



January 10, 2014

Honorable Jerome Horton
Chair, State Board of Equalization

Honorable George Runner, Senator
Chair, State Board of Equalization Property Tax Committee

Dear Chairman Horton and Senator Runner,

Thank you for your ongoing work on valuation of bundled nontaxable software (embedded software), particularly the recent Board of Equalization (BOE) questionnaire to all county assessors. This project involved a lot of time and commitment, and we commend the Board's staff for their work.

When we initially approached you and the other Board members to request that a county survey be conducted, very little statewide data was available regarding assessor valuation of bundled nontaxable software. As a result of your efforts, the questionnaire responses point to the following general observations:

- There is a lack of uniformity pertaining to the tax treatment and valuation of bundled nontaxable software among the 48 counties that responded to the questionnaire. For example, about half of the counties surveyed have made adjustments to remove bundled nontaxable software from the cost of the machinery or equipment, while the other counties have not.
- The number of assessment appeals filed per year generally appears to be trending upward for the years surveyed. For example, for the three most recent years there were 236 cases where an assessment was appealed in 2010-11, dropping to 192 in 2011-12, and growing to 285 in 2012-13.
- Some counties are allowing assessment adjustments based on invoices, studies or vendor letters of determination, etc. while others are rejecting such documentation. Here again, the ratio for counties accepting vs. rejecting documentation is split 50/50.

- A number of counties used a percentage approach to ascertain the value of nontaxable bundled software (relative to the cost of the equipment), in cases where an invoice, manufacturer/vendor itemized cost breakdown, study, etc. may have been unavailable.

These findings demonstrate that there is a clear need for uniformity in this area. They are also important to our joint effort in seeking solutions that improve uniformity, certainty and fairness for taxpayers.

We have reviewed the report that your staff will be presenting to you at the January 16 BOE meeting, and we find that while the report does a good job describing the current situation and the challenges associated with embedded software valuation, it could be improved with certain information that would be helpful to BOE members in defining the next steps.

For example, the report indicates that of the 48 counties that responded to the questionnaire, 10 counties rejected exemption requests because “taxpayers did not provide sufficient evidence ... or sufficient data to make value determinations.” However, there is no explanation as to what portions of evidence or data assessors find deficient, or why it is deemed deficient. We believe this information is critical in resolving documentation issues.

The report includes queried responses from four states on their treatment of application software, and based on this limited sample, may suggest taxation of application software as a way to promote uniformity and consistency without a comprehensive examination of other approaches or methodologies. Moreover, the report does not include a discussion of how the other 45 states treat embedded software, and does not mention that 11 states have either eliminated or significantly scaled back taxes on business personal property – in some cases to resolve valuation issues.

Finally, the report indicates that the BOE’s State-Assessed Property Tax Division has “received numerous studies over the last two years” and that “there are many different methodologies employed by assesses and their consultants in the studies.” We believe it would be helpful if the BOE staff would describe the components of supportable documentation and studies, and provide information pertaining to the methodologies referenced.

To further this process, we ask the Property Tax Committee to convene a meeting to discuss the questionnaire results, the various methods that state-assessed taxpayers and BOE staff use to ascertain the value of bundled nontaxable software, and other topics that would be helpful for the Board to determine how to proceed. There are several valuation methods used by county-assessed taxpayers that we can share with you.

Thank you for the opportunity to share these thoughts, and I look forward to discussing possible solutions with you.

Sincerely,

A handwritten signature in black ink that reads "TERESA CASAZZA". The signature is written in all caps and is slightly slanted to the right.

Teresa Casazza
President
California Taxpayers Association

cc: Board Member Betty Yee
Board Member Michelle Steel
Board Representative Marcy Jo Mandel