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**HOUSE OF REPRESENTATIVES
AS REVISED BY THE COMMITTEE ON
COMMUNITY AFFAIRS
BILL ANALYSIS & ECONOMIC IMPACT STATEMENT**

BILL #: HB 1723

RELATING TO: Ad Valorem Taxation

SPONSOR(S): Committee on Finance & Taxation and Representatives Starks and others

STATUTE(S) AFFECTED: Sections 192.001, 193.155, 196.012, 196.195, and 196.196, Florida Statutes

COMPANION BILL(S): HB 897 (c), CS/S 918 (c), SB 1170 (c)

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:

- (1) FINANCE AND TAXATION YEAS 9 NAYS 2
- (2) COMMUNITY AFFAIRS YEAS 6 NAYS 0
- (3) GENERAL GOVERNMENT APPROPRIATIONS
- (4)
- (5)

I. SUMMARY:

The bill provides that computer software constitutes personal property only to the extent of the value of the unmounted or uninstalled medium on or in which the information, program, or routine is stored or transmitted. This effectively removes the value of software, except for the value of the diskette or other medium on which the information is stored, from ad valorem taxation.

The bill removes the authority for property appraisers to correct assessments of homestead property subject to the limitation on assessments unless property has not been assessed and back taxes are due.

The bill expands the definition of "educational institution" as it relates to property tax exemptions to include nonprofit private schools principally conducting classes accepted for continuing postgraduate dental education credit by the Division of Medical Quality Assurance, thereby exempting such institutions from ad valorem taxation.

The bill modifies the guidelines for determining profit or nonprofit status of applicants seeking property tax exemptions to include proof that a corporation is organized as nonprofit; has a valid consumer certificate of exemption; and has a valid exemption from federal income tax. Finally, the bill provides that use of property to conduct activities which cause a corporation to qualify for a consumer certificate of exemption is considered an exempt use.

If all counties taxed computer software, it is estimated that the loss to counties, municipalities, school districts, and special districts could be (\$47.4) million in FY 1997-98. At a minimum, the loss is estimated to be (\$4.3) million. Expanding the definition of "educational institution" is expected to result in a decrease in taxable value in Dade County of less than \$3 million and a decrease in tax of an estimated \$62,000. The modification to the guidelines for determining profitability and exempt use will have a negative indeterminate fiscal impact on local governments.

II. SUBSTANTIVE ANALYSIS:

A. PRESENT SITUATION:

Article VII, section 4, Florida Constitution, provides that by general law, regulations shall be prescribed that secure a just valuation of all property for ad valorem taxation. However, agricultural land, land producing high water recharge to Florida's aquifers and land used for recreation may be classified and assessed on the basis of use. Inventory and livestock may be assessed at a specified percentage of its value or exempted. Also increases in the value of homestead property is subject to limitations.

Section 192.042, F.S., states that all property shall be assessed for ad valorem taxes according to its just value as follows:

- (1) Real property, on January 1 of each year. Improvements or portions not substantially completed on January 1 are not assessed.
- (2) Tangible personal property, on January 1 of each year, except construction work in progress until it is substantially completed.

Section 192.001(11) defines tangible personal property. It provides:

(d) "Tangible personal property" means all goods, chattels, and other articles of value (but does not include the vehicular items enumerated in s. 1(b), Art. VII of the State Constitution and elsewhere defined) capable of manual possession and whose chief value is intrinsic to the article itself. "Construction work in progress" consists of those items of tangible personal property commonly known as fixtures, machinery, and equipment when on the process of being installed in new or expanded improvements to real property and whose value is materially enhanced upon connection or use with a preexisting, taxable, operational system or facility. Construction work in progress shall be deemed substantially completed when connected with the preexisting, taxable, operational system or facility. Inventory and household goods are expressly excluded from this definition.

Consequently, all tangible personal property, except inventory and household goods, is subject to ad valorem taxation.

Whether computer software constitutes tangible personal property is the subject of debate and litigation. No rules or guidelines of the Department of Revenue address the issue; nor does the department have a position on whether computer software is taxable. Consequently, it is unclear whether property appraisers treat computer software uniformly throughout the state. In addition, property appraisers find it difficult to estimate the amount of computer software on their tax rolls. Tangible personal property is self disclosed, and taxpayers lump software with hardware or with other electronic data processing equipment.

The issue of the taxability of computer software as tangible personal property is the subject of litigation in at least two counties, Dade County and Volusia County. Airbus Service Company, Inc. v. Robbins, et al., Dade County Circuit Court Case Nos. 94-22883 CA 27 and 95-24228 CA 27, and Lockheed/Martin and General Electric Co. v. Volusia County, Volusia County Circuit Court Case Nos. 92-10367, 94-10343, and 94-

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11173. In other counties the issue has been raised by taxpayers to the property appraiser or is an issue before the value adjustment board.

Article VII, section 4(c), Florida Constitution, limits annual increases in the assessment of homestead property to the lower of 3 percent or the percentage change in the Consumer Price Index. New homestead property and homestead property which has changed ownership is to be assessed at fair market value. Subsequent increases in assessment are subject to the annual limitation.

Section 193.155, F.S., implements the limitation in increases in assessments of homestead property. In subsection (8) it provides for corrections of erroneous assessments. If errors are made in arriving at any annual assessment under the section due to a material mistake of fact concerning an essential characteristic of the property, the assessment must be recalculated for every such year. Further, if changes, additions, or improvements are not assessed at just value as of the first January 1 after they were substantially completed, the property appraiser is to determine the just value for such changes, additions, or improvements for the year they were substantially completed and make corrections to assessments for subsequent years. If property was not assessed and back taxes are due pursuant to s. 193.092, F.S., then the calculation for back taxes are made pursuant to s. 193.092, F.S.

Section 193.155(9), F.S., provides for the payment of tax plus a penalty of 50 percent of the unpaid taxes for each year and 15 percent interest per annum if it is determined within the prior 10 years that a person was not entitled to the homestead property assessment limitation. However, if person entitled to a homestead exemption inadvertently receives the limitation on assessments following a change of ownership the assessment must be corrected but the taxpayer is not subject to the unpaid taxes, penalties, or interest.

Section 196.198, F.S., exempts educational institutions and their property used exclusively for educational purposes from property tax.

Section 196.012, F.S., defines "educational institution" as any federal, state, parochial, church, or private school, college, or university conducting regular classes and courses of study required for eligibility to certification by, accreditation to, or membership in the State Department of Education of Florida, Southern Association of Colleges and Schools, or the Florida Council of Independent Schools; educational direct-support organizations; and facilities located on the property of eligible entities which will become owned by those entities on a date certain.

Chapter 194, F.S., provides a process for taxpayers to challenge ad valorem assessments. Each county has a value adjustment board whose duty is to review and decide upon petitions by taxpayers challenging their assessment. The county property appraiser may appeal the decision of the value adjustment board to the appropriate county circuit court if he or she disagrees with such decision.

Chapter 196, F.S., provides exemptions from property taxation. Section 196.192, F.S., provides that all property owned by an exempt entity and used exclusively for exempt purposes shall be totally exempt. Additionally, all property owned by an exempt entity and used predominantly for exempt purposes shall be exempt from ad valorem taxation to the extent of the ratio that such predominant use bears to the nonexempt use.

“Exempt use of property” or “use of property for exempt purposes” is defined in s. 196.012, F.S., to mean predominant or exclusive use of property owned by an exempt entity for educational, literary, scientific, religious, charitable, or governmental purposes.

Section 196.195, F.S., provides some guidelines for the determination of whether an applicant for a religious, literary, scientific, or charitable exemption is a nonprofit or profit making venture. The guidelines include, but are not limited to, the reasonableness of advances or payment of salary to persons who have direct or indirect control of the entity, the reasonableness of any contractual arrangement between the entity and parties who have direct or indirect control of the entity, and the reasonableness of charges made for services by the entity. Section 196.196, F.S., provides criteria for determining whether property is entitled to charitable, religious, scientific, or literary exemption. The criteria include the nature and extent of the activity and the extent to which the property has been made available to groups who perform exempt purposes at a charge that is equal to or less than the cost of providing the facilities for their use. It provides that only property which is used predominantly for an exempt purpose is to be exempt. Further, it provides that profit making purposes are not exempt.

B. EFFECT OF PROPOSED CHANGES:

The bill defines computer software to include among other things operating and application programs and all related documentation. It provides that computer software constitutes personal property only to the extent of the value of the unmounted or uninstalled medium on or in which the information, program, or routine is stored or transmitted. Also, it provides that after installation or mounting, computer software does not increase the value of the computer or computer-related equipment. The bill effectively removes the value of software, except for the value of the diskette or other medium on which the information is stored, from ad valorem taxation.

The definition of computer software is to apply to the 1997 tax rolls and thereafter and to any assessment in an administrative or judicial action pending on the effective date of the section.

The bill deletes the provision allowing corrections of erroneous assessments of homestead property subject to the limitation on increases in assessments. Assessments of such homestead property is changed only if property is not assessed and back taxes are due pursuant to s. 193.092, F.S.

The bill expands the definition of "educational institution" as it relates to property tax exemptions to include nonprofit private schools principally conducting classes accepted for continuing postgraduate dental education credit by the Division of Medical Quality Assurance, thereby exempting such institutions from ad valorem taxation.

The Board of Dentistry of the Division of Medical Quality Assurance states that there is only one organization in Florida that is a postgraduate dental institution affected by this bill. That organization is the L. D. Pankey Institute in Key Biscayne, Florida. Therefore, it will be exempt from ad valorem taxation by statute.

According to the Executive Director of the L. D. Pankey Institute and the Dade County Tax Collector's Office, the Institute has been granted an educational exemption from

property taxes since 1992. This has required special appeal to the value adjustment board by the institute each year. This bill will grant this exemption by statute.

The bill amends s. 196.195, F.S., to provide that the demonstration of proof that a corporation is organized as nonprofit under ch. 617, F.S., has a valid consumer certificate of exemption pursuant to s. 212.08(7)(o), F.S., and has a valid exemption from federal income tax under s. 501(c)(3) of the Internal Revenue Code is sufficient to establish the organization's nonprofit status. Additionally, the bill amends s. 196.196, F.S., to provide that use of property in conducting activities which cause a corporation to qualify for a consumer certificate of exemption under s. 212.08(7)(o), F.S., is considered an exempt use of property.

C. APPLICATION OF PRINCIPLES:

1. Less Government:

a. Does the bill create, increase or reduce, either directly or indirectly:

(1) any authority to make rules or adjudicate disputes?

No

(2) any new responsibilities, obligations or work for other governmental or private organizations or individuals?

No

(3) any entitlement to a government service or benefit?

No

b. If an agency or program is eliminated or reduced:

(1) what responsibilities, costs and powers are passed on to another program, agency, level of government, or private entity?

NA

(2) what is the cost of such responsibility at the new level/agency?

NA

(3) how is the new agency accountable to the people governed?

NA

2. Lower Taxes:

- a. Does the bill increase anyone's taxes?

See II.C.2.c. below

- b. Does the bill require or authorize an increase in any fees?

See II.C.2.c. below

- c. Does the bill reduce total taxes, both rates and revenues?

The bill provides new exemptions or expands existing exemptions from ad valorem taxation. Such exemptions result in reductions in taxes in jurisdictions which are at the maximum tax rate. Other jurisdictions can offset the tax loss by increasing the tax rate. In such jurisdictions the exemption results in a shift from the entities which qualify for the exemption to those that do not.

- d. Does the bill reduce total fees, both rates and revenues?

No

- e. Does the bill authorize any fee or tax increase by any local government?

No

3. Personal Responsibility:

- a. Does the bill reduce or eliminate an entitlement to government services or subsidy?

No

- b. Do the beneficiaries of the legislation directly pay any portion of the cost of implementation and operation?

No

4. Individual Freedom:

- a. Does the bill increase the allowable options of individuals or private organizations/associations to conduct their own affairs?

No

- b. Does the bill prohibit, or create new government interference with, any presently lawful activity?

No

5. Family Empowerment:

a. If the bill purports to provide services to families or children:

(1) Who evaluates the family's needs?

NA

(2) Who makes the decisions?

NA

(3) Are private alternatives permitted?

NA

(4) Are families required to participate in a program?

NA

(5) Are families penalized for not participating in a program?

NA

b. Does the bill directly affect the legal rights and obligations between family members?

No

c. If the bill creates or changes a program providing services to families or children, in which of the following does the bill vest control of the program, either through direct participation or appointment authority:

(1) parents and guardians?

NA

(2) service providers?

NA

(3) government employees/agencies?

NA

D. SECTION-BY-SECTION ANALYSIS:

Section 1 amends s. 192.001, F.S., to define "Computer software." It provides that computer software constitutes personal property only to the extent of the value of the unmounted or uninstalled medium on which the information is stored. Finally, it provides that after installation computer software does not increase the value of the computer or computer-related equipment. The provision takes effect upon the act becoming law, and applies to the 1997 tax rolls and thereafter and to any assessment in an administrative or judicial action pending on the effective date of the section.

Section 2 amends s. 193.155, F.S., to remove the authority for property appraisers to correct assessments of homestead property subject to the limitation on assessments unless property has not been assessed and back taxes pursuant to s. 193.092, F.S., are due.

Section 3 amends s. 196.012(5), F.S., to include nonprofit private schools that conduct regular courses of study accepted for continuing postgraduate dental education by a board of the Division of Medical Quality Assurance of the Department of Business and Professional Regulation in the definition of "educational institution" for purposes of exemption of such institutions from ad valorem taxation.

Section 4 amends s. 196.195, F.S., to provide that the demonstration of proof that a corporation is organized as nonprofit under ch. 617, F.S., has a valid consumer certificate of exemption pursuant to s. 212.08(7)(o), F.S., and has a valid exemption from federal income tax under s. 501 (c)(3) of the Internal Revenue Code is sufficient to establish the organization's nonprofit status.

Section 5 amends s. 196.196, F.S., to provide that use of property in conducting activities which cause a corporation to qualify for a consumer certificate of exemption under s. 212.08(7)(o), F.S., is considered an exempt use of property.

Section 6 provides that except as otherwise provided herein, this act shall take effect January 1, 1998.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring Effects:

None

2. Recurring Effects:

None

3. Long Run Effects Other Than Normal Growth:

None

4. Total Revenues and Expenditures:

None

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring Effects:

None

2. Recurring Effects:

Since property appraisers do not treat computer software uniformly throughout the state, the loss to local governments is indeterminate. If all counties taxed computer software, it is estimated that the loss to counties, municipalities, school districts, and special districts could be (\$47.4) million in FY 1997-98. At a minimum, the loss is (\$4.3) million in FY 1997-98. This minimum represents the estimate for Charlotte, Dade, Duval, and Orange Counties which are among those counties currently taxing computer software.

Expanding the definition of "educational institution" is expected to result in a decrease in taxable value in Dade County of less than \$3 million and a decrease in tax of an estimated \$62,000.

The modification to the guidelines for determining profitability and exempt use will have a negative indeterminate fiscal impact on local governments.

3. Long Run Effects Other Than Normal Growth:

None

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

1. Direct Private Sector Costs:

None

2. Direct Private Sector Benefits:

Those entities which own computer software will have a reduced tax burden.

The L. D. Pankey Institute will benefit from the grant of the tax exemption and from reduced legal costs.

3. Effects on Competition, Private Enterprise and Employment Markets:

None

D. FISCAL COMMENTS:

Paragraph 212.08(7)(o)2.d., F.S., relating to sales tax exemptions provides a definition of "education institution" similar to that for property taxes yet it includes nonprofit private schools which conduct regular classes and courses of study accepted for continuing education credit by a Board of the Division of Medical Quality Assurance of the Department of Business and Professional Regulation or which conduct regular classes and courses of study accepted for continuing education credit by the American Medical Association. Therefore, the L.D. Pankey Institute is exempt from sales tax under the definition in s. 212.08, F.S.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

Some property appraisers have assessed computer software for ad valorem tax purposes. The bill limits the ability of these property appraisers to include such property on personal property tax rolls. In counties imposing ad valorem tax on computer software the bill reduces the authority municipalities and counties have to raise revenue. State wide the reduction in revenue raising authority is estimated to be (\$12.1) million for counties and municipalities, but at a minimum of (\$3.2) million. Therefore, the bill requires a two-thirds vote of each house to pass.

In addition, the bill reduces the authority of the City of Key Biscayne and Dade County to impose taxes on the L.D. Pankey Institute. The impact of this provision is expected to be a negative (\$62,000). Finally, the bill removes computer software from ad valorem tax rolls thereby reducing the ability of municipalities and counties to raise revenue by an indeterminate amount.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

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V. COMMENTS:

Similar provision as that provided in this bill defining computer software was contained in HB 2273 and SB 2226 filed during the 1996 Legislative Session.

House Bill 307 and SB 552 filed during the 1996 Legislative Session contained a similar provision for the expansion of the educational exemption.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

One amendment was passed by the House Committee on Community Affairs on April 15, 1997. The amendment strikes Section 2 from the bill thereby eliminating any changes to section 193.155, F.S., that remove the authority for property appraisers to correct assessments of homestead property.

VII. SIGNATURES:

COMMITTEE ON FINANCE AND TAXATION:

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