Table 2
Manufacturing Inventory Personal Property Tax for Tax Year 2019

Item	Value	Appraised Value Percentage
Supplemental - Raw Materials	\$884,665,826	42.96%
Supplemental - Finished Goods	\$145,918,282	7.09%
Supplemental - Goods in Process	\$421,629,907	20.48%
Supplemental - Machine in Process of Installation	\$219,520,073	10.66%
Supplemental - Parts Held for Owner's Use	\$148,215,066	7.20%
Supplemental - Supplies Held for Owner's Liability	\$98,180,317	4.77%
Inventory	\$41,341,806	2.01%
Supplemental - Incomplete Construction	\$13,591,215	0.66%
Supplemental - Inventory	\$59,430,750	2.89%
Supplies Held for Owner's Use	\$249,456	0.01%
Supplemental - Tool in Process of Installation	\$5,935,586	0.29%
Supplemental - Consigned Goods	\$2,090,482	0.10%
Raw Materials	N/A	N/A
Finished Goods	\$15,621	0.00%
Consigned Goods	\$1,396	0.00%
Cost as of July	\$18,423,048	0.89%
Parts Held for Owner's Use	\$7,778	0.00%
Goods in Process	N/A	N/A
Total Appraised Value of Inventory	\$2,059,216,609	
Assessed Value of Inventory	\$1,235,529,965	
Estimated Property Taxes on Manufacturing Inventory	\$30,888,249	

Formal definitions of all Property Tax classes are presented in Appendix B. Class III tax rates would apply to manufacturing inventory located outside municipal borders, while Class IV tax rates would apply to manufacturing inventory located inside municipal borders. In Table 2, the estimated property taxes on manufacturing inventory were calculated by taking the weighted average of the Class III and Class IV rates and applying this rate of 2.5% to the assessed value of the manufacturing inventory, as it is often difficult to determine whether certain manufacturing inventory items fall outside or inside municipal boundaries. Manufacturing property tends to be more heavily concentrated in jurisdictions with higher than average property tax rates.

As shown in Table 3, five industries account for 68.5 percent of the total taxable inventory value. Detail on all manufacturing classifications is presented in Appendix C.

Table 3
Manufacturing Inventory Appraised Value for Tax Year 2019 (Largest Industries)

NAICS	Description	Appraised Value	% of Total
325	Chemical Manufacturing	\$ 556,491,558	27.0%
331	Primary Metal Manufacturing	\$ 426,811,907	20.7%
332	Fabricated Metal Product Manufacturing	\$ 177,536,519	8.6%
336	Transportation Equipment Manufacturing	\$ 134,302,840	6.5%
339	Nonmetallic Mineral Manufacturing	\$ 116,455,216	5.7%

Since the number of Inventory Tax Credit claimants is small, summaries of the credit by manufacturing classification have been withheld to avoid the possible disclosure of tax information for individual taxpayers. The amount of tax credit is constrained by the Taxpayer's Corporation Net Income Tax liability. For Taxpayers who take advantage of this credit, approximately 85 percent of available credit is used on average. The average amount of credit claimed per year from 2011 to 2014 was roughly \$5.5 million. The elimination of the Business Franchise Tax in January 2015 reduced the average credit claimed between 2015 and 2018 to \$3.4 million per year, as the tax credit currently only offsets the Corporation Net Income Tax. When all returns are finalized for the 2016 to 2018 period, the average annual credit claimed since 2015 is expected to range between \$4.0 million and \$4.5 million per year.

Appendix A
Manufacturing Property Tax Adjustment Credit Claims by Tax and Business Type

Table A-1
Claims from Current Report

	2012	2013	2014	2015	2016	2017	2018	Total
BFT (PTE)	\$ 549,663	\$ 394,511	\$ 181,249	\$ 0	\$ 0	\$ 0	\$ 0	\$ 1,125,423
BFT (C-Corp)	2,232,806	2,133,700	1,006,891	0	0	0	0	5,373,397
CNIT	1,722,414	3,859,477	4,576,216	5,442,592	3,481,413	2,431,865	286,448	21,800,425
Total	\$ 4,504,883	\$ 6,387,688	\$ 5,764,356	\$ 5,442,592	\$ 3,481,413	\$ 2,431,865	\$ 286,448	\$ 28,299,245

Table A-2
Claims from July 1, 2019 Report

	2012	2013	2014	2015	2016	2017	2018	Total
BFT (PTE)	\$ 518,646	\$ 394,511	\$ 172,794	\$ 0	\$ 0	\$ 0	\$ 0	\$ 1,085,951
BFT (C-Corp)	2,232,012	3,963,267	1,006,891	0	0	0	0	7,202,170
CNIT	1,722,414	2,029,910	2,226,503	2,093,067	1,619,975	1,158,597	0	10,850,466
Total	\$ 4,473,072	\$ 6,387,688	\$ 3,406,188	\$ 2,093,067	\$ 1,619,975	\$ 1,158,597	\$ 0	\$ 19,138,587

Table A-3
Changes in Claims from July 1, 2019 Report to Current Report

	2012	2013	2014	2015	2016	2017	2018	Total
BFT (PTE)	\$ 30,967	\$ 0	\$ 8,455	\$ 0	\$ 0	\$ 0	\$ 0	\$ 39,422
BFT (C-Corp)	794	-1,829,567	0	0	0	0	0	-1,828,773
CNIT	0	1,829,567	2,349,713	3,349,525	1,861,438	1,273,268	286,448	10,949,959
Total	\$ 31,761	\$ 0	\$ 2,358,168	\$ 3,349,525	\$ 1,861,438	\$ 1,273,268	\$ 286,448	\$ 9,160,608

Appendix B

Property Tax Classes and the Freeport Amendment

Property Tax Classes:

Class I – All tangible personal property employed exclusively in agriculture, including horticulture and grazing; all products of agriculture, including livestock, while owned by the producer; all notes, bonds, bills and accounts receivable, stocks and any other intangible personal property.⁶

Class II – All property owned, used and occupied by the owner exclusively for residential purposes; all farms, including land used for horticulture and grazing, occupied and cultivated by their owners or bonafide tenants.

Class III – All real and personal property situated outside municipalities, exclusive of Classes I and II.

Class IV – All real and personal property situated inside municipalities, exclusive of Classes I and II.

Freeport Amendment:

West Virginia Constitution §10-1c. Exemption from ad valorem taxation of certain personal property of inventory and warehouse goods, with phase into full exemption over five-year period.

Notwithstanding any other provisions of this Constitution, tangible personal property which is moving in interstate commerce through or over the territory of the State of West Virginia, or which was consigned from a point of origin outside the State to a warehouse, public or private, within the State for storage in transit to a final destination outside the State, whether specified when transportation begins or afterward, but in any case specified timely for exempt status determination purposes, shall not be deemed to have acquired a tax situs in West Virginia for purposes of ad valorem taxation and shall be exempt from such taxation, except as otherwise provided in this section. Such property shall not be deprived of such exemption because while in the warehouse the personal property is assembled, bound, joined, processed, disassembled, divided, cut, broken in bulk, relabeled, or repackaged for delivery out of state, unless such activity results in a new or different product, article, substance or commodity, or one of different utility. Personal property of inventories of natural resources shall not be exempt from ad valorem taxation unless required by paramount federal law.

The exemption allowed by the preceding paragraph shall be phased in over a period of five consecutive assessment years, at the rate of one fifth of the assessed value of the property per assessment year, beginning the first day of July, one thousand nine hundred eighty-seven.

⁶ Class I property has been exempt from the Property Tax since Tax Year 2008.

Appendix C
Manufacturing Inventory Property Tax by North American Industry Classification System (NAICS) Codes for Tax Year 2019

NAICS	Description	Appraised Value of Inventory	Assessed Value of Inventory	Estimated Property Taxes On Manufacturing Inventory	Share of Total Appraised Value
325	Chemical Manufacturing	\$556,491,558	\$333,894,935	\$8,013,478	27.02%
331	Primary Metal Manufacturing	\$426,811,907	\$256,087,144	\$6,146,091	20.73%
336	Transportation Equipment Manufacturing	\$134,302,840	\$80,581,704	\$1,933,961	6.52%
332	Fabricated Metal Product Manufacturing	\$177,536,519	\$106,521,911	\$2,556,526	8.62%
327	Nonmetallic Mineral Product Manufacturing	\$116,455,216	\$69,873,130	\$1,676,955	5.66%
339	Miscellaneous Manufacturing	\$102,237,250	\$61,342,350	\$1,472,216	4.96%
321	Wood Product Manufacturing	\$119,996,654	\$71,997,992	\$1,727,952	5.83%
324	Petroleum and Coal Product Manufacturing	\$108,759,567	\$65,255,740	\$1,566,138	5.28%
326	Plastics and Rubber Product Manufacturing	\$108,997,444	\$65,398,466	\$1,569,563	5.29%
333	Machinery Manufacturing	\$71,936,910	\$43,162,146	\$1,035,892	3.49%
335	Electrical equipment, Appliance and Component Manufacturing	\$52,203,863	\$31,322,318	\$751,736	2.54%
322	Paper Manufacturing	\$28,117,435	\$16,870,461	\$404,891	1.37%
311	Food Manufacturing	\$15,505,806	\$9,303,484	\$223,284	0.75%
312	Beverage and Tobacco Manufacturing	\$15,511,123	\$9,306,674	\$223,360	0.75%
337	Furniture and Related Product Manufacturing	\$9,989,916	\$5,993,950	\$143,855	0.49%
334	Computer and Electronic Product Manufacturing	\$5,817,493	\$3,490,496	\$83,772	0.28%
323	Printing and Related Support Activities	\$6,192,300	\$3,715,380	\$89,169	0.30%
315	Apparel Manufacturing	\$1,101,738	\$661,043	\$15,865	0.05%
314	Textile Product Mills	\$724,274	\$434,564	\$10,430	0.04%
313	Textile Mills	\$520,066	\$312,040	\$7,489	0.03%
316	Leather and Allied Product Manufacturing	\$6,730	\$4,038	\$97	0.00%
TOTAL		\$2,059,216,609	\$1,235,529,965	\$29,652,719	100.00%