

MINUTES
SENATE LOCAL GOVERNMENT & TAXATION COMMITTEE

DATE: Wednesday, January 18, 2017

TIME: 3:00 P.M.

PLACE: Room WW53

MEMBERS PRESENT: Chairman Johnson, Vice Chairman Bayer, Senators Hill, Rice, Vick, Patrick, Burgoyne, and Nye

ABSENT/ EXCUSED: Senator Siddoway

NOTE: The sign-in sheet, testimonies and other related materials will be retained with the minutes in the committee's office until the end of the session and will then be located on file with the minutes in the Legislative Services Library.

CONVENED: **Chairman Johnson** called the meeting of the Local Government and Taxation Committee (Committee) to order at 3:00 p.m.

PASSED THE GAVEL: Chairman Johnson passed the gavel to Vice Chairman Bayer.

DOCKET NO. 35-0101-1602 **Cynthia Adrian**, Tax Policy Specialist with the Idaho State Tax Commission (Commission), presented **Docket No. 35-0101-1602**.

Rule 006, relating to the incorporation of reference materials, includes the Multistate Tax Commission (MTC) Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions as adopted in 1994. **Ms. Adrian** explained that the Commission adopted the MTC rules and is currently utilizing 1994 valuations. Because the MTC is in the process of updating its rules, the Commission felt it was necessary to clarify that it was still using 1994 MTC valuations.

Senator Hill asked if legislation will be required if the Commission adopts new MTC rules. **Ms. Adrian** replied that the process may be completed through negotiated rulemaking.

Rule 075, relating to tax on individuals, estates, and trusts, updates tax brackets for calendar year 2017.

Rule 263 adjusts the amount of guaranteed payments that are sourced as compensation for services for calendar year 2016.

Rule 771 adds calendar year 2016 and applicable grocery tax credits capped at \$100. **Senator Hill** asked if annual rulemaking was necessary to update the calendar year. **Ms. Adrian** clarified that it is possible to establish inclusive language to avoid such rules in the future.

Rule 872, amended to be consistent with 2016 HB 353, allows employers who pay their employees only once a month to file and remit withholding on a monthly basis instead of twice a month.

Rule 874, amended to be consistent with 2016 HB 352, changes the due date for employers to file employee and withholding information with the Commission from the last day of the second month to the last day of the first month. **Senator Patrick** sought clarification of filing date requirements, and **Ms. Adrian** explained that tax

documents often have different date requirements for submission, and most are federally mandated.

MOTION: **Senator Burgoyne** moved to approve **Docket No. 35-0101-1602**. **Senator Vick** seconded the motion. The motion carried by **voice vote**.

DOCKET NO. 35-0201-1601 **Ms. Adrian** presented Docket No. 35-0201-1601. Rule 310 adds the interest rate for calendar year 2017 to the Revenue Rulings calendar, and **Ms. Adrian** explained how the interest rate is determined, as referenced in the Revenue Rulings table.

MOTION: **Senator Patrick** moved to approve **Docket No. 35-0201-1601**. **Senator Hill** seconded the motion. The motion carried by **voice vote**.

DOCKET NO. 35-0102-1601 **Marni Odermann**, Tax Policy Specialist with the Commission, presented **Docket No. 35-0102-1601**.

Rule 079 pertains to the production exemption and **Ms. Odermann** noted that two changes were made to provide clarity to the taxpayer and were negotiated rulemaking. The first change clarifies that equipment and supplies used for quality control purposes during the production process are exempt from sales tax. **Ms. Odermann** stated that identical changes were made to rules relating to production which include farming and ranching, above ground and underground mining, and lumber manufacturing. The second change, amended to be consistent with 2016 HB 386, adds reference to the beginning and end of the production process for farming operations.

A discussion ensued regarding what constitutes equipment and supplies used in the quality control process as defined in Rule 079 and in statute. **Senator Hill** asked if there were clear criterion or guidelines regarding this language. **Ms. Odermann** stated that quality control must occur during the production process, and a bright-line exists as to when this process begins and ends as defined in statute; however there is no specific criterion as to what constitutes quality control equipment. **Ms. Odermann** suggested that the Commission's intent was to clarify to the taxpayer that the quality control process, and equipment use therein, do qualify for the production exemption.

Senator Rice asked how a quality control function is determined integral to the production process, and if an auditor has discretion in determining how many quality tests are necessary and thus exempt. **Ms. Odermann** explained that the determination is made by an auditor within the context of use, and she suggested that an auditor would not necessarily make determinations on the necessity of a specific part of the production process.

Senator Hill asserted that regardless of how many times quality control tests are conducted, if the equipment used in the process and is deemed integral and necessary, then it is exempt from sales tax. **Ms. Odermann** responded that deference is given to businesses to determine what is necessary for their production process.

Senator Rice followed up by asking if the Commission, rather than examining the amount of equipment or supplies used in the quality control process, examines if the equipment itself is used for this purpose. **Ms. Odermann** responded that the intent of the rule change is to clarify that equipment is exempt from sales tax when used in the performance of quality control.

Senator Burgoyne sought clarification regarding origination of this rule change, asking what prompted the Commission to translate what was historically interpreted into formal rulemaking. **Ms. Odermann** explained that the Commission discovered in 2015 that the only published information regarding this exemption was related to mining. As a result, the Commission decided to clarify this exemption for all producers. In response to follow-up questions from **Senator Burgoyne**, **Ms. Odermann** asserted that it is the general practice of the Commission to narrowly construe sales tax against the taxpayer, and that principle applies to this exemption, as well. **Senator Burgoyne** commented that he sees value in codifying these rules for the taxpayer rather than relying on interpretation and asked Ms. Odermann to report back to the Committee if the taxpayer has the burden of proving they are entitled to the exemption in this regard.

Senator Rice asked for clarification regarding the words "and necessary" in context of this rule. **Ms. Odermann** replied that the words "and necessary" help establish the burden of proof for the taxpayer that equipment in this context must be integral to the quality control process.

Ms. Odermann continued presenting **Docket No. 35-0102-1601**. Rules 080, relating to lumber manufacturing, 081, relating to underground mining, and 082, relating to above ground, open pit mining, were all negotiated rulemaking and have identical rule changes that add equipment and supplies used for quality control to the production exemption.

Rule 083, amended to be consistent with 2016 HB 386, recognizes that the movement of crops and produce can include several steps from point of harvest and exempts equipment and supplies used for the removal from storage of agricultural commodities. Additionally, the exemption of equipment and supplies used in the quality control process is added to the rule. In response to a question from Senator Patrick about licensed vehicles used in the movement of crops, **Ms. Odermann** stated that such vehicles are not included in the exemption.

Rule 096 and 102 were amended to be consistent with 2015 HB 39, which removed the hand-tools-under-\$100 exclusion from the production exemption. **Ms. Odermann** pointed out the substantive changes in Rules 096 and 102, which include the removal of conflicting language regarding hands tools in irrigation equipment and logging, respectively. In response to a question from **Senator Nye**, **Ms. Odermann** clarified that hands tools used in production in any amount of one cent or more now qualify for the sales tax exemption.

Rule 100, amended to be consistent with 2015 HB 75, exempts from sales tax prescription eyeglass, their component parts, and prescription contact lenses. **Ms. Odermann** explained the substantive changes which include clarifying examples of products that are and are not included in the exemption, and the effective date of these exemptions.

A discussion ensued regarding how to apply tax to related products that are not tax exempt. **Ms. Odermann** remarked that giveaways, such as cleaning solution and carrying cases, are subject to use tax that is applied to the value of the purchase price. **Senator Hill** commented that the Commission may want to consider providing clarification to practitioners on how use tax is applied in this regard. **Ms. Odermann** agreed, noting this was negotiated rulemaking with input from industry.

Senator Burgoyne sought clarification regarding the application of sales and use tax at the wholesale and retail level, suggesting an issue of double taxation. **Ms. Odermann** referenced Section 100.03, which delineates only medical items

listed in statute as tax exempt for resale, which now includes prescription glasses, component parts, and contact lenses. **Ms. Odermann** asked Doug Harrie, Sales Tax Audit Manager with the Commission, to address the possible issue of double taxation. **Mr. Harrie** explained that the application of tax is situational. For instance, if a practitioner purchases items tax-exempt for resale, sales tax is applied to the consumer during purchase; conversely, if a practitioner purchases items they intend to giveaway and pay tax on those items, no further use tax is applied. **Mr. Harrie** reported the Commission follows the entire transaction to ensure tax is applied appropriately.

Ms. Odermann presented Rule 107, amended to be consistent with 2016 HB 348, which adds paddleboards and similar vessels to the list of watercraft that are taxable to nonresident purchasers.

MOTION: **Senator Burgoyne** moved to approve **Docket No. 35-0102-1601**. **Senator Patrick** seconded the motion. The motion carried by **voice vote**.

DOCKET NO. 35-0102-1602 **Ms. Odermann** presented **Docket No. 35-0102-1602**. Rule 037, amended to be consistent with 2016 HB 540, exempts from sales and use tax fixed-wing aircraft primarily used for wildfire air tactical support under contract with the federal government.

Pursuant to Senate Rule 39(H), **Senator Nye** disclosed a possible conflict of interest under applicable law.

MOTION: **Senator Patrick** moved to approve **Docket No. 35-0102-1602**. **Senator Rice** seconded the motion. The motion carried by **voice vote**.

DOCKET NO. 35-0102-1603 **Ms. Odermann** presented **Docket No. 35-0102-1603**. Rule 041, amended to be consistent with 2015 HB 11, incorporates statutory changes to Idaho Code § 63-3622J referencing the Older Americans Act. **Ms. Odermann** noted that she would report back to the Committee what age constitutes a senior citizen in this regard.

MOTION: **Senator Burgoyne** moved to approve **Docket No. 35-0102-1603**. **Chairman Johnson** seconded the motion. The motion carried by **voice vote**.

DOCKET NO. 35-0110-1601 **Tom Shaner**, Tax Policy Specialist with the Commission, presented **Docket No. 35-0110-1601**, relating to cigarette and tobacco products tax. Rule 017, amended to be consistent with 2016 HB 376, repeals the minimum bond requirement of \$1,000 and now requires the bond amount to be the greater of twice the estimated average tax liability for the reporting period or the value of stamps in the wholesaler's inventory, including the value of stamps ordered but not received.

MOTION: **Senator Vick** moved to approve **Docket No. 35-0110-1601**. **Senator Burgoyne** seconded the motion. The motion carried by **voice vote**.

PASSED THE GAVEL: Vice Chairman Bayer passed the gavel to Chairman Johnson.

ADJOURNED: There being no further business at this time, **Chairman Johnson** adjourned the meeting at 4:05 p.m.

Senator Johnson
Chair

Jennifer Carr
Secretary