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ENGROSSED HOUSE BILL 1376

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State of Washington

52nd Legislature

1991 Regular Session

By Representatives Wang, Holland, Fraser, Silver, Phillips, Brumsickle, Wynne, Horn, Pruitt, Orr, Sprenkle, Hine and Brekke; by request of Software Study Committee.

Read first time January 28, 1991. Referred to Committee on Revenue.

1 AN ACT Relating to the taxation of computer software; amending RCW  
2 84.36.815; amending 1990 c 255 s 2 (uncodified); adding a new section  
3 to chapter 84.04 RCW; adding a new section to chapter 84.36 RCW; adding  
4 a new section to chapter 84.40 RCW; creating new sections; and  
5 declaring an emergency.

6 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

7 NEW SECTION. **Sec. 1.** (1) The legislature finds that:

8 (a) Computer software is a class of personal property that is  
9 itself comprised of several different subclasses of personal property  
10 which can be distinguished by their use, development, distribution, and  
11 relationship to hardware, and includes custom software, canned  
12 software, and embedded software;

13 (b) Because different classes of software serve different needs,  
14 may be used by different taxpayers, and present different  
15 administrative burdens on both the state and the citizens of the state

1 of Washington, the different classes of software should be treated  
2 differently for tax purposes;

3 (c) Canned software should continue to be subject to property tax,  
4 but, because of its rapid obsolescence, should be subject to tax for  
5 only two years; and the taxable interest should reside with the end  
6 user;

7 (d) Canned software that has been modified should continue to be  
8 taxable on the canned portion of the software;

9 (e) Embedded software should continue to be taxed as part of the  
10 machinery or equipment of which it is a part;

11 (f) Custom software should be exempt from taxation, in part because  
12 of the difficulty in accurately and uniformly determining the value of  
13 such software;

14 (g) Retained rights in computer software should be exempt from the  
15 property tax in part because of the difficulty in accurately and  
16 uniformly determining the value of such software, the difficulty in  
17 determining the scope and situs of such rights, and the adverse  
18 economic consequences to the state of taxing such rights; and

19 (h) So-called "golden" or "master" copies of software should be  
20 exempt from property tax like business inventory.

21 (2) It is the intent of the legislature that:

22 (a) The voluntary compliance nature of the personal property tax  
23 system should be preserved and nothing in this act shall be construed  
24 to reduce the taxpayer's obligation to fully and accurately list all  
25 taxable computer software;

26 (b) Computer software should be listed and assessed for property  
27 taxes payable in 1991 and 1992 in the same manner and to the same  
28 extent as computer software was listed and assessed for taxes due in  
29 1989;

1 (c) The definition of custom software, golden or master copies, and  
2 retained rights shall be liberally construed in accordance with the  
3 purposes of this act;

4 (d) This act shall provide fairness, equity, and uniformity in the  
5 property tax treatment of each class of computer software in the state  
6 of Washington; and

7 (e) No inference should be taken from this act regarding the  
8 application of the property tax to data bases.

9 NEW SECTION. **Sec. 2.** A new section is added to chapter 84.04 RCW  
10 to read as follows:

11 (1) "Computer software" is a set of directions or instructions that  
12 exist in the form of machine-readable or human-readable code, is  
13 recorded on physical or electronic medium, and directs the operation of  
14 a computer system or other machinery or equipment. "Computer software"  
15 includes the associated documentation that describes the code and its  
16 use, operation, and maintenance and typically is delivered with the  
17 code to the user. "Computer software" does not include data bases.

18 A "data base" is text, data, or other information that may be  
19 accessed or managed with the aid of computer software but that does not  
20 itself have the capacity to direct the operation of a computer system  
21 or other machinery or equipment.

22 (2) "Custom computer software" is computer software that is  
23 designed for a single person's or a small group of persons' specific  
24 needs. "Custom computer software" includes modifications to canned  
25 computer software and can be developed in-house by the user, by outside  
26 developers, or by both.

27 A group of four or more persons is presumed not to be a small group  
28 of persons for the purposes of this subsection unless each of the  
29 persons is affiliated through common control and ownership. The

1 department may by rule provide a definition of small group and  
2 affiliates consistent with this subsection.

3 For purposes of this subsection, "person" has the meaning given in  
4 RCW 82.04.030.

5 (3) "Canned computer software," occasionally known as prewritten or  
6 standard software, is computer software that is designed for and  
7 distributed "as is" for multiple persons who can use it without  
8 modifying its code and that is not otherwise considered custom computer  
9 software.

10 (4) "Embedded software" is computer software that resides  
11 permanently on some internal memory device in a computer system or  
12 other machinery or equipment, that is not removable in the ordinary  
13 course of operation, and that is of a type necessary for the routine  
14 operation of the computer system or other machinery or equipment.  
15 "Embedded software" may be either canned or custom computer software.

16 (5) "Retained rights" are any and all rights, including  
17 intellectual property rights such as those rights arising from  
18 copyrights, patents, and trade secret laws, that are owned or are held  
19 under contract or license by a computer software developer, author,  
20 inventor, publisher, licensor, sublicensor, or distributor.

21 (6) A "golden" or "master" copy of computer software is a copy of  
22 computer software from which a computer software developer, author,  
23 inventor, publisher, licensor, sublicensor, or distributor makes copies  
24 for sale or license.

25 NEW SECTION. **Sec. 3.** A new section is added to chapter 84.36 RCW  
26 to read as follows:

27 (1) All custom computer software, except embedded software, is  
28 exempt from property taxation.

1 (2) Retained rights in computer software are exempt from property  
2 taxation.

3 (3) Modifications to canned software are exempt from property  
4 taxation, but the underlying canned software remains subject to  
5 taxation as provided in section 4 of this act.

6 (4) Master or golden copies of computer software are exempt from  
7 property taxation.

8 NEW SECTION. **Sec. 4.** A new section is added to chapter 84.40 RCW  
9 to read as follows:

10 (1) Computer software, except embedded software, shall be valued in  
11 the first year of taxation at one hundred percent of the acquisition  
12 cost of the software and in the second year at fifty percent of the  
13 acquisition cost. Computer software, other than embedded software,  
14 shall have no value for purposes of property taxation after the second  
15 year.

16 (2) Embedded software is a part of the computer system or other  
17 machinery or equipment in which it is housed and shall be valued in the  
18 same manner as the machinery or equipment.

19 NEW SECTION. **Sec. 5.** (1) The department of revenue shall  
20 conduct a study of the property tax exemptions and valuation rules  
21 provided for computer software in sections 3 and 4 of this act. In the  
22 study, the department shall determine whether the exemptions and  
23 valuation rules are reasonably necessary and appropriate to achieve  
24 fairness, equity, and uniformity in the property tax treatment of  
25 computer software. The study shall also include a review of computer  
26 software taxation in other states, techniques for valuing computer  
27 software, and the effects of changing technology upon the appropriate  
28 application of property taxation to computer software.

1 (2) To assist in the performance of the study, the department shall  
2 form an advisory committee with appropriate representation from  
3 businesses and county assessors.

4 (3) The department shall report the findings of the study to the  
5 committees of the legislature that deal with revenue matters no later  
6 than November 30, 1998.

7 **Sec. 6.** RCW 84.36.815 and 1988 c 131 s 1 are each amended to read  
8 as follows:

9 In order to qualify for exempt status for any real or personal  
10 property (~~pursuant to the provisions of chapter 84.36 RCW, as now or~~  
11 ~~hereafter amended~~)) under this chapter except personal property under  
12 section 3 of this act, all foreign national governments, churches,  
13 cemeteries, nongovernmental nonprofit corporations, organizations, and  
14 associations, private schools or colleges, and soil and water  
15 conservation districts shall file an initial application on or before  
16 March 31 with the state department of revenue. All applications shall  
17 be filed on forms prescribed by the department and shall be signed by  
18 an authorized agent of the applicant.

19 In order to requalify for exempt status, such applicants except  
20 nonprofit cemeteries shall file a renewal application on or before  
21 March 31 of the fourth year following the date of such initial  
22 application and on or before March 31 of every fourth year thereafter.  
23 An applicant previously granted exemption shall annually file, on forms  
24 prescribed by the department, an affidavit certifying the exempt status  
25 of the real or personal property owned by the exempt organization.  
26 When an organization acquires real property qualified for exemption or  
27 converts real property to exempt status, such organization shall file  
28 an initial application for the property within sixty days following the  
29 acquisition or conversion. If the application is filed after the

1 expiration of the sixty-day period a late filing penalty shall be  
2 imposed pursuant to RCW 84.36.825, as now or hereafter amended.

3 When organizations acquire real property qualified for exemption or  
4 convert real property to an exempt use, the property, upon approval of  
5 the application for exemption, is entitled to a property tax exemption  
6 for property taxes due and payable the following year. If the owner  
7 has paid taxes for the year following the year the property qualified  
8 for exemption, the owner is entitled to a refund of the amount paid on  
9 the property so acquired or converted.

10 **Sec. 7.** 1990 c 255 s 2 (uncodified) is amended to read as follows:

11 (1) For property taxes due in 1991, a county assessor shall list  
12 and assess computer software in the same manner and to the same extent  
13 as computer software was listed and assessed for taxes due in 1989. If  
14 the assessor adds an item of computer software to the assessment list  
15 for any taxpayer for 1991 taxes, and that item was not listed and  
16 assessed for 1989 taxes for that taxpayer, the assessor shall have the  
17 burden of proving the item of computer software is taxable within the  
18 intent of this act.

19 (2) For property taxes due in 1992, a county assessor shall list  
20 and assess computer software in the same manner and to the same extent  
21 as computer software was listed and assessed for taxes due in 1989. If  
22 the assessor adds an item of computer software to the assessment list  
23 for any taxpayer for 1992 taxes, and that item was not listed and  
24 assessed for 1989 taxes for that taxpayer, the assessor shall have the  
25 burden of proving the item of computer software is taxable within the  
26 intent of this act.

27 NEW SECTION. **Sec. 8.** If any provision of this act or its  
28 application to any person or circumstance is held invalid, the

1 remainder of the act or the application of the provision to other  
2 persons or circumstances is not affected.

3 NEW SECTION. **Sec. 9.** Sections 2 through 4 and 6 of this act  
4 apply to taxes levied for collection in 1993, and thereafter.

5 NEW SECTION. **Sec. 10.** This act is necessary for the immediate  
6 preservation of the public peace, health, or safety, or support of the  
7 state government and its existing public institutions, and shall take  
8 effect immediately.