Designing a Review of Tax Preferences

Office of Performance Evaluations
Idaho Legislature
Office of Performance Evaluations

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Joint Legislative Oversight Committee 2021–2022

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March 25, 2021

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Joint Legislative Oversight Committee
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Idaho and its local governments collected $6.3 billion in income, property, and sales taxes in fiscal year 2020. Idaho has at least 166 tax preferences in its income, property, and sales tax code worth billions of dollars.

The Legislature systematically reviews the state’s direct spending each year through the Joint Finance-Appropriations Committee and legislative approval process, but it does not have a review process for money directed by tax preferences. As a result, the Legislature is managing tax policy with little information about tax preferences – not knowing the extent to which these preferences actually meet legislative priorities.

Should the Legislature choose to design a systematic review of tax preferences, a successful design must include the following elements:

- legislative priorities
- strategy to inform policy
- clearly defined scope
- sufficient resources for analysis

Other states have changed their reviews over time. The Legislature can start with a small scope and later adapt the review to match its experience and evolving needs.

We thank the Idaho Tax Commission and the Division of Financial Management for their assistance on this project.

Sincerely,

Rakesh Mohan, Director
Office of Performance Evaluations
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The Idaho Constitution grants the Legislature comprehensive authority to set tax policy. As part of tax policy, the Legislature has enacted provisions such as exemptions, credits, and deductions that reduce taxes for specific taxpayers. These provisions are known as tax preferences. The Legislature may enact preferences to encourage specific taxpayer behavior or to promote equity when the normal tax structure would lead to inequity.

**The Legislature is managing tax policy with little information about tax preferences.**

While the Legislature systematically reviews billions of dollars in direct spending each year through the Joint Finance-Appropriations Committee and legislative approval process, the Legislature has no review for the billions of dollars allocated through tax preferences.

Comparisons between direct spending and tax preferences arise because a preference may have the same goal as a spending program. For example, tax credits and grants can both promote economic development. Paying to build improvements or lowering the taxes for those who pay for improvements can promote infrastructure.

Idaho and its local governments collected $6.3 billion in income, property, and sales taxes in fiscal year 2020. Idaho has at least 166 tax preferences in its income, property, and sales tax code worth billions of dollars.

The Legislature has little information it can use to ensure that tax preferences are good tax policy. Annual reports with descriptive information about many tax preferences are published by the Division of Financial Management, the
Department of Commerce, and the Tax Commission. The Legislature can request information ad-hoc from the commission or other departments. The information in these reports provides a good starting point to analyze tax preferences. But the information is not sufficient to determine whether the tax preferences are achieving legislative priorities. The Legislature does not have data on many preferences to answer questions including the following:

- Who are the intended beneficiaries and are they using the tax preference?
- Are preferences impacting different regions of the state or industries in a uniform way?
- What performance measures would be good indicators of the successful implementation of a tax preference?
- How does a tax preference impact state or local government revenue?
- What should be considered a tax preference and not part of the normal tax base?
- How do economic trends or other changes over time affect tax preferences?

**A systematic review of tax preferences could fill some gaps in knowledge.**

While there are several gaps in the Legislature’s knowledge about the operation of Idaho’s tax policy, no state has a complete understanding of the potential outcomes and impacts of tax preferences. If the Legislature believes it has enough information to manage tax policy through existing reports, interim committees, working groups, interest group analyses, and public testimony, then no further action is needed.

However, if the Legislature decides that the gaps in knowledge are too wide, it could pursue a systematic review of tax preferences. The review should be tailored to fit Idaho’s needs and priorities. Exhibit 1 lists four questions, based on practices in other states, that the Legislature should answer if it chooses to review tax preferences.
A review can evolve over time. The Idaho Legislature could start with a small scope. Over time, the Legislature will be better able to identify the most useful information and analysis. As staff gain experience conducting analysis, they will build expertise to answer more complicated questions.

The Legislature can also continue to learn from reviews in other states. According to research by the Pew Charitable Trusts, 34 states and the District of Columbia review tax preferences. The reviews in Idaho’s neighboring states range from Washington’s, which has one of the oldest and most comprehensive reviews of tax preferences, to Montana’s, which began a periodic review of all income tax credits in 2019.

Exhibit 1

We identified four questions that the Legislature should answer if it chooses to design a systematic review of tax preferences.

1. What values and goals motivate the Legislature’s review of tax preferences?
   Options include:
   - Simplify the tax code
   - Regularly examine the performance of tax preferences
   - Address issues with a broad impact with dispersed costs or benefits

2. How will the Legislature ensure that a review informs policy?
   Options include:
   - Incorporate the review into germane committee process
   - Create a standing joint interim committee
   - Integrate a sunset clause when drafting or modifying a tax preference
   - Include more detailed performance standards when drafting tax preference legislation

3. How will the Legislature define the review’s scope?
   The Legislature should determine:
   - Which tax preferences to include
   - How frequently a preference should be reviewed
   - What questions analysts should answer during the review

4. What resources will the Legislature dedicate to make the review effective?
   The Legislature should determine:
   - The number of staff and where they should be located
   - Which elements should be set in statute, delegated to the legislative committee, and delegated to staff
   - How to ensure analysts will have authority to access necessary information
Legislative interest

The Idaho Constitution grants the Legislature comprehensive authority to set tax policy. Most revenue comes from property, sales, and income taxes. The Legislature has reduced taxes owed by specific taxpayers by enacting preferences such as exemptions, credits, and deductions.

While the Legislature systematically reviews billions of dollars in direct spending each year through the Joint Finance-Appropriations Committee and legislative approval process, the Legislature has no review for tax preferences.

In March 2020, two legislators requested that our office explore options to systematically review tax preferences. The evaluation request is in appendix A. The requesters stated that “the financial consequences of tax breaks that don’t successfully advance the state’s interest are a shift in taxes to the average citizen and the underfunding of necessary programs.” The request noted that sales tax exemptions exceeded sales tax collections in fiscal year 2019.
Evaluation approach

In the scoping process for this evaluation, we found that other states have a variety of approaches to reviewing tax preferences. Our objective for this evaluation is to outline the options available to the Legislature should it also choose to review tax preferences.

With this objective in mind, we completed the following tasks:

- Assessed information already available about Idaho’s tax preferences
- Created a checklist for policymakers to use in selecting a review process for tax preferences

See appendix B for our evaluation scope.

Methods

To understand Idaho’s tax structure, we worked with the Division of Financial Management, the Tax Commission, the Legislative Services Office, and the Department of Insurance. We also reviewed statute, administrative rule, agency publications and legislative committee minutes.

We surveyed nonlegislative stakeholders in Idaho who have been active participants in the policymaking process. We asked what they would like to learn about tax preferences, whether they had any concerns about a review, and what the state could do to build confidence in a review. We received responses from 13 people who represent 29 associations, businesses, and nonprofits.

We worked with subject-matter experts, such as the Pew Charitable Trusts and the National Conference for State Legislatures. We also interviewed staff who conduct tax preference reviews to learn about practices in other states. More information about the methodology for this report can be found in appendix C.
A tax preference is a deviation from the normal tax structure that reduces taxes owed. For a more in-depth discussion about the normal tax structure see appendix D. Generally, state legislatures use tax preferences for two reasons: (1) to incentivize specific taxpayer behavior, or (2) to promote equity by adjusting taxes for those who would be unduly burdened under the normal structure. The state also incorporates some federally required tax preferences. Deviations include the following examples:

- credits
- deductions
- deferrals
- exclusions
- exemptions
- preferential rates

Tax preferences are sometimes referred to as tax expenditures. Comparisons to direct spending arise because a tax preference may have the same goal as a spending program. For example, tax credits and grants can promote economic development. Similarly, infrastructure can be improved through direct payments and by lowering taxes.

This chapter provides an overview of Idaho’s tax preferences and summarizes what is known, what is not known, and what could be learned by reviewing tax preferences in a systematic way.
Idaho’s major taxes have preferences.

In fiscal year 2020, Idaho and its local governments collected over $7 billion in taxes, $6.3 billion of which came from income, property, and sales taxes. Idaho has at least 166 tax preferences in its income, property, and sales tax code. A list is in the supplemental report, *Idaho’s Tax Preferences*.

The **income tax** has 42 preferences including deductions, exclusions, and credits.

The **sales tax** has 80 preferences, including exemptions for certain buyers, sellers, goods, services, and uses. Idaho also excludes certain transactions that other states would tax, such as paying for utilities, digital streaming services, and haircuts. Idaho also taxes some items that other states exclude from the sales tax, such as groceries. Idaho has an income tax credit for groceries.

The **property tax** has 44 preferences. These preferences exempt property from taxation based on the property’s type, use, and owner. Exemptions may also be granted to property owners who have experienced certain types of hardship or to businesses that invest in the community.

Other taxes have preferences as well. For example, Idaho’s tax on insurance premiums has exemptions and lower rates for certain organizations and insurance types. Idaho’s tax on motor fuels has exemptions for fuel purchased by certain organizations and for certain uses. Idaho’s tax on hydro-generated electricity exempts electricity sold for certain purposes.
The Legislature is managing tax policy with little information about tax preferences.

The Idaho Constitution grants lawmakers authority to develop tax policy to provide revenue for state and local government. At the time of the ratification of the Constitution, the main source of revenue was the property tax. The Constitution required that property taxes be “uniform upon the same class of subjects,” and any exemptions must be “necessary and just.” These principles are similar to those referenced for all taxes by a 2007 interim committee on tax preferences. Exhibit 2 discusses some examples of how tax preferences intersect with the principles of tax policy.

The Legislature has little information about the impact of tax preferences. However, state agencies do collect some descriptive information about tax preferences to carry out their statutory responsibilities.

The Division of Financial Management publishes the general fund revenue book at the beginning of each legislative session. The book includes statutory references, legislative history, and the estimated value of income and sales tax preferences. The state collected $2.16 billion in income tax in fiscal year 2020. The division estimated that income tax preferences that calendar year were valued at $660 million.

The state collected $2.09 billion in sales tax in fiscal year 2020. The division estimated that sales tax preferences were valued at $800 million. The division also estimated $1.65 billion of value to taxpayers of untaxed services. Upon reviewing the general fund revenue book’s reported preferences as included in the supplemental report, Idaho’s Tax Preferences, the division and the Tax Commission identified several preferences that they believe to be significantly underestimated.

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1. Idaho Constitution article VII, § 2, “The legislature shall provide such revenue as be needful;” Idaho Constitution article VII, § 5, Taxes “shall be levied and collected under general laws, which shall prescribe such regulations...[and] the legislature may allow such exemptions from taxation...as shall seem necessary and just.”
Managing tax policy requires making tradeoffs among many priorities.

**Stability**
- Governments should have stable and predictable revenue.
- Taxpayers should be able to predict how much they will owe.
- Preferences may narrow the base and lead to less stability.

**Simplicity**
- Taxes should be easy to calculate and simple to pay.
- Government should be able to easily verify information.
- The cost to comply with the tax code should be low.
- Preferences may add complexity when criteria to qualify are unclear or recordkeeping is cumbersome.

**Fairness**
- Taxpayers should be treated fairly based on their ability to pay or their use of services.
- Preferences may adjust taxes for those who would be unduly burdened.

**Efficiency & Neutrality**
- Taxpayers should make decisions based on the merits, not to avoid taxes.
- Government influence of taxpayer behavior should be limited and deliberate.
- Preferences can both address and aggravate inefficiencies in the normal tax structure.

Source: Office of Performance Evaluations' summary of priorities listed in reports from the Legislature’s 2007 interim committee on tax expenditures, the National Conference of State Legislatures, and the US Government Accountability Office.
The Legislature requires the Department of Commerce to publish an annual report on the reimbursement incentive credit. This credit is awarded to encourage economic development and job creation and is given at the department’s discretion.

Local governments collected $1.93 billion in property taxes on $192 billion of property in calendar year 2020. The Legislature requires counties to submit data to the Tax Commission on 15 of the 44 preferences. These preferences led $38.2 billion of property to be excluded from the tax base. The commission is also required by statute to report certain information to the Legislature and governor’s office and to work with them as requested. For example, at the request of the Legislature, the commission has prepared reports that estimate the shift among taxpayers resulting from certain property tax preferences.

The Department of Insurance does not regularly publish a report on tax preferences for the insurance premium tax. However, the department was able to give us an estimate of the value of tax preferences for calendar year 2019. The department reported that the tax brought in about $103 million in revenue. The state had an estimated $21 million in tax preferences for insurance premiums.

Up to $100,000 of the market value of a primary residence is exempt from property tax.
The Legislature does not have sufficient data to determine whether tax preferences achieve legislative priorities.

Each year, the Legislature reviews direct spending through the appropriations process. The review allows the Legislature to examine where money is spent and to reassess its spending priorities. Spending is also subject to public examination through the Controller’s website, Transparent Idaho.

Tax preferences are not subject to the same level of scrutiny. The Legislature may have created a tax preference with a specific goal in mind, such as encouraging economic development or job creation. The Legislature does not have data to assess whether its goals are being achieved for most tax preferences. The Legislature also does not have the opportunity to determine whether the priorities that led to the adoption of a tax preference remain legislative priorities. Examples of known and unknown information about tax preferences are in exhibit 3.

**Intended recipients**

The Legislature intends to provide tax relief to a category of taxpayers when it implements a tax preference. For many preferences, the Legislature does not receive any data to assess:

- whether the preference is reaching intended beneficiaries;
- whether the preference lowers taxes for unintended beneficiaries; and
- whether the preference benefits regions of the state or industries in a uniform way.

**Performance measures**

The Legislature enacts many preferences with the intention of changing taxpayer behavior in a way that promotes a public policy. For example, the Legislature may create a tax credit to encourage businesses to create jobs. However, the credit may not be successful if businesses do not know about it or if qualifying is
too burdensome. Alternatively, a business may have created jobs whether it received the credit or not.

The Legislature’s intent in enacting a tax preference is often implied rather than explicit, which complicates identifying performance measures. Preferences are also rarely enacted with clearly defined expectations about the magnitude of impact.

Exhibit 3
The Legislature is managing tax policy with relatively little known information.
The Legislature does not have enough information to know the effect of tax preferences on revenue.

Estimates of the value of tax preferences do not necessarily represent potential tax revenue. Estimates do not account for overlapping exemptions. For example, specific transactions may be exempt multiple times from the sales tax. A household purchasing natural gas for heating is covered under exemptions for both utilities and heating materials. A nonprofit hospital purchasing durable medical equipment is also covered twice, as the hospital and the equipment are exempt from the tax. In these cases, adding the value of the two exemptions is double counting.

Estimates do not account for taxpayer behavior that changes due to the preference. For example, some tax preferences are intended to encourage economic growth. The estimates for these preferences do not include possible revenue brought in through additional investment or job creation. Conversely, taxing a previously untaxed activity may lead to less of that activity in Idaho.

The state also does not have a value estimate for many tax preferences. For example, county assessors do not report the value of 29 of 44 property tax preferences. Many types of exempt property are never assessed.

Many of the division’s estimates for income and sales tax preferences are based on historical trends or industry-level data rather than up-to-date data collected on the use of the preference. The estimates may not capture changes in the use of a preference that deviate from historical trends. Developing more precise estimates would require taxpayers to report additional information and the commission to dedicate resources to capturing and reporting that information.
What the Legislature intends as the normal tax base is not always clear.

The tax base does not have an objective definition. Neither does statute make clear where Idaho’s tax base ends and tax preferences begin, which complicates any discussion of tax preferences. For example, sales of services and production equipment are excluded from taxation. These exclusions could either be defined as tax preferences or as outside the sales tax base. Idaho also exempts certain types of property, such as government land, that would not be taxed in any state. These exemptions may be considered part of the normal tax structure rather than preferences.

If the Legislature wishes to learn more about tax preferences, it can either specify what it considers the tax base or specify elements of the tax code to review. Appendix D discusses the tax base for each tax based on approaches at the federal level and in other states.

Government property and purchases are not taxed.
Tax preferences change over time.

Incremental changes to Idaho’s tax code may affect existing tax preferences and create unintended consequences. In addition, other states and the federal government change their tax policies. For example, the US Supreme Court ruled in 2018 that states could collect sales tax on out-of-state internet sales.

Even when Idaho makes no statutory changes to tax policy, things change:

- industries and sectors grow or wane
- inflation occurs
- demographics shift
- technology changes tax administration

Shifts in the economy change how much people pay in taxes and how much revenue is collected from each tax. These changes may affect whether Idaho’s tax policy continues to meet goals set by the Legislature. Of recent note, the effect of tax policy has been changed by the large and uneven increase in property values, which has altered how the property tax load is distributed across different categories of property.

In 2018, the United States Supreme Court ruled in *South Dakota v. Wayfair* that states can collect sales tax from certain businesses that do not have a physical presence in the state.
A systematic review of tax preferences could fill some gaps in knowledge.

Gaps in knowledge about the operation of Idaho’s tax policy are large. These gaps, however, are not the result of any particular decision. No state has a complete understanding of the gaps we identified.

The Legislature already has some tools to fill gaps in knowledge. It can convene interim committees dedicated to tax policy issues of interest. The Legislature can also propose bills to change, add, or remove tax preferences. Stakeholders may provide feedback during the lawmaking process through public hearings.

The Legislature can invest in other ways to improve knowledge about tax policy. House Bill 73, passed during the 2021 legislative session, enabled the State Controller’s Office to establish a uniform accounting system for local governments. The intent of the legislation, as stated in the newly created Idaho Code 67-448, was to “provide for uniform and transparent financial data of local governmental entities to better inform lawmakers, decision-makers, and citizens. . . .”

If the Legislature is satisfied with its current tools, it could continue with the status quo. When more information is needed, the Legislature could review agency reports or make an ad-hoc request for data from the Tax Commission and administering agencies. The Legislature could also ask the Joint Legislative Oversight Committee for ad-hoc evaluations of specific tax preferences or invest additional resources in reporting at the Tax Commission.

While ad-hoc approaches can help fill gaps in knowledge, they risk appearing arbitrary. One stakeholder summarized this concern by stating that ad-hoc approaches would “waste time... start fights, and generate little... revenue.”

A systematic review of tax preferences is one option to fill gaps in knowledge about the tax system. Each state that regularly reviews its tax preferences tailors the review to the needs and priorities of policymakers.

The Legislature must weigh the potential benefits of a review against its costs. The costs would likely include additional staff to conduct analysis, staff time and software costs at the Tax Commission, and lawmakers’ time and attention.
The goal of this chapter is to outline steps the Legislature should consider if it wants to develop a systematic review of tax preferences. According to research by the Pew Charitable Trusts, 34 states and the District of Columbia have a statutory, systematic review of tax preferences. Systematic reviews include a plan for how the state will:

- evaluate specific preferences within a specified time;
- use performance criteria; and
- use the findings to inform policy choices.

Among Idaho’s neighboring states, Montana, Oregon, Utah and Washington have systematic reviews. These reviews range in comprehensiveness and resources. For example, Washington has one of the oldest and most thorough reviews of tax preferences. In 2019 Montana began a review limited to income tax credits.

We surveyed Idaho stakeholders who are engaged with state tax policy to learn about possible interest in, and concerns about, a systematic review of tax preferences. Most stakeholders expressed interest in ensuring that tax preferences meet legislative intent. Some also viewed a review as an opportunity to address certain tax and spending priorities.

Stakeholders were concerned that a review may not effectively inform policy decisions. Their concern was echoed by lawmakers who participated in a 2007 interim committee, which had developed a set of principles and a process to evaluate Idaho’s tax preferences. That process was not adopted, and some stakeholders reported that lawmakers on the committee did not believe their efforts influenced policy.
The Legislature faces four questions in developing a review.

Each state that reviews tax preferences tailors the review to the needs and resources of its legislature. States differ in which taxes they levy, how they use tax preferences, and why they want to review them. Based on reviews in other states, we identified four questions that the Legislature should answer if it chooses to review tax preferences.

What values and goals motivate the Legislature’s review of tax preferences?

How will the Legislature ensure that a review informs policy?

How will the Legislature define the review’s scope?

What resources will the Legislature dedicate to make the review effective?
A successful review must be motivated by the Legislature’s priorities.

Stakeholders said they want to ensure the Legislature is the main driver of any review. The Legislature can lead an effective review by explicitly stating its goals.

One goal could be to simplify the tax code. Many preferences have been part of the code from the beginning of the tax. Others were added for specific policy goals that may no longer match legislative priorities.

Another goal may be to regularly examine the performance of tax preferences. When the Legislature wishes to direct resources toward a public policy, it may directly spend money through appropriations or indirectly spend money through tax preferences. Direct spending requires automatic, regular examination by the Joint Finance-Appropriation Committee and the full Legislature through the budget process. A tax preference review could similarly support the examination of resources directed through preferences. The review would also give the Legislature an opportunity to clearly articulate the intent of a preference and evaluate its performance against that intent.

Finally, another goal of the review may be to address issues with a broad impact. Typically, concerns are brought to the Legislature in an ad-hoc manner when costs or benefits are concentrated among certain stakeholders. Issues with dispersed costs or benefits are less likely to be brought to the Legislature’s attention.
A successful review will have a clear strategy to inform policy.

Stakeholders raised concerns that the Legislature would not find the review useful and that it would not result in any policy changes. Other states have tools to ensure reviews are useful. The Idaho Legislature may wish to adopt some of these tools.

Assign responsibility of tax preferences to a joint committee

States commonly have a joint legislative committee involved in the review of tax preferences that meets regularly during the interim. Indiana, Montana, and Utah assign the review to standing interim committees dedicated to revenue and taxation. These committees have additional responsibilities such as revenue projection for budget setting. Though Nevada and Wyoming do not have systematic reviews of tax preferences, they have standing revenue-focused committees that meet during the interim.

In Oregon, the germane committee reviews the analysis of a tax credit and recommends whether the credit should be extended, modified, or allowed to expire. After the germane committee review, the Joint Committee on Tax Credits reviews the analysis and germane committee recommendation. Washington assigns responsibility for review and hearing public testimony to a citizens’ commission appointed by legislative leadership and to the Joint Legislative Audit and Review Committee, which oversees legislative performance evaluations. In Florida, the budget committee decides how much money will be available for incentives, including tax credits.

All the reviews we looked at included an opportunity for public testimony. The legislative committee involved in reviewing tax preferences often has the authority to introduce legislation to carry out its recommendations. The full legislature, of course, has final say in any policy decision.
Integrate sunset clauses

A sunset clause repeals statute on a specified date unless the Legislature acts. With a sunset clause, the Legislature is required to make a proactive decision about a tax preference.

Tying a legislative review to the expiration of a law has precedent in Idaho. For example, the Legislature is required to approve or reject administrative rules annually through concurrent resolution.

States with sunset clauses often use them to prioritize which tax preferences will be reviewed. Sunset dates are often chosen to ensure adequate time for the program to work and to gather information.

Include more detailed performance standards and fiscal impact notes

The Idaho Legislature requires all bills to have a statement of purpose and a fiscal impact note. Some states require additional information for bills that create or renew tax preferences to help lawmakers clearly judge whether the preference is meeting its intent and budget commitment.

Tax preference bills in Washington include the purpose of the preference and “specif[y] clear, relevant, and ascertainable metrics and data requirements that allow the joint legislative audit and review committee and the legislature to measure the effectiveness of the new tax preference in achieving the [indicated] purpose.”
A successful review will have a clearly defined scope.

A review should be authorized in statute. The statute should ensure that the review includes a way to decide which tax preferences to review, the review schedule, and the questions to answer.

Tax preferences to include

The Legislature may wish to review all tax preferences or a subset depending on the focus. The Legislature would decide what constitutes a tax preference, which preferences to include, and how to resolve ambiguities. The supplemental report, *Idaho’s Tax Preferences*, lists the state’s tax preferences and appendix D discusses potential ambiguities.

Review schedule

A decision must be made about how often preferences will be reviewed and when each preference will be reviewed. Montana and Washington review a defined set of preferences every 10 years. Utah reviews tax credits every three years. Setting the review schedule should account for the number of included preferences and resources available for the review.

The focus of the review can also inform how to prioritize preferences. Older preferences may have drifted from their initial purpose with changes in the economy. Montana reviews older preferences first. Preferences could also be grouped by government purpose, the same way that agencies are reviewed by the budget committee. Oregon and Washington review similar preferences at the same time to ensure they work effectively together. Lawmakers in these states also compare preferences with spending programs to identify which strategies are getting the best results. Finally, preferences could also be grouped by tax type or by the intended recipient such as industry.
Questions to answer

Questions addressed by a review should be guided by the Legislature’s information needs and resources the Legislature decides to dedicate. The review could discuss the legislative history of a tax preference, how a taxpayer claims the preference, and cost estimates. The review could also include detailed comparisons of taxes among states, economic modeling, and studies that estimate behavior changes.

For each preference, the analyst must know what the Legislature intended and what questions the Legislature wants answered. Exhibit 4 shows examples of possible questions grouped by the required level of resources.

A review can answer the same questions for every tax preference. Montana’s revenue committee has a list of criteria for every tax credit. On the other hand, criteria can be specific to each tax preference. For example, when Indiana analyzed a deduction on home insulation costs, it estimated the cost of qualifying projects and the discount that the deduction represented.

One major concern early in a review process is determining performance criteria. Many aspects of the tax code lack explicit rationale and may be too old to discern intent from legislative record. Even if legislative intent is known, the intent may not specify clear metrics. The review may need concrete metrics to determine whether the preference is meeting its intent.
Exhibit 4

Analysts could answer some questions about a tax preference with minimal resources while other questions would need significant expertise.

<table>
<thead>
<tr>
<th>Resource intensity</th>
<th>Question</th>
<th>Examples of methods or resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>What is the intent of the tax preference?</td>
<td>Review of legislative history</td>
</tr>
<tr>
<td></td>
<td>Do other states have a similar preference?</td>
<td>Review of statute</td>
</tr>
<tr>
<td></td>
<td>What has research found on similar tax preferences?</td>
<td>Review of existing research</td>
</tr>
<tr>
<td></td>
<td>What is the state's cost of administering the preference?</td>
<td>Outreach to state agencies</td>
</tr>
<tr>
<td></td>
<td>What is the geographic distribution of claimants?</td>
<td>Access to Tax Commission data</td>
</tr>
<tr>
<td></td>
<td>What is the fiscal impact of income tax preferences, based on current tax filings?</td>
<td>Access to Tax Commission data and possible software update</td>
</tr>
<tr>
<td></td>
<td>How has the economy changed since the preference was created?</td>
<td>Review of economic data</td>
</tr>
<tr>
<td>Medium</td>
<td>How much would a hypothetical business in a certain industry pay in taxes in Idaho compared to other states?</td>
<td>Outreach to businesses and other states</td>
</tr>
<tr>
<td></td>
<td>What is the administrative burden to taxpayers who receive the preference?</td>
<td>Outreach to taxpayers</td>
</tr>
<tr>
<td></td>
<td>Does the administrative burden prevent taxpayers from benefitting?</td>
<td>Outreach to taxpayers</td>
</tr>
<tr>
<td></td>
<td>What is the fiscal impact of sales tax preferences, based on recorded transactions?</td>
<td>Possible modifications to sales tax reporting forms</td>
</tr>
<tr>
<td>High</td>
<td>How much can changes in behavior be attributed to a tax preference?</td>
<td>Research design and possible changes to preference structure</td>
</tr>
<tr>
<td></td>
<td>Does the preference have positive or negative economic impacts on other taxpayers?</td>
<td>Economic modeling software</td>
</tr>
</tbody>
</table>
A successful review will provide sufficient resources for the analysis.

The scope of the review will inform what resources will be needed. The Legislature will have to decide who will conduct analysis, how to structure and authorize a review, and how to address data accessibility challenges.

**Staff**

Stakeholders emphasized that a review must be nonpartisan, impartial, and objective. Analysts must be competent and adequately resourced.

Some states assign analysis to their equivalents of Idaho’s Legislative Services Office. Staff in those states report to legislative leadership or to partisan committees. Although analysts may work independently, they do not have structural independence. Idaho’s Legislature could dedicate additional staff to an existing division of the Legislative Services Office or create a new division focused on revenue.

Some states emphasize nonpartisanship by giving their analysts a degree of structural independence. Staff in Montana and Washington work for equally bipartisan and bicameral committees in charge of the review. Idaho’s Legislature could create a separate committee and independent legislative office for the purpose of reviewing tax preferences. The Legislature could also assign those responsibilities to the Joint Legislative Oversight Committee and the Office of Performance Evaluations.

Some states assign analysis of tax preferences to staff within executive branch agencies. These agencies are often responsible for collecting revenue or administering the specific tax preference. Indiana and Oregon had assigned responsibility for analysis to the executive branch but reassigned the responsibility to legislative staff.

Finally, some states empower the committee in charge of the review to contract with independent consultants or with higher education entities.
The Legislature has choices about how many staff to commit to the analysis. Montana dedicates a single staffer to its revenue committee, while Indiana has six positions that produce an annual report evaluating tax incentives.

One consideration for the Legislature is Idaho’s small legislative staff. The National Conference of State Legislatures reported that Idaho had fewer legislative staff in 2015 than all but four states: North Dakota, South Dakota, Vermont, and Wyoming. These four states had less than half of Idaho’s population. Exhibit 5 shows how Idaho’s legislative staff compares to neighboring states with reviews.

Exhibit 5

Idaho has fewer legislative staff than neighboring states that review preferences.

<table>
<thead>
<tr>
<th>State</th>
<th>2015 Legislative staff</th>
<th>2020 Population estimate</th>
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<tr>
<td>Idaho</td>
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<td>1,826,913</td>
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<tr>
<td>Montana</td>
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<tr>
<td>Oregon</td>
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<td>4,241,507</td>
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<td>Utah</td>
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<tr>
<td>Washington</td>
<td>536</td>
<td>7,693,612</td>
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Direction and authority

After the Legislature decides how many and which staff will conduct analysis, a review must have clear direction and authority. The Legislature can provide this direction and authority in one of three ways: (1) defining in statute, (2) delegating to a committee, or (3) delegating to the analysts.

Using statute to define the scope of analysis sets clear expectations and gives analysts the most credibility when pursuing their work. Each state sets the length of the review schedule in statute. However, statute limits flexibility. For example, Montana listed in statute six criteria for the committee to use, such as whether the preference changes taxpayer decisions, but when the committee met, it realized that these criteria required an investment in staff, research design, and data collection.
Rather than detailing the scope in statute, the committee responsible for the review can decide some elements of the scope. Elements of the scope delegated to a committee have the benefit of greater flexibility than statute but lack the same formality. A committee could also adjust the scope based on analyst input more easily than if the scope were in statute. This flexibility allows for continuous improvement.

Either by design or through omission, reviews often require analysts to decide what constitutes a tax preference, whether a particular preference should be reviewed, and the intent of a tax preference. In doing this, analysts have flexibility to manage workloads, cope with missing data, or tailor methods to best meet the legislature’s needs. However, this flexibility comes with the risk that the review may be considered arbitrary.

**Information access**

To answer some questions, analysts may require access to information that is not publicly available. The Legislature should take two steps to ensure analysts can access appropriate information.

The first step is statutory authority. Depending on whether lawmakers would like data analyzed on an aggregate level or at a taxpayer-specific level, the Legislature should ensure that the committee and analysts have authority to access information at the required level. Appendix E gives some examples of statutory access in other states.

The second step is technical. Agencies may not collect adequate data for a detailed review of tax preferences. The Legislature should ensure that agencies, such as the Tax Commission, can collect relevant data so analysts can meet the Legislature’s needs. The Legislature could also have beneficiaries report information when claiming a tax preference.
The Legislature can adapt a review to its experience and evolving needs.

A review can evolve over time.

Indiana began with a five-year cycle and was initially unclear about which tax preferences constituted an incentive. Now, Indiana has a seven-year review cycle and a clear list of preferences for review.

After Washington completed its first ten-year review, its legislature decided to exclude certain preferences from further review, and the analysts decided to work more closely with stakeholders.

Montana started its review with six criteria set in statute. Its committee later adjusted the criteria to better fit the information available.

The Idaho Legislature could start with a small scope. Over time, the Legislature will be better able to identify the most useful information and analysis. As staff gain experience analyzing tax preferences, they will build expertise to answer more complicated questions.

The labor component of real property is exempt from sales tax.
Request for evaluation
March 9, 2020

Mr. Rakesh Mohan  
Office of Performance Evaluations  
954 W. Jefferson Street, Suite 202  
Boise, ID 83702

Dear Rakesh:

Problem: Tax breaks are not systematically reviewed
Idaho’s tax system relies on three primary sources: income taxes, property taxes, and sales taxes. The Idaho Legislature decides who and what can be taxed. Tax breaks (sales tax exemptions, new business tax incentives, personal property tax exemptions, etc.) are established with some legislative intent in mind, but the Legislature lacks a process to regularly review and evaluate tax breaks as economic realities change. The problem is exacerbated by the lack of any objective evaluative criteria to assess the net long-term benefit of a tax break, and the absence of any timeframe within which the tax break will be reviewed or be subject to sunset. In short, most tax breaks (especially sales tax exemptions and exceptions) continue in perpetuity.

Magnitude of the problem:
The financial consequences of tax breaks that don’t successfully advance the state’s interest are a shift in taxes to the average citizen and the underfunding of necessary programs. Idahoans have experienced property tax increases due to continuous school bonds and levies, periodic increases in the gas tax, sustaining the grocery tax, increasing college tuitions, and the imposition of new and increasing fees. Sales tax exemptions and exceptions reached $2.48 billion in FY’19, which is larger than the entire FY’19 sales tax growth. This is up from $1.5 billion in FY’05, totaling over $28 billion in the last 15 years. With no consistent review process, evaluative criteria or sunset provisions, the magnitude of the fiscal impact will continue to put pressure on other methods of funding vital state services and responsibilities, including education, transportation, healthcare, prisons, public lands and so on.

Study objectives:
- Identify practices that could be adopted in Idaho to regularly review and evaluate tax breaks in a way that maximizes objectivity. These might include sunset clauses or regularly scheduled legislative committees that review tax breaks. Such reviews should include key stakeholders, including the legislature, industry and economic experts.
- Identify commonly used quantifiable evaluative criteria for determining if a tax break is delivering a net long-term benefit to the state.
Investigate and report on other impacts, fiscal or otherwise, that the current fiscal policies on tax breaks may have on the state’s ability to sustainably meet its constitutional and statutory obligations.

**Desired Outcomes and OPE Report Use:**
- Create a list of criteria that lawmakers can refer to when evaluating new and existing tax breaks.
- Recommend a sustainable, objective process for reviewing and deciding if a tax break should be retained or eliminated, including the timeframe within which such reviews should occur.
- OPE findings, conclusions and recommendations will be used by the Legislature to determine the degree to which current fiscal policies should be changed to accommodate the growing revenue needs of Idaho.

Sincerely,

Rep. Rick D. Youngblood
Rep. Steve Berch

jm
Evaluation scope

We will identify key structural, procedural, and policy questions that the Legislature should consider when setting up a systematic review of tax preferences. We will study the approaches of other states and identify essential components to produce analysis useful to policymakers, and recommend first steps should the Legislature elect to establish a formal tax preference review. We will answer the following questions:

What information does the state already have on tax preferences?

How could the Legislature scope and prioritize Idaho’s tax preferences for review?

What criteria could the Legislature use to evaluate tax preferences?

What resources and data would be needed to produce evaluations using various criteria?

How could the Legislature structure the conduct of independent evaluations?

How can the Legislature integrate these evaluations into policy making?
Background research

As part of our scoping process, we read reports from the Pew Charitable Trusts and the US Government Accountability Office about tax preference evaluations. We also reviewed documents from Idaho’s legislative interim committees and working groups from 2007, 2015, 2019, and 2020.

We interviewed subject matter experts from the Pew Charitable Trusts and the National Conference of State Legislatures. We also attended a two-day virtual conference sponsored by both organizations. We interviewed members of Pew Evaluators Network Advisory Group, which included the founder of Indiana’s incentive review and supervisors of preference reviews in the District of Columbia, Nebraska, Virginia, and Washington.

We reviewed documents published by other states, focusing on Idaho’s neighboring states plus Indiana. Indiana had been identified by legislators and subject-matter experts as a leader in evaluating tax preferences. We interviewed staff who conduct analysis in Indiana, Oregon, and Washington.

Idaho’s tax structure

We developed a list of tax preferences in Idaho based on the Division of Financial Management’s general fund revenue book, documents published or previously shared with us by the Tax Commission, and a review of statute. We also included data from the Legislative Services Office, the Department of Commerce, the Department of Insurance, and the Tax Commission.
Stakeholder survey

We surveyed stakeholders in Idaho to identify areas they wanted to know more about and concerns they had with a review of tax preferences.

We selected stakeholders who were interested in Idaho tax policy by reviewing the minutes from 187 meetings of the House Revenue and Taxation Committee from 2015 to 2020 and the 2015 interim committee on tax policy. We recorded the number of times an organization was represented at or an individual attended a meeting. After excluding state agencies, we sent the survey to the 25 organizations and individuals that testified most frequently. We received responses from 13 people representing 29 organizations.
Idaho collects tax revenue from three major sources and a myriad of smaller ones. This appendix discusses taxes with revenue greater than $2 million in fiscal year 2020.

Taxes can be imposed at three major points: (1) what the taxpayer earns, (2) what the taxpayer buys or sells, and (3) what the taxpayer owns.

**Taxes on sales and consumption:**

**$2.6 billion**

Taxes on sales and consumption are the largest category of taxes both in revenue collected and in number of separate taxes. These taxes are levied as a percentage of a transaction or on a per-unit basis. Excise taxes are a type of sales tax levied on a specific good or service.

In addition to the taxes levied in Idaho, examples of taxes on sales include the value added tax, a consumption tax used by many countries other than the United States; a gross receipts tax, levied as a percentage of all sales including on goods meant for resale; and numerous taxes on specific transactions or goods.

**Sales and use tax**

**Fiscal year 2020 revenue: $2.09 billion**

**Idaho Code Title 63 Chapter 36**

Idaho levies a 6 percent tax on the retail sale, rental, or lease of tangible personal property and certain services. The retailer collects the tax from the buyer. The Legislature grants some local governments authority to impose additional sales tax.
The use tax is owed when the sales tax was not collected for personal property acquired for consumption or acquired for an exempt purpose but consumed. For example, a buyer owes use tax when they purchase a car in a state without a sales tax and bring the car to Idaho. The use tax is also owed by a retailer that purchases wood for resale and instead uses the wood for in-house repair.

Nationwide, 46 states and the District of Columbia have a sales tax. Each of these states, but Alaska, levy the sales tax statewide. Local governments in 38 states can levy sales taxes.

Types of tax preferences. The Legislature can enact sales tax preferences by excluding a type or use of tangible personal property or service, by excluding a buyer or seller, or by taxing at a lower rate.

The sales tax also includes implicit preferences. Implicit preferences are transactions that should be taxed but fall outside the statutory language defining the tax. For example, until 2019 only sellers with a physical presence in Idaho had to collect sales taxes. State and federal law did not account for large retailers selling through the internet in states where the retailer had no physical presence.

Discussion of tax base. The sales tax is typically viewed as a tax on consumption. What is considered a normal sales tax is a matter of debate since each state imposes its sales tax on different transactions. Only with a clear definition of a normal sales tax can implicit tax preferences be defined.

One measure of the breadth of the sales tax base is to compare taxed sales to personal income. Idaho taxed sales equal to 40 percent of personal income in fiscal year 2017, fourteenth highest in the nation. Sales tax bases ranged from 22 percent in California to 105 percent in Hawaii. The broader the tax base, the lower the tax rate needs to be to collect a given amount of revenue.

Another measure of breadth is to compare the types of transactions where sales tax applies. A 2017 survey by the Federation of Tax Administrators found that Idaho taxed 30 out of 176 services. Idaho ranked thirty-eighth in number of services taxed. The average state taxed 60 services. The federation also tracks whether states tax certain goods. Every state but Illinois excludes sales of prescription drugs from taxation. Idaho taxes nonprescription drugs, which are excluded by ten states and
taxed at a lower rate by one state. Idaho also taxes food, excluded by 33 states and taxed at a lower rate by 6. Of the six states that tax food, five including Idaho reimburse residents for taxing food.

**Motor fuels tax**

**Fiscal year 2020 revenue: $353.6 million**

**Idaho Code Title 63 Chapter 24**

Idaho levies a tax on motor fuel of 32 cents per gallon. The state also taxes aircraft engine fuel at 7 cents per gallon of aviation gasoline and 6 cents per gallon of jet fuel. Compressed or liquefied natural gas is taxed in equivalent gallons of motor fuel according to a conversion rate in statute. A 1 cent per gallon transfer fee is charged on all petroleum products. The taxes are collected from the distributor.

Unlike other excise taxes, the motor fuels tax is levied in lieu of the sales or use tax. All but five states exempt motor fuels from their general sales tax. In Idaho, if a purchase of fuel is exempt from the motor fuels tax, the buyer owes a 6 percent use tax on the purchase unless exempt from the use tax.

**Types of tax preferences.** The Legislature can enact motor fuels tax preferences by exempting uses or users from the tax or by charging different rates of tax. Distributors may sell special fuel that is dyed to indicate that it has not been taxed, though the 1 cent transfer fee still applies. The fuel can only be used for certain uses or by certain users. When selling or using undyed fuel for exempt purposes, distributors may also deduct an amount from taxes owed or the state may refund the tax to the consumer when the consumer files income taxes.

**Discussion of tax base.** The motor fuels tax is often viewed as a user fee since the tax typically funds transportation infrastructure rather than general government. As such, the tax base may be defined as impact on transportation infrastructure rather than on category of goods. Fuel is often exempt from the tax when used in ways that do not affect transportation infrastructure such as in agricultural uses or for stationary engines. Users may use untaxed fuel or receive a refund for the tax, and if the tax base is defined relative to the impact on transportation infrastructure, these exemptions would not constitute tax preferences.
Insurance premium tax

Calendar year 2019 revenue: $102.2 million

Idaho Code Title 41 Chapter 4

Idaho levies a tax on insurance companies on the value of insurance premiums sold to Idaho residents or for risks ‘resident to this state.’ The tax is in lieu of any other tax except taxes on real property.

The premium tax has a unique retaliatory aspect. For each insurer outside of Idaho, the Department of Insurance calculates two amounts and charges the greater of the two:

- Idaho basis (1.5 percent of most premiums)
- Domiciled jurisdiction’s rate for Idaho insurers

Other states calculate taxes the same way for Idaho domiciled insurers.

The retaliatory nature of the insurance premium tax complicates an analysis of Idaho’s tax. Increasing or removing a tax preference would only increase taxes on Idaho insurers or insurers from jurisdictions with lower taxes than Idaho. The increase would cause Idaho insurers to pay higher taxes on premiums sold in states with lower taxes. Similarly, a decrease in the tax would only affect Idaho insurers or insurers from jurisdictions with lower taxes than Idaho.

Types of tax preferences. The Legislature can enact insurance premium tax preferences by exempting or charging at a lower rate specific types of organizations or types of insurance.

Discussion of tax base. Insurance premium taxes predate income and sales taxes. The income tax is meant to tax earnings after accounting for expenses, and the insurance premium tax is a tax on earnings before accounting for expenses. Just as the motor fuels tax was meant to fund transportation infrastructure, insurance premium taxes were originally created to help fund state insurance departments.
Product-specific excise taxes

**Fiscal year 2020 revenue: $59.1 million**

**Idaho Code Title 23 Chapter 10 (beer), Title 23 Chapter 13 (wine), Title 63 Chapter 25 (cigarette and tobacco products)**

Idaho has four excise taxes imposed on specific products in addition to the general sales tax. These product taxes are often levied to reduce consumption of the products. Idaho collects excise taxes from distributors or wholesalers. A tax of 15 cents per gallon is collected on beverages with less than 4 percent alcohol by weight and 45 cents per gallon if more than 4 percent alcohol by weight. A tax of 2.85 cents per cigarette is collected as is a 40 percent tax on the wholesale price of other tobacco products.

**Types of tax preferences.** The Legislature could enact tax preferences that exempt specific producers, users, or uses from excise taxes. As the goal of these taxes is usually to discourage the use of a product, tax preferences are typically rare, though they do exist in other states for small producers or for communion wine.

Room taxes

**Fiscal year 2020 revenue: $20.4 million**

**Idaho Code: Title 67 Chapter 47 (travel and convention), Title 67 Chapter 49 (auditorium districts)**

In addition to the general sales tax, Idaho levies a 2 percent travel and convention tax and authorizes auditorium districts to levy a local sales tax up to 5 percent. Both taxes are collected by the lodging establishment and apply to the rental of lodging for less than 30 days.

The base of the two taxes differs slightly. Overnight spaces in campgrounds and recreational vehicle parks are subject to the travel and convention tax but not the auditorium district tax, and the rental of meeting rooms is subject to the auditorium district tax but not the travel and convention tax.

**Types of tax preferences.** Buyers exempt from the sales tax are also exempt from room taxes.
Kilowatt-hour tax

Fiscal year 2020 revenue: $2.1 million

Idaho Code Title 63 Chapter 27

Idaho imposes a tax of $0.0005 per kilowatt hour of hydro-generated electricity for sale, barter, or exchange. Electricity sold for use in manufacturing, mining, milling, smelting, refining, and processing is exempt from the tax.

Taxes on income: $2.16 billion

Idaho’s income tax is levied on income earned by individuals, trusts, and corporations. Although the personal and corporate income tax are part of the same statute and have many of the same definitions and tax preferences, the income tax is often divided into the personal income tax and the corporate income tax.

Personal income tax

Fiscal year 2020 revenue: $1.91 billion

Idaho Code Title 63 Chapter 30

Idaho taxes Idaho-based income, as measured by federal taxable income modified by additions and subtractions in Idaho statute, on estates, individuals, and trusts at $10 plus an increasing portion of income.

Idaho is one of 43 states with an income tax. Two states tax only dividend and interest income, while the rest also tax wage and salary income.

Types of tax preferences: The Legislature can enact tax preferences through three methods:

- Deductions and exclusions reduce the amount of income taxed.
- Credits reduce the amount of taxes owed.
- Tax deferrals allow taxpayers to defer payment.

Conforming to the federal definition of income is often
considered a tax preference because conforming causes the state to adopt federal preferences. The state can choose not to adopt specific federal preferences by requiring that Idaho taxpayers add income not included in federal taxable income.

**Discussion of tax base:** Income is defined as the sum of consumption plus the change in net worth. The first tax preference analyses conducted by the federal government categorized any element of the tax code that deviated from this definition as a tax preference. Some elements of income are not feasible to tax or calculate, such as the consumption value someone derives from living in their home.

When states estimate the value of tax preferences, some states calculate the cost of conforming to federal income tax code. Others begin their analysis by defining the tax base as the federal starting point for calculating their income tax.

**Corporate income and corporate franchise tax**

**Fiscal year 2020 revenue: $246 million**

**Idaho Code Title 63 Chapter 30**

Idaho imposes a tax on the net earnings (revenues minus costs) of corporations at $10 plus 6.925 percent. The starting point in Idaho is the corporation’s federal net taxable income. For multistate corporations, the portion of earnings a corporation must pay in taxes is calculated using the share of property, payroll, and sales in Idaho. Sales is weighted twice as much as much as the other two. Some industries have special apportionment methods.

**Types of tax preferences:** The Legislature can enact tax credits, deductions, exemptions, and deferrals for corporations. States can also determine what corporations can categorize as an expense. Additionally, the method used by a state to apportion the income of multistate corporations can be considered a tax preference.

**Discussion of tax base:** For multistate corporations, the tax burden is apportioned by the share of their economic activity in each state. Historically, most states had measured this apportionment by an equal weighting of a corporation’s property, payroll, and sales in the state as a share of its total. However, most states have moved to weighting sales more heavily or exclusively with the goal of encouraging investment and job creation.
Taxes on property: $2.04 billion

Calendar year 2019 revenue: $2.04 billion

Idaho Code Title 63 Chapters 2 to 17

Idaho allows local governments to levy a tax on the value of property in the government’s district. Each government sets its budget and computes the amount it will need to collect from property taxes to meet that budget. The tax is distributed equally among all taxable property in the district. Each county collects the taxes and distributes the revenue among local governments. Each county assessor is responsible for assessing the value of most property in their county. The Tax Commission assesses operating property, such as that owned by railroads and utilities, which may span multiple counties.

Types of tax preferences. All property, real and personal, is subject to the property tax unless exempted. The Legislature can exempt property based on the characteristics of the owner, the property, or the use of the property. Other states allow for different categories of property to be taxed at different rates, but the Idaho Constitution requires property to be taxed at the same rate. Another type of tax preference involves differential treatment during assessment.

Discussion of tax base. Real property consists of land and any immobile improvements such as buildings. Personal property is anything subject to ownership except real property. In contrast to the sales tax base, which may be broader than what is in statute, the property tax base may be narrower than what is in statute.

Statute states that all property is to be taxed unless specifically exempt. A report done for the Oregon Legislature tracks the history of property tax in the United States and found that certain categories of property have never been taxed. For example, property controlled by government, churches, and charitable organizations were never meant to be taxed. Though Idaho has a statutory exemption for these properties, some people may not consider the exemptions to be deviations from a normal tax structure.
This chapter contains sample language from statute used to structure the tax preference reviews in Indiana, Montana, Oregon, Utah, and Washington. The sections of statute are organized under the four questions that the Legislature should answer if it chooses to review tax preferences.
What are the values and goals that motivate the Legislature’s review of tax preferences?

**Indiana**

Indiana Code § 2-5-3.2-1 (2019)

(b) “The general assembly intends that each tax incentive effectuate the purposes for which it was enacted and that the cost of tax incentives should be included more readily in the biennial budgeting process. To provide the general assembly with the information it needs to make informed policy choices about the efficacy of each tax incentive, the legislative services agency shall conduct a regular review, analysis, and evaluation of all tax incentives according to a schedule developed by the legislative services agency.”

**Washington**


“The legislature recognizes that tax preferences are enacted to meet objectives which are determined to be in the public interest. However, some tax preferences may not be efficient or equitable tools for the achievement of current public policy objectives. Given the changing nature of the economy and tax structures of other states, the legislature finds that periodic performance audits of tax preferences are needed to determine if their continued existence will serve the public interest. The legislature further finds that tax preferences that are enacted for economic development purposes must demonstrate growth in full-time family-wage jobs with health and retirement benefits. Given that an opportunity cost exists with each economic choice, it is the intent of the legislature that the overall impact of economic development-focused tax preferences benefit the state’s economy.”
How will the Legislature ensure that a review informs policy?

Indiana

Indiana Code § 2-5-3.2-1 (2019)

(e) “The interim study committee on fiscal policy shall do the following:

(1) Hold at least one (1) public hearing after September 30 and before November 1 of each year at which:

(A) the legislative services agency presents the review, analysis, and evaluation of tax incentives; and

(B) the interim study committee receives information concerning tax incentives.

(2) Submit to the legislative council, in an electronic format under IC 5-14-6, any recommendations made by the interim study committee that are related to the legislative services agency's review, analysis, and evaluation of tax incentives prepared under this section."

(f) “The general assembly shall use the legislative services agency's report under this section and the interim study committee on fiscal policy's recommendations under this section to determine whether a particular tax incentive:

(1) is successful;

(2) is provided at a cost that can be accommodated by the state's biennial budget; and

(3) should be continued, amended, or repealed.”
Oregon
Or. Rev. Stat. § 315.051(2) (2020)

Oregon requires that the statement of purpose for new or extended tax credits contain the following information:

(a) “The stated public policy purpose, if any, of the credit.

(b) The expected timeline for achieving the public policy purpose, if a timeline exists.

(c) The best means of measuring achievement of the public policy purpose.

(d) The taxpayers or other entities or individuals that directly benefit from allowance of the credit and whether the credit is intended to benefit particular targets. . .”

Washington

(2) “For each tax preference, the committee must provide a recommendation as to whether the tax preference should be continued without modification, modified, scheduled for sunset review at a future date, or terminated immediately. The committee may recommend accountability standards for the future review of a tax preference.”


(1) “The joint legislative audit and review committee shall report its findings and recommendations for scheduled tax preferences to the citizen commission for performance measurement of tax preferences by August 30th of each year. The commission may review and comment on the report of the committee. The committee may revise its report based on the comments of the commission. The committee shall prepare a final report that includes the comments of the commission and submit the final report to the finance committee of the house of representatives and the ways and means committee of the senate by December 30th.”
How will the Legislature define the review’s scope?

Indiana

Indiana Code § 2-5-3.2-1 (2019)

(a) “As used in this section, "tax incentive" means a benefit provided through a state or local tax that is intended to alter, reward, or subsidize a particular action or behavior by the tax incentive recipient, including a benefit intended to encourage economic development. The term includes the following:

(1) An exemption, deduction, credit, preferential rate, or other tax benefit that:

   (A) reduces the amount of a tax that would otherwise be due to the state;

   (B) results in a tax refund in excess of any tax due; or

   (C) reduces the amount of property taxes that would otherwise be due to a political subdivision of the state."

(c) “The legislative services agency shall conduct a systematic and comprehensive review, analysis, and evaluation of each tax incentive scheduled for review. . . ."

(h) ". . . The legislative services agency may revise the schedule as long as the legislative services agency provides for a systematic review, analysis, and evaluation of all tax incentives and that each tax incentive is reviewed at least once every seven (7) years."
(6) “The revenue and transportation interim committee shall review the tax credits scheduled for review in the biennium of the next regular legislative session, including any individual or corporate income tax credits with an expiration or termination date that are not listed in this section and make recommendations to the legislature about whether to eliminate or revise the credits. The legislature may extend the review dates by amending this section. The revenue and transportation interim committee shall review the credits using the following criteria:

(a) whether the credit changes taxpayer decisions, including whether the credit rewards decisions that may have been made regardless of the existence of the tax credit;

(b) to what extent the credit benefits some taxpayers at the expense of other taxpayers;

(c) whether the credit has out-of-state beneficiaries;

(d) the timing of costs and benefits of the credit and how long the credit is effective;

(e) any adverse impacts of the credit or its elimination and whether the benefits of continuance or elimination outweigh adverse impacts; and

(f) the extent to which benefits of the credit affect the larger economy.”
Oregon

(1) “Prior to the beginning of each odd-numbered year regular session, the Legislative Revenue Officer shall submit a report addressing each income or excise tax credit that is scheduled to expire during the next even-numbered year.”

(2) “The report required in subsection (1) of this section shall set forth:

(a) The stated public policy purpose, if any, of the credit.

(b) The expected timeline for achieving the public policy purpose, if a timeline exists.

(c) The best means of measuring achievement of the public policy purpose.

(d) The taxpayers or other entities or individuals that directly benefit from allowance of the credit and whether the credit is intended to benefit particular targets.

(e) The effectiveness of the credit in benefiting its targets and any evidence that demonstrates its impact on its targets.

(f) The expected results if the credit is allowed to expire under current law and any potential results of making incremental changes in the value of the credit rather than allowing it to expire.

(g) Background information on the effect of similar credits allowed in other states.

(h) Information regarding whether use of a tax credit is an effective and efficient way to achieve the stated policy goal.

(i) The administrative and compliance costs associated with the credit.

(j) Analysis of whether a direct appropriation might achieve the stated public policy purpose of the credit more efficiently.

(k) What other incentives, including state or local subsidies or federal tax expenditures or subsidies, are available in this state that have a similar policy purpose.”
Utah
Utah Code § 59-10-137(2)(b)

(iv) “ensure that the committee's recommendations described in this section include an evaluation of:

(A) the cost of the tax credit to the state;
(B) the purpose and effectiveness of the tax credit; and
(C) the extent to which the state benefits from the tax credit; and

(v) undertake other review efforts as determined by the committee chairs or as otherwise required by law.”

Utah Code § 59-10-137(2)(d)

(ii) “The committee shall complete a review described in this Subsection (3)(d) three years after the effective date of the tax credit and every three years after the initial review date."

Washington

(1) “The joint legislative audit and review committee must review tax preferences according to the schedule developed under RCW 43.136.045. The committee must consider, but not be limited to, the following factors in the review as relevant to each particular tax preference:

(a) The classes of individuals, types of organizations, or types of industries whose state tax liabilities are directly affected by the tax preference;

(b) Public policy objectives that might provide a justification for the tax preference, including but not limited to the legislative history, any legislative intent, or the extent to which the tax preference encourages business growth or relocation into this state, promotes growth or retention of high wage jobs, or helps stabilize
communities;

(c) Evidence that the existence of the tax preference has contributed to the achievement of any of the public policy objectives;

(d) The extent to which continuation of the tax preference might contribute to any of the public policy objectives;

(e) The extent to which the tax preference may provide unintended benefits to an individual, organization, or industry other than those the legislature intended;

(f) The extent to which terminating the tax preference may have negative effects on the category of taxpayers that currently benefit from the tax preference, and the extent to which resulting higher taxes may have negative effects on employment and the economy;

(g) The feasibility of modifying the tax preference to provide for adjustment or recapture of the tax benefits of the tax preference if the objectives are not fulfilled;

(h) Fiscal impacts of the tax preference, including past impacts and expected future impacts if it is continued. For the purposes of this subsection, "fiscal impact" includes an analysis of the general effects of the tax preference on the overall state economy, including, but not limited to, the effects of the tax preference on the consumption and expenditures of persons and businesses within the state;

(i) The extent to which termination of the tax preference would affect the distribution of liability for payment of state taxes;

(j) The economic impact of the tax preference compared to the economic impact of government activities funded by the tax for which the tax preference is taken at the same level of expenditure as the tax preference. For purposes of this subsection the economic impact shall be determined preference determined using the Washington input-output model as published by the office of financial management;
(k) Consideration of similar tax preferences adopted in other states, and potential public policy benefits that might be gained by incorporating corresponding provisions in Washington.

What resources will the Legislature dedicate to make the review effective?

**Indiana**

Indiana Code § 2-5-3.2-1 (2019)

(c) “The legislative services agency shall conduct a systematic and comprehensive review, analysis, and evaluation of each tax incentive scheduled for review. . . .”

**Montana**


(4) “The legislative services division shall provide staff assistance to the committee. The committee may request the assistance of the staffs of the office of the legislative fiscal analyst, the legislative auditor, the department of revenue, and any other agency that has information regarding any of the tax or revenue bases of the state.”

**Utah**

Utah Code § 59-10-137(2)

(b) “in conducting the review required under Subsection(2)(a), the committee shall:

(i) schedule time on at least one committee agenda to conduct the review;

(ii) invite state agencies, individuals, and organizations concerned with the tax credit under review to provide testimony;
(iii)(A) invite the Governor’s Office of Economic Development to present a summary and analysis of the information for each tax credit regarding which the Governor’s Office of Economic Development is required to make a report under this chapter; and

(iii)(B) invite the Office of the Legislative Fiscal Analyst to present a summary and analysis of the information for each tax credit regarding which the Office of the Legislative Fiscal Analyst is required to make a report under this chapter.”

Washington

(1) “The joint legislative audit and review committee must review tax preferences according to the schedule developed under RCW43.136.045. . . .”


(1) “The joint legislative audit and review committee shall report its findings and recommendations for scheduled tax preferences to the citizen commission for performance measurement of tax preferences by August 30th of each year. . . .”


(6) “The joint legislative audit and review committee shall provide clerical, technical, and management personnel to the commission to serve as the commission’s staff. The department of revenue shall provide necessary support and information to the joint legislative audit and review committee.”
Responses to the evaluation

I have always believed that tax policy should be fair, simple, and predictable.

—Brad Little, Governor

[The Tax Commission stands ready to assist the Legislature in any way it can toward gaining a fuller understanding of tax preference impacts and their policy implications.

—Jeff McCray, Chairman
Idaho Tax Commission
March 15, 2021

Rakesh Mohan, Director  
Office of Performance Evaluations  
954 W. Jefferson St., Ste. 202  
Boise, ID 83720

Dear Director Mohan:

I want to thank the Office of Performance Evaluations for your recent work and report on Designing a Tax Preference.

I have always believed that tax policy should be fair, simple, and predictable. I encourage those in the Legislature and other stakeholder groups working on sound tax policy to ensure there are no unintended and burdensome tax shifts resulting from any policy changes.

I look forward to seeing policymakers review the findings in your report. The report will prove to be valuable as we continue tax policy discussions in the future.

Sincerely,

Brad Little  
Governor of Idaho
March 17, 2021

Rakesh Mohan
Director
Office of Performance Evaluations
Idaho Legislature

Dear Rakesh,

Thanks for the opportunity for the Idaho State Tax Commission to review and comment on the Office of Performance Evaluations’ (OPE) new report, “Designing a Tax Preference Review.” It’s a thorough and concise reference to help state policymakers more knowledgeably consider options available to them for improving Idaho’s tax system.

The OPE report accurately expresses the difficulty of identifying the financial or social impacts of tax preferences or their effectiveness toward realizing the goals or expectations stated in establishing them. As the report notes: “No state has a complete understanding of the gaps (in knowledge about tax preferences) we identified.”

The Tax Commission appreciates that the report includes our concerns about what we believe to be significant underestimates in the financial impacts of some tax preferences. That includes the estimate of $9.2 million per year in foregone revenue due to the sales tax exemption on remotely accessed computer software and digital subscriptions. However, we would have preferred that the estimated impact be listed as “Unknown” to more accurately reflect the absence of reliable data.

As you know, the Tax Commission is an Executive agency involved solely with the administration of Idaho tax laws. We have no role in determining the relative efficacy of tax policy considerations. That said, the Tax Commission stands ready to assist the Legislature in any way it can toward gaining a fuller understanding of tax preference impacts and their policy implications.

Sincerely,

Jeff McCray, Chairman for:

Commissioner Tom Katsilometes
Commissioner Janet Moyle
Commissioner Elliot Werk