Committee Minutes:

Joint Legislative Sales Tax Task Force

House Majority Caucus Room

July 22, 2003

10:00 a.m.

The meeting was called to order at 10:15 a.m. by Cochairman Representative Dolores Crow after it was moved to the East Conference Room of the JR Williams Building due to overcrowding. Members present were Cochairman Senator Hal Bunderson, Senator Joe Stegner, Senator Edgar Malepeai, Senator Fred Kennedy, Representative Dell Raybould, Representative Wendy Jaquet and Representative Margaret Henbest.

Others present included Honorable Pete Cenarrusa; Bob Fick, Associated Press; Ben Ysursa, Secretary of State; Bill Roden, Hopkins, Roden; Phil Homer, Idaho Association of School Administrators; Representative Kathy Skippen, Representative Steve Smylie and Representative Shirley Ringo, Idaho House of Representatives; George Moses; Justin Ruen, Association of Idaho Cities; Jim Weatherby, Boise State University; Val Brooks, Idaho Credit Union League; Vera Raybould; Larry Benton, Benton and Associates; Gayle Batt and Kristin Hagedorn, Idaho Water Users; Don Olerding, Idaho Grain Producers; Mike Ferguson and Derek Santos, Division of Financial Management; Tony Poinelli, Idaho Association of Counties; Jack Jones, AARP/Area 3 Council on Aging; Sam Haws, Dan John and Dewey Hammond, State Tax Commission; Steve Ahrens, Idaho Association of Commerce and Industry; Steve Millard, Idaho Hospital Association; Woody Richards, Moffatt Thomas; Laird Maxwell, Idahoans for Tax Reform; F.M.Duck, F.M. Duck dot com; Mark Durham and Alex LeBeau, Idaho Association of Realtors; John Eaton, Building Contractors of SW Idaho; Pam Eaton, Idaho Retailers Association; Brent Olmstead, Milk Producers of Idaho; Bea Black, Boise School District; Rick Naesebout, Idaho Dairymen's Association; Mike Huntington, Intermountain Gas Company; Neil Colwell, Avista; Ken McClure and Molly Creswell, Givens Pursley; Tom Ryder, J.R. Simplot Co.; Mike Reynoldson, Qwest; Brian Whitlock, Governor's Office; Rich Hahn, Idaho Power; Betsy Russell, Spokesman Review; Pete Skamser, National Federation of Independent Business; Andrea Mihm, Sullivan and Reberger; Ed Lodge, Connolly and Smyser; Dave Kerrick; Sherman Burger; Paul Pusey, Consultant, Idaho Manufactured Housing Association; Ron Williams, Idaho Consumer Owner Utilities Association/Idaho Cable Telecommunications Association; Carl Bianchi, Maureen Ingram, Katharine Gerrity and Caralee Lambert, Legislative Services Office. Staff members present were Susan Bennion and Toni Hobbs.

After opening remarks by the Cochairmen, the Honorable Pete Cenarrusa was introduced to discuss the history of sales tax in Idaho. Mr. Cenarrusa stated that during his nine terms in the House of Representatives, beginning in 1950, there was a lot of interest in the sales tax issue.

The first sales tax in Idaho was passed in 1935 at 2%. The people called for a referendum to repeal this sales tax and it failed by a 52.3% majority. It is thought this failed due to confusion over how the question was posed.

In 1957 the Senate warned the House of Representatives that the Senate would initiate legislation to change the constitution to allow the Senate to be able to introduce revenue measures if the House would not transfer a revenue bill to them. As a result the House decided to transmit three bills to the Senate. They were:

1. 3% Sales Tax
2. Gross Income Tax (Indiana Plan)
3. Heath Plan (allowed federal income tax to be deducted from state income tax)

The Senate immediately killed all three bills.

In the 1958 general election, both houses became controlled by the Democratic party. This was the same year that Right to Work was on the ballot. Governor Bob Smylie was the only republican to be elected. During this year there was a push to develop a head tax and Governor Smylie argued this was the most regressive tax ever passed.

In 1960 the Republican party gained the majority in both houses again. In 1963, the House of Representatives passed the sales tax with exemptions by one vote. The feeling was at this time that if the Senate passed this bill, Governor Smylie would sign it. Before the Senate could pass it, the majority leader of the Senate received a copy of an Idaho Statesman editorial criticizing the sales tax bill. After this, the bill did not pass the Senate by a vote of 12 to 32.

In 1965, a sales tax bill finally passed both houses and was signed by Governor Smylie. People were able to get a referendum on the next ballot to kill the sales tax with a *yes* vote meaning the sales tax would remain in effect and a *no* vote was against the sales tax. The way this question was worded made it very confusing for voters. The referendum repealing the sales tax failed. In **Mr. Cenarrusa's** opinion this sales and use tax would not have passed had several exemptions not been included. There were 17 original exemptions.

- In 1984 the sales tax was increased to 4%
- In 1985 that sales tax was temporarily increased to 5%
- In 1987 the 5% sales tax was made permanent
- In 2003 the sales tax has been raised to 6%

In thirty-eight years the sales tax has doubled from 3% to 6%.

Mr. Cenarrusa commented that exemptions to the sales and use tax are appropriate if they result in increasing the economy with additional revenues. The economy does seem to have shifted from an industrial economy to a service economy. Thus the push toward taxing services.

Mr. Cenarrusa stated that this task force has a very difficult job in front of them and wished them luck. To study all of these exemptions will require a lot of time and effort.

President Pro Tempore Bob Geddes was introduced to discuss the role and mission of the Sales Tax Task Force. He mentioned that Governor Bob Smylie's book ***Governor Smylie Remembers*** includes an interesting description of what happened from 1931 to 1965 when the sales tax was implemented.

Senator Geddes continued that currently there are 72 exemptions to the sales and use tax. The objective of this task force is to determine if modifications need to be made. The goal should not be to simply raise revenues, the goal should be to establish equity and fairness in our sales tax structure.

In the 1700s, Economist Adam Smith wrote why certain nations were flourishing while others were not. Much of his study has become the handbook of the way tax structure is developed, even today. He quoted that "Virtue is more feared than vice because its excesses are not subject to regulation of coincidence." **Senator Geddes** continued that in Adam Smith's fourth maxim of taxation, he warned that many high taxes obstruct the industry of the consumption of the taxed commodities and frequently affords a smaller revenue to government than what might be drawn from the more moderate tax. A similar argument was used this session regarding raising the cigarette tax. Adam Smith had the contention that whatever you tax, you discourage. If you think about this and what has happened in the past 38 years with our tax structure and the state's economy, our service industries have flourished. These are the industries that enjoy a sales tax exemption. Production industries that are highly taxed and highly regulated have declined.

Senator Geddes cautioned the committee to remember why the exemptions were implemented in the first place before doing away with them. He said that the committee needs to rely on the resources available to help understand the economics and circumstances that can help business and industry flourish. Many people also understand what would be harmful. If nothing else comes out of this task force, at least there will have been the opportunity to objectively look at the 72 sales tax exemptions and to remember why they were put in place.

Mr. Dewey Hammond, State Tax Commission, was the next speaker. **Mr. Hammond** introduced **Commissioner Sam Haws** who has oversight over sales and use tax with the State Tax Commission. He also introduced **Mr. Dan John** who is the manager of tax policy.

Mr. Hammond distributed a handout that was prepared due to a request from **Senator Bunderson.** This document is available electronically through the Legislative Services Office. **Mr. Hammond** commented that the document tries to answer the following questions for each exemption:

- The name of the exemption
- When was it enacted
- Was it in the original sales tax act? If not, when did it arrive?
- Where it is in the code
- A common sense description
- Today's value or cost
- The estimated first year tax that would be received if the exemption was removed

The last point raises an issue that has to do with the fact that on July 1, 2005, the sales tax rate will be lowered back to 5%. A revenue source providing between $160,000,000 and $170,000,000 annually will sunset. How will these moneys be replaced? As this material was prepared the question of which rate to use arose. It does make a difference. The fiscal cost of these exemptions at 5% is slightly over 1 billion dollars and at 6% it is 1.2 billion. His information was done using 6%.

In preparing the document, the Tax Commission put the sales tax exemptions into the following four categories:

1. Specific uses not taxed
2. Goods not taxed
3. Services not taxed
4. Specific entities not taxed

This document also include revenue charts showing Idaho tax collections by tax type in the last twenty years. **Mr. Hammond** noted that while corporate and individual income tax, along with property and sales tax have grown over this time period, the relative proportions have stayed about the same.

A pie chart showing Idaho fiscal year 2004 estimated state and local tax revenue also shows that the proportions of corporate and individual income tax, property tax and sales tax do not change that much. These figures are total money received minus refunds.

Mr. Hammond also discussed the 1965 definition of "Sale" as used in Idaho Code Section 63-3612. He also included any amendments that were made to this definition from 1965 to 1999.

In the spring of 1965 **Mr. Cenarrusa,** as speaker of the House of Representatives, asked the Revenue and Taxation Committee to issue a report capturing the intent of the Sales Tax Act. A copy of this report from the Chairman of the 1965 Revenue and Taxation committee in support of House Bill 222. This is also available electronically through the Legislative Services Office.

Mr. Hammond continued with an explanation of a comparison of states that tax services. He broke the taxation of services into three categories.

The first is those states that tax most categories of service transactions. There are 164 services that could be taxed. The states in this category tax at least 140 of those. These states are Hawaii, New Mexico and South Dakota.

The second group of 14 states tax at least 60 of the 164 services that could be taxed. These states include Arkansas, Connecticut, D.C., Florida, Iowa, Kansas, Minnesota, Mississippi, New York, Tennessee, Texas, Washington, Wisconsin and Wyoming.

Of the remaining 29 states, 16 states (including Idaho) tax less than 30 of the 164. Idaho taxes 29. There are 24 states (including Idaho) that tax fewer than 10 of the 19 enumerated labor and repair services. The degree to which Idaho taxes services tends to be at the low end of all states and well below those states that extensively tax services.

Mr. Hammond included in his information a spreadsheet that itemizes all of the exemptions at a tax rate of 6%.

Senator Bunderson asked how the estimated amount of the exemption and the predicted amount of first year tax was reached? **Mr. Hammond** said that was reached using a study of the population affected, history and theory. In response to a question from **Senator Stegner, Mr. Hammond** explained that for analysis purposes the first year tax amount over time would eventually equal the estimated amount of the cost of the exemption. He said this should happen in two or three years after the exemption is removed.

Senator Bunderson stated that his understanding of the committee's charge includes looking at the economic impact of the exemptions. He asked if the Tax Commission took economic impact into account when this study was completed. **Mr. Hammond** said that this information was gathered to help familiarize the committee, in a condensed fashion, with what the exemptions were and their cost. They did not consider the ripple effects. He stated they could do that for a later meeting.

Mr. Randy Nelson, Associated Taxpayers of Idaho, was introduced to discuss the recommendations of the Governor's 20/20 Task Force. The first meeting of this task force was October 10-11, 2002. This included a lot of discussion about demographics and background, the economic outlook at that time and understanding the tax system.

As a result of the meetings, the task force developed some guiding principles to give them directions. These include:

A. The State of Idaho should continue to budget annually.
B. Idaho's short and long-term economic health relies on a business-friendly climate that encourages job creation.
C. Idaho enjoys the highest possible credit rating giving us low cost flexibility for financing alternatives. This advantage must be preserved.
D. Idaho is recognized for its well-balanced tax structure. This advantage must be preserved to achieve the long-term goals of a strong business climate.
E. Idaho's economy is rapidly changing from a production to a service base, and those changes require a thorough review of tax exemptions.
F. Idaho must adequately fund economic development in the State to be competitive with neighboring states.
G. Business practices at the state level must involve a continuous improvement system to ensure that inefficient or ineffective practices are discontinued or corrected.
H. Education is a key element in Idaho's economic development focus.
I. The Idaho legislature will benefit from the Moore Study now being completed for the Idaho Tax Foundation, a sister organization of the Associated Taxpayers of Idaho.
J. Idaho state government needs to do a better job of harnessing its most valuable asset - State employees.

This complete report is available at www.idaho2020taskforce.us

Mr. Nelson stated that Item E should probably also include the term exclusions or untaxed services. These terms do show up later in the report.

The committee developed seven recommendations by the time the legislative session started in 2003. Of those seven the following relate closely to what the Sales Tax Task Force is doing:

- Support the effort of the Streamlined Sales Tax Project to collect tax on remote sales by simplifying and modernizing sales/use tax administration.
- Increase the sales tax rate by 1% effective June 1, 2003 and sunset this increase three years from the date of enactment. Distribution formula should be modified so that all increased revenues accrue to the State's General Fund. The Legislature should appoint an interim committee to study all sales tax exemptions and untaxed services during this three year period with the intent of lowering the overall sales tax rate by broadening the base against which the tax is applied. The state should continue to pursue efficiencies in order to reduce expenditures.

An intermediate recommendation made by the committee was to place a sunset provision or an Idaho Administrative Procedure Act (IDAPA) like process on all sales tax exemptions and require legislative review and action in order to be reinstated. Stagger the reviews so that at least 25% of the exemptions are examined in any one year. This process would be ongoing. The advantages and disadvantages to this recommendation are explained further in **Mr. Nelson's** document that is available at www.idaho2020taskforce.us

Representative Jaquet asked if the committee looked at expanding the fiscal note on tax legislation that would talk of doing an analysis of different income groups and how they would be effected by this change in tax policy. **Mr. Nelson** said the committee did not get into that much detail.

Senator Bunderson asked if there was a status report of the states that have signed on to the Streamline Sales Tax Project. **Mr. Dan John,** State Tax Commission, answered that 18 states have complied with the agreement. This represents about 23% of the population of the United States. This is important because the agreement was once there were 10% of the states and 20% of the population on board, they could go to Congress to try to get the standards changed to allow taxation of remote sales. According to a study by the University of Tennessee, Idaho is losing about $44 million by not being able to collect these taxes.

In response to a question from **Senator Bunderson, Mr. John** stated that Idaho participated in the document that was eventually approved by the group as an observer state. Idaho was able to give insight into what the group was doing, but they were not allowed to vote. Since that time, eight states have actually passed legislation to put into practice what is in the agreement. This is mainly definitions such as how many tax rates you can have in a state and if there is a definition in the agreement, that is what the state must use. An example of this is food. Many states exempt food but they each have their own definition. With this legislation, if the agreement contains a definition of food, that is what the state must use.

At this time 18 states have committed to making their laws and rules comport to what is in the agreement. Next, the Federation of Tax Administrators, the Streamlined Sales Tax Group and the Multi state Tax Commission will go to Congress for further action. In **Mr. John's** opinion, Congress will make some moves to get legislation in place to expand the nexus standards to allow for the collection of sales tax from remote sellers.

Senator Bunderson asked for clarification of where Idaho stands and what we have to do to get remote sellers to collect and remit sales tax on sales into the state of Idaho. **Mr. John** stated that they are currently just watching the process. Idaho's population did not add much to get the 20% necessary for this to go forward. If Congress allows expanded nexus, Idaho would need to modify our law to conform with the agreement. As soon as that was certified, Idaho would be able to share in the proceeds of these taxes. Of all the states involved in the streamline project, Idaho was probably the closest to having a sales tax act that conforms to the agreement. **Mr. John** continued that as Congressional action gets closer, Idaho will need to act quickly to bring our laws into compliance. He has staff identifying all code sections that would need to be amended if expanded Nexus occurs and if Idaho participates. It would be nice to be able to actually have a vote in the agreement process. **Senator Bunderson** asked if it would be an advantage for Idaho to add its name to the list and to encourage our congressional delegation to support that legislation. **Mr. John** said the more states that are on board, the better chance of getting something passed in Congress. The larger states are of course more important due to the population issue.

The meeting was reconvened after lunch and **Representative Crow** asked for suggestions for the direction the task force should take for the next meeting. She gave the following ideas as options:

- Look at each individual exemption, determine whether or not it is essential and what to do with it
- Look at what would happen if other entities were taxed by dropping some exemptions or lowering the rate

Representative Jaquet commented that developing a set of guiding principles (including things like accountability, fairness, stability, adequacy, transparency, comparability and simplicity) to be used when examining each exemption would be helpful. This would make sure everything was looked at in the same way. **Representative Crow** stated that the Revenue and Tax Committee considers all of those things on every tax issue and maybe for those that are not on that committee this would be helpful. **Representative Jaquet** added that there are at least three or four task force members that are not on legislative tax committees and it would be nice for them to be brought up to speed in this area. **Representative Henbest** agreed with the issue of developing guiding principles. She said this would be in line with **Senator Geddes** suggestion of looking at fairness and equity in each exemption. **Representative Raybould** added that the suggestion of looking at fairness and equity is good but one more item needs to be added. Idaho is in competition both nationally and internationally, especially in the manufacturing and production industries in the state. Due to this, the task force needs to look at whether adding or taking away an exemption to that industry would put them at a competitive disadvantage or maybe even put them out of business.

Senator Stegner reminded the committee to be careful of the effect any change that is made to the sales tax exemptions could potentially have on the other tax systems in the state, including property tax and income tax. **Senator Bunderson** added that exemptions also produce income due to the fact that the exemption is in place. On any decision that is made, the task force needs to understand the full impact of the consequences involved with an exemption.

On a practical matter, **Senator Bunderson** said that the complexities of these issues are so great that the task force, if the job is done correctly, will not be able to complete it's mission by January 2004. In his opinion, anyone who comes after this task force should be able to look at the report and understand exactly what was done and why those conclusions were reached. **Representative Crow** added that in her opinion, the task force needs to be very careful of defending what is currently on the books and of the unintended consequences of any changes that might be made.

Mr. Steve Ahrens, IACI, asked if the committee intends to leave the original 17 exemptions to the 1965 sales tax act intact or will those also be examined. **Representative Crow** stated that it was the task force's charge to look at all of the exemptions and to make recommendations. This needs to be done very carefully and in-depth and to complete it will take a lot of time. She stated that it was her idea to pick certain exemptions to be researched for the next meeting and to proceed from there. **Representative Crow** also said that, in her opinion, the original 17 exemptions probably do not need to be revisited. **Representative Jaquet** commented that the committee's charge seems to be to look at all 72 exemptions, including the original 17. In the original 17 exemptions there could be something that needs to be adjusted due to the fact that the state's economy has changed to a more service based economy. In response to a question from **Representative Raybould, Representative Jaquet** said that staff is available from the Legislative Services Office as well as the resources of DFM and the State Tax Commission as mentioned by **Senator Geddes**.

Senator Stegner in response to the question from **Mr. Ahrens,** stated that, in his opinion, the charge of this committee is to examine broadening the sales tax base and that would seem to include looking at all of the exemptions. The committee should not start with any presumptions that certain exemptions will remain in effect. **Senator Kennedy** agreed with **Senator Stegner.** The charge seems to be fairly specific that the committee examine the 72 exemptions that exist. In order to make a determination as to whether the exemptions meet the fair and equitable standards discussed by the Pro-tem, he suggested defining what ***fair and equitable*** means. This will allow the committee to examine each exemption in the same manner. He continued that he received a memo from Northern Idaho stating hope that the committee will look at all 72 exemptions and to keep those that are fair and equitable.

Representative Crow asked the committee what criteria they would like to use to examine these exemptions. **Representative Henbest** commented that discussion points that had been mentioned by committee members and, in her opinion, should be incorporated into the guiding principles for the committee to use include:

- Fairness and Equity
- Examining the economic ramifications of changing any sales tax policy
- Ramifications of changing an exemption on other tax systems
- Will there by stability and adequacy in the future
- Simplifying/Streamline Sales Tax
- Transparency/Accountability/Comparability - how do we ask different entities to justify whether their particular exemption does in fact have an economic trickle down effect

Senator Bunderson suggested that in preparation for the next meeting they prepare a matrix that includes background information on consequences. He also suggested grouping the exemptions by categories so the committee can vote on which exemptions to discuss first. He added the need to be sensitive to the original 17 exemptions but they do need to be looked at also. He suspects that the underlying rationale supporting those original 17 when they were originally crafted into law probably still has validity. But that needs to be justified. The taxpayers and the citizens of this state would want the committee to justify in an objective manner each exemption that exists.

Representative Jaquet said that before examining the exemptions, she would like to define the framework that will be used for those examinations. **Senator Bunderson** answered that he would like to have a list of guiding principles included with the matrix and allow the committee to vote on those that will be used. **Representative Jaquet** added that she would also like to see a presentation from DFM discussing how Idaho's economy is changing. **Senator Bunderson** said that he has talked to DFM about this and will get that finalized.

The next meeting was tentatively scheduled for September 9 and 10, 2003. The meeting was adjourned at 2:15 p.m.