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TITLE 50 DEPARTMENT OF LOCAL GOVERNMENT FINANCE

Proposed Rule
LSA Document #05-252

DIGEST

Amends 50 IAC 4.2-4-3 to establish procedures for the valuation of computer application software in conformance with P.L.214-2005 (HEA 1120-2005). Effective 30 days after filing with the Secretary of State.

IC 4-22-2.1-5 Statement Concerning Rules Affecting Small Businesses
Estimated Number of Small Businesses Subject to This Rule:
The Department cannot accurately estimate the number of small businesses that will be directly affected by the valuation of application software governed by this rule. The valuation reduction provided under IC 6-1.1-31-7 and implemented by this rule will be available for businesses that possess and specifically identify application software as part of their Business Personal Property Return.
Estimated Average Annual Administrative Costs That Small Businesses Will Incur:
The Department cannot estimate the annual administrative costs that this rule will require. The administrative cost or associated reporting or record keeping cost to a small business will depend on the specific valuation of application software owned, controlled, or possessed by the small businesses, and/or the employment of a professional appraiser in order to value application software. A small business seeking to value application software to isolate the cost in order to remove that cost from assessable computer equipment would have to file an annual personal property return.
Estimated Total Annual Economic Impact on Small Businesses:
The Department estimates that there will be minimal impact on small businesses as a result of compliance with this rule.
- Justification of Requirements or Costs on Small Businesses Where Rule Is Not Expressly Required by Law: Businesses may incur compliance costs, such as the employment of a professional appraiser, incurred by small businesses in connection with the filing of the required annual personal property return to value the cost of application software. However, the employment of a professional appraiser is an option for the taxpayer and is not required by this rule.
- Supporting Data, Studies, and Analyses: The Department reviewed the Fiscal Impact Statement for House Enrolled Act 1120-2005 prepared by Legislative Services Agency. The Department has not relied on any other formal studies in reaching these estimates.

Regulatory Flexibility Analysis of Alternative Methods:
A method for the valuation of computer application software is required by P.L.214-2005 (HEA 1120-2005), the Department has performed minimal analysis of alternatives to this proposed rule.
- Explanation of Preliminary Determination: The adoption of this rule was mandated by P.L.214-2005 (HEA 1120-2005) to identify the fair market value of application software.
- Supporting Data, Studies, and Analyses: The Department reviewed the Fiscal Impact Statement for House Enrolled Act 1120-2005 (P.L.214-2005), prepared by Legislative Services Agency. The Department did not rely on any other formal studies in its decision not to employ alternatives to rulemaking.

50 IAC 4.2-4-3

SECTION 1. 50 IAC 4.2-4-3 IS AMENDED TO READ AS FOLLOWS:

50 IAC 4.2-4-3 Fully depreciated, retired, or nominally valued property; computer equipment; report and valuation
Authority: IC 6-1.1-31-1
Affected: IC 6-1.1-1-11

Sec. 3. (a) Depreciable personal property, as defined in ~~50 IAC 4.2-1-1(h),~~ **50 IAC 4.2-1-1(i),** that has not been retired from use must be reported for personal property assessment purposes whether or not the cost of ~~such~~ **the** property has been:

(1) removed from; ~~the taxpayer's books and records, has been~~
(2) recorded on; ~~the taxpayer's books and records,~~ or ~~has been~~
(3) recorded at a nominal value on;
the taxpayer's books and records.

(b) ~~Restoration of depreciable personal property written off.~~ Any fully depreciated personal property that:
(1) has been written off the taxpayer's books and records; and
(2) is:
(A) on hand at the tax situs; and
(B) not permanently retired;
on the assessment date;
must be reported in the return. The cost of ~~such~~ **the** property must be clearly shown as an adjustment in the space provided on the tax return as provided in section 4 of this rule.

(c) ~~Permanently retired depreciable personal property defined.~~ "Permanently retired depreciable personal property" means depreciable personal property that has been removed from the manufacturing process on the assessment date, or has been removed from services other than manufacturing on the assessment date, and is awaiting disposition, and must be scheduled to be scrapped, removed, or disposed of and will be considered to be permanently retired providing the taxpayer actually scraps or sells such property.
(1) ~~Adjustment for permanently retired depreciable personal property.~~ Depreciable personal property that is:
(A) on hand at the tax situs on the assessment date, included in the cost per books as reported by the taxpayer in their return; and
(B) permanently retired on the assessment date as herein defined;
is subject to an adjustment as herein provided if the taxpayer so elects.
(2) ~~Amount of adjustment.~~ The cost per books of permanently retired depreciable property can be taken as an adjustment from book cost of depreciable property on the return provided the cost of ~~such~~ **the** property is included in the cost per books actually reported on the return.
(3) ~~Eligibility.~~ In order to qualify for this adjustment, a taxpayer will need to substantiate that the property was:
(A) permanently retired; and
(B) not in use.

(d) ~~Valuation of permanently retired depreciable personal property.~~ Permanently retired depreciable personal property should be valued at its net scrap or net sale value. The valuation of this property:
(1) should be shown separately on the tax return; and
(2) will not be subject to the thirty percent (30%) limitation of original cost.

(e) ~~Valuation of depreciable personal property with a nominal value.~~ Depreciable personal property recorded on the books and records at a nominal or no value must be recorded at its actual acquisition cost determined by reference to the insurable value in the year of acquisition for Indiana property tax assessment purposes. This category of property would include, but not be limited to, bulk purchase or the acquisition of a going business concern.

(f) Valuation of computer equipment. Computers are made up of three (3) elements:
(1) hardware;
(2) operational software; and
(3) application software.
Computers (including hardware and operational software), must be reported at the actual acquisition cost regardless of how this property may be valued on the taxpayers books and records.

(g) Computers are made up of the following elements:
(1) Hardware. Hardware is composed of:
(A) mechanical;
(B) magnetic;
(C) electrical; and
(D) electronic;
devices and other components ~~which~~ **that** constitute the physical computer assembly.

(2) Operational software. The operational program:

(A) controls the hardware; ~~and~~

(B) actually makes the machine operational; ~~It~~

(C) is fundamental and necessary to the functioning of the computer hardware itself; ~~and~~

(D) performs such functions as loading, scheduling, supervision, and data management; ~~It~~

(E) represents the internalized instruction codes that translate information into a form usable by the equipment; ~~and~~

(F) controls the basic operations of the central processing unit to perform arithmetic ~~and/or~~ **or** logical operations, **or both,** automatically by means of programmed instructions; ~~It~~ **and**

(G) is not normally accessible or modifiable by the user.

(3) Application software. The application program is a written sequence of instructions which details the operations the equipment is to perform in order to achieve a specific objective of the user.

(h) If the value recorded on the books and records reflects charges for customer support services such as educational services, maintenance, or application software that relate to future periods and not to the value of the tangible personal property, ~~such~~ **the** charges may be deducted as nonassessable intangible personal property (to the extent that a separate charge or value can be identified).

(i) The true tax value at the time of acquisition of computer application software may be determined using the following:

(1) An independent, professional appraisal:

(A) must be made in conformance with generally accepted standards for appraisal practice;

(B) shall not be based on a contingent fee arrangement;

(C) shall include consideration of the cost, market, and income approaches; and

(D) shall distinguish the boundary in the equipment between exempt intangible application software and nonexempt tangible operational software.

The appraiser must have demonstrated competence in the valuation of software.

(2) In lieu of an independent professional appraisal, the taxpayer can evaluate existing assets already listed on its books and records and adjust them accordingly to reflect the software content using the valuation methods described in subdivision (1)(C).

~~(h)~~ **(j)** The allocation of interest incurred during construction and installation must be made (capitalized) for personal property tax purposes regardless of the fact that Section 263 of the Internal Revenue Code of 1986 is not applicable in certain cases. *(Department of Local Government Finance; 50 IAC 4.2-4-3; filed Dec 7, 1988, 9:35 a.m.: 12 IR 840, eff Mar 1, 1989; reinstated by IC 6-1.1-3-22, eff Jul 1, 2003)*

Notice of Public Hearing

Under IC 4-22-2-24, notice is hereby given that on January 17, 2006 at 10:00 a.m., at the Indiana Government Center-South, 402 West Washington Street, Conference Center Room 1, Indianapolis, Indiana the Department of Local Government Finance will hold a public hearing on a proposed amendment governing the valuation of computer application software.

This proposed rule does not impose any requirement or costs on a regulated entity not expressly required by state or federal law.

Copies of these rules are now on file at the Indiana Government Center-North, 100 North Senate Avenue, Room 1058(B) and Legislative Services Agency, One North Capitol, Suite 325, Indianapolis, Indiana and are open for public inspection.

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