



BOARD OF EQUALIZATION

## PROPERTY TAX COMMITTEE MEETING MINUTES

HONORABLE GEORGE RUNNER, COMMITTEE CHAIR  
450 N STREET, SACRAMENTO

JANUARY 16, 2014 - 10:00 A.M.

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### ACTION ITEM

#### Agenda Item No: 1

##### Title:

Report on Bundled Nontaxable Software – Embedded Software

##### Issue:

The report submitted to the Committee represents the findings and observations of Board staff from the information obtained regarding the treatment of nontaxable software when it is part of a bundled purchase order.

##### Committee Discussion:

Committee Chair Runner opened the Committee meeting by introducing the agenda item and asked staff to give a report on the issue.

Dean Kinnee, Chief, County-Assessed Properties Division, gave the Committee an overview of the report and explained how the data in the report was collected.

Presentations were made by:

Honorable Larry Stone, Santa Clara County Assessor, Chair of the California Assessors' Association (CAA) Ad Hoc Committee on Embedded Software

Ms. Therese Twomey, Fiscal Policy Director, California Taxpayers Association (Cal Tax)

Mr. W. Greg Turner, Vice President, Senior Tax Counsel, Council on State Taxation (COST)

##### CAA

The 40-year old statute in Revenue and Taxation Code section 995 is difficult to administer and no longer feasible in today's world where practically every industry contains equipment that has application software. The report prepared by Board staff helps to array the problems and strikes the right tone. The CAA advocates legislation to catch up to today's technology and asks the Board to join the CAA in seeking a legislative solution. In the interim, a workaround fix must be sought. The CAA has drafted guidelines to provide taxpayers with an outline of what county assessors need in order to allow the tax exclusion provided for application software in section 995. It is anticipated that the guidelines will be available within one month.

## **COST**

Legislation would be limited by the California Constitution and, therefore, it is difficult to compare California with other states. Quality of evidence is the difficulty in identification of the proper value for software. The Board should inform taxpayers what type of evidence is necessary to get nontaxable software excluded. Guidelines will be productive and useful. Tables could be useful, but most manufacturers are not willing to provide the necessary data to facilitate tables, and the sheer vastness of types of equipment and industries makes tables impractical.

## **CAL TAX**

The report prepared by Board staff is missing significant information. (1) What assessors determine is insufficient data? What areas need more clarification? (2) Only five states surveyed—what about other states? (3) State-Assessed Properties Division (SAPD) works with assessees on exempting application software—look at studies submitted to SAPD. What are good components?

It is problematic that 58 assessors have different procedures for assessing application software. Cal Tax does not believe legislation is the cure for the problem. Cal Tax asks that the Property Tax Committee hold meetings to further discuss SAPD studies and discuss parameters for possible studies. Taxpayers cannot get data from manufacturers due to confidentiality agreements. Cal Tax is concerned that the CAA is putting together guidelines without industry input.

## **Tables**

Member Steel suggested that tables be developed for application software, similar to the tables developed for other equipment by Board staff.

Member Horton stated that we must establish baseline evaluation methodologies through some extensive studies. We must get to conclusive numbers, and Board staff should develop tables. The problem is the ability to verify data and an issue of trust. Member Horton stated that he does not want the Legislature to solve the issue.

Cal Tax agreed that tables would be a simple approach and could equalize the uncertainty that currently exists, and that tables need not be built from the ground up. Percentages have been discussed within industry, and the tables could reflect percentages that have been accepted by counties.

COST indicated that it would be impractical to try to develop tables because of the difficulty of trying to identify property that is changing rapidly. Additionally, there is no data available from manufacturers to develop tables. It is more meaningful to develop guidelines to identify data necessary to document exemption claims.

CAA stated that industry is extremely guarded about data and that it is not likely that sufficient data would be made available to develop tables. Santa Clara County budgeted for and attempted to get information from industries, however, the industries did not want to participate or provide data. Arbitrary percentages are not supportive of documentation/evidence to allow county assessors to make value determination. Assessors cannot trust vagaries; they need cost accounting data to implement the provisions of section 995.

## **Studies**

CAA indicated the problem with studies is the vastness of industries and the number of properties within the industries. The CAA concluded that, from the county perspective,

studies have not provided enough evidence to justify assessment reductions.

SAPD indicated that it has used some studies submitted by taxpayers as a starting point in their process.

COST requested guidelines for taxpayers regarding what data is necessary to document exemption claims.

Cal Tax wants the Board to pursue the discussion regarding studies and acceptable documentation to assist in the valuation process.

### Letter To Assessors

Committee Chair Runner stated that SAPD does extract data to exempt software from data submitted by state assessees. The first step would be to develop a Letter To Assessors (LTA) providing guidelines on what SAPD has used to identify exempt software.

Member Yee stated that the core focus in establishing guidelines is what documentation is necessary. Member Yee further stated that we should gain more insight into what other states are employing to value application software.

Member Mandel indicated that it could be useful to get data from other states. Currently, counties have different ideas about what is sufficient data for assessors and appeals boards.

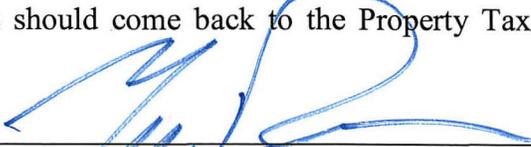
Member Horton stated that we should wait to develop an LTA until after the CAA completes their guidelines.

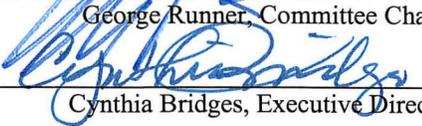
### Committee Action:

Member Yee moved to draft an LTA discussing the various methodologies submitted to SAPD and discussing the challenges with each of the methodologies and the adjustments that are necessary to make value determinations. The motion was seconded by Committee Chair Runner and approved by the Committee.

Committee Chair Runner directed staff to monitor the guidelines from the CAA and to solicit more information from other states. The Chair further indicated a possible meeting later to discuss any new information that may have potential solutions to the embedded software issues. The Committee Chair directed that the topic should come back to the Property Tax Committee in May 2014.

Approved:

  
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George Runner, Committee Chair

  
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Cynthia Bridges, Executive Director

BOARD APPROVED

At the 3/25/14 Board Meeting

  
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Joann Richmond, Chief  
Board Proceedings Division