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Guest Commentary



California's Business Equipment Tax: A Beast of Burden for All

By Loren Kaye

Business taxpayers, especially those in the high-technology sector, have long complained that the property tax on business equipment is inconsistent, arbitrary, and inefficient. This report explores those issues and sheds light on the debate using both statistical and anecdotal documentation.

Notwithstanding the sincere efforts at cooperation between Cal-Tax, business taxpayers, and assessors, a deep divide still exists between taxpayers and tax agencies concerning the fundamental fairness of the application of the personal property tax. This report may provide some information to help bridge that divide and provide some common ground upon which to achieve some mutually acceptable solutions.

Growth in the technology sector and in the use of high-technology is key to California's future prosperity. Computers and other high-technology equipment are pervasive in the economy. From the perspective of business taxpayers, inconsistent or misapplied taxation of this type of equipment may have serious consequences on the growth of these sectors of the California economy.

In particular, the role of obsolescence as a factor in depreciation is the subject of an ongoing debate among taxpayers, assessors, State Board of Equalization (BOE) members and staff, and other interested parties. For purposes of valuing business equipment, the concept of "useful life" should include economic and technological obsolescence, as well as physical deterioration.



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The extent to which these other aspects are considered is a major policy issue for many industries and assessors.

For fiscal year 2000-01, gross-assessed valuation of real property and improvements totaled \$2.2 trillion. Assessment of tangible personal property totaled \$155 billion, or about 8 percent of all county-assessed valuation. Said another way, county-assessed personal property (which also includes boats and private airplanes) will bring in less than \$1.6 billion of the total \$24 billion-plus in statewide property tax revenues last year.

Most counties spend a disproportionate amount to collect personal property tax compared to the revenues received. According to a BOE survey, there is a 3-to-1 ratio statewide between county-employed real property appraisers and business property appraisers. That is, one-quarter of county appraisers value business property, to raise approximately 8 percent of property tax revenues.

Based on interviews conducted with numerous business property taxpayers, valuation is the most controversial and contentious aspect of the personal property tax. Assessors' offices – and the BOE – have relied on what many taxpayers believe to be anachronistic techniques and formulas to determine fair market value for property that loses value very rapidly. In today's environment of rapidly changing technologies and markets, taxpayers are highly critical of taxing agencies' reliance on a decades-old study of long-lived, heavy industrial property, and the application of that study's analytical framework to other unrelated types of equipment.

Even assessors agree. Two retired assessors and an incumbent assessor interviewed for this report favor repealing the tax. Among other things, they stated their belief that compliance costs for small- and medium-sized businesses are out of proportion to the tax generated from these businesses.

One of the greatest frustrations noted by taxpayers was the wide degree of inconsistency among counties for the tables that are used to determine the fair market value of property. A survey of the 20 counties with at least \$1 billion each of assessed value of personal property found variation among the counties in the manner and extent that similar property is valued.

The BOE's Assessment Practices Surveys found that, in counties with the largest personal property tax bases, most assessors did not use the board's recommended index factors, many did not follow the recommended depreciation schedules, and many made other adjustments to recommended approaches to valuation. In many cases, these surveys revealed that assessors generally favor administrative efficiencies over accurate, consistent valuations.

The inconsistency and unpredictability of the valuation system also encourage appeals.

A study of valuation differences among industries found evidence of wide disparities in several industries between their opinions of property valuation and the appraisals by county assessors. Not surprisingly, much of the disputed property was high-technology equipment or within the high-tech industry. According to the author, "High-technology equipment of all sorts was the source of well over half the total disputes reported. Other machinery, equipment, fixtures, office equipment, copiers, etc., each were disputed, but *en toto* these other categories amounted to less dispute than high-technology equipment alone." Of the four manufacturing industries reported to have the greatest margin of disputed valuation, three have high levels of technology equipment: aerospace, semiconductors, and computers and electronics.

There are substantial differences in the new BOE-adopted depreciation curves for non-production computers, compared with the schedule in place in the earlier part of the decade. Especially for rapidly obsolescing personal computers, the curves are steeper, and begin from a lower base. This results in consistently lower "fair market value" assessments (and lower property taxes paid) under the new tables, compared with relying on the office equipment table.

Most assessors include copiers as office equipment with a life of six years. But copiers are being replaced more quickly than in the past, and older copiers are re-leased at lower prices. However, the assessors' trend factors reflect physical life, not the technological life or the economically productive life.

A market does not exist for some equipment that is no longer used for production, including specialized, expensive tools. Nonetheless, some county assessors insists on valuing this idle equipment at a 20 percent minimum value, whereas taxpayers believe the value for equipment no longer used should be closer

to 0 percent. In fact, some equipment may have a negative value, because the cost to get rid of it exceeds the value.

According to retailers, depreciation factors in California are worse than in neighboring states.

Every category of business surveyed complained of the headaches caused by double assessment. Usually, if the taxpayer caught the mistake, it would be resolved on appeal. But the compliance costs – to research the equipment, file appropriate paperwork, and attend appeal meetings – disproportionate to what are easily correctable mistakes, not disputes over valuation.

For example, one biotechnology company was assessed for the same piece of equipment by both the real and business tax divisions of the Los Angeles County Assessor's Office. The assessor's office did not dispute that a double assessment occurred, but nonetheless required the taxpayer to provide extensive documentation and spend time in personal appearances to resolve the issue. The impression left with taxpayers is that the auditors for each division pick up the equipment because there is no disincentive for them not to record it and, more importantly, that there is a distinct lack of communication between the business and real property divisions.

The inconsistency and unpredictability of the valuation system also encourage appeals. Most high-technology companies report that they appeal annually, in large part because they want to keep their options open for taking advantage of another company's appeal or settlement. They protect their rights by appealing, even though this may be an inefficient use of resources. For larger companies, appeals can cost upwards of \$100,000.

Taxpayers in one large county decried the audit practice as "insular," and the auditors and supervisors as "inaccessible." Taxpayers believe that auditors give more attention to escape assessments – situations where property escaped assessment and the auditor increased the tax assessment – turning a blind eye to possible overvaluations.
