

Committee Minutes:

**JOINT LEGISLATIVE SALES TAX EXEMPTION TASK
FORCE**

Joe R. Williams Building, West Conference Room, First Floor

September 9, 2003

9:30 A.M.

The meeting was called to order at 9:30 by Cochairman Senator Bunderson. Other members present included Senator Joe Stegner, Senator Fred Kennedy, Senator Edgar Malepeai, Cochairman Representative Dolores Crow, Representative Dell Raybould, Representative Wendy Jaquet and Representative Margaret Henbest. Staff members present were Mike Nugent, Maureen Ingram, Katharine Gerrity and Toni Hobbs .

Others present were Pam Eaton, Idaho Retailers Association; Alex LeBeau, Idaho Association of Realtors; Randy Nelson, Associated Taxpayers of Idaho; Brett Olmstead, MPI; Woody Richards, Moffatt Thomas; Robert Overstreet, Hooper Cornell; Rex Hanson, American Council of Engineers Companies of Idaho; Gayle Batt, Idaho Water Users Association; Jason Hancock, Legislative Services; Andrea Mihm, Sullivan and Reiberger; Rick Smith, Hawley Troxell; John Eaton, Building Contractors; George Moses; Suzanne Schaefer, SBS and Associates, LLC; Pete Skamser, National Federation of Independent Business; Nicole Lafavour; Tom Ryder, JR Simplot Company; Michael Gifford, Idaho Associated General Contractors; Skip Smyser and Ed Lodge, Connelly and Smyser, Ltd.; Dar Olberding, Idaho Grain Producers; Roger Sherman, United Vision for Idaho; Judy Brown, Idaho Center on Budget and Tax Policy; Betsy Russell, The Spokesman Review; Laird Maxwell, Idahoans for Tax Reform; Representative Shirley Ringo; Bob Corbell, Dry Cleaners/HVAC/Independent Electrical Contractors; Duayne Diderickson, Les Bois Park; Vera Raybould; Phil Homer, Idaho School Administrators; Erik Heidemann, BSU Dept. Public Policy & Administration; Ron Williams, Idaho Cable Telecommunications Association; Brad Hoaglund, Idaho Outfitters and Guides Association; David McNamee, Action Collection Service; Joe Gallegos, AARP; Tom Laws, Micron; Russ Hendricks, Farm Bureau; Derek Santos, DFM; Ken McClure and Molly Cresswell, Givens Pursley; Molly Steckel; Diana Zacharias, NFIB; Bob Aldridge; Jeremy Pisca, Evans Keane LLP.; Jack Jones, AARP/Area 3 Aging Agency; Roger Seiber and Jerry Deckard, Capital West; Judy Sargent; Josh Witbeck; Jack Lyman, Idaho Mining Association and Bob Seehusen, Idaho Medical Association.

The minutes from the last meeting were approved after a motion from Representative Raybould and a second from Senator Kennedy.

The Honorable Pete Cenarrusa spoke to the committee regarding the history of the sales tax in Idaho. He commented that Governor Smylie used the "head tax" to create the permanent building fund appropriation along with cigarette taxes, beer taxes and liquor taxes. This totaled about \$7,415,000. The creation of this permanent building fund helped build many of the state buildings we have today as well as to improve the universities of the state.

Senator Bunderson stated that the committee members had responded positively to the list of guiding principles that had been distributed and invited the public to make comments to their legislator or Legislative Services office through E-mails, phone calls or letters. This information is available on the Internet at <http://www2.state.id.us/legislat/03intcom.html> under the Sales Tax Task Force Interim Committee section. It was discussed that this criteria is just to be used as a guideline and can be changed or added to at any time. Part of the charge of the task force is to look at the existing exemptions to sales tax in the state to see if they are still valid. **Senator Bunderson** said that he and Cochairman **Representative Crow** had asked the Tax Commission to lay out the criteria as objectively as possible.

Representative Henbest commented that she would like to see a vision of where the committee is going long term before looking at the exemptions specifically. She reminded the members that the sales tax increase will sunset in two years and this will impact the budget. In her opinion part of the charge of this task force was to look at replacing the funds from the sales tax increase with a more appropriate tax due to the changing economy. **Senator Bunderson** stated that the charge of the committee as he understands it is to evaluate the sales tax system to see if it is reasonable within the changing economy and should the base be broadened so that the overall rate can be lowered. **Representative Crow** agreed with Senator Bunderson. **Senator Bunderson** added that after they gather the information and present it to the legislature they will be better informed but that it will take awhile to look at the entire picture. Without studying the exemptions first it will be hard to reach any specific conclusions. **Representative Raybould** said that as he understands the charge they are to review the exemptions and give recommendations to the legislature whether they should remain in place. The charge is not to revamp the tax structure.

Representative Henbest reread the letter to the task force and stated that **Senator Bunderson** seems to be correct.

Derek Santos, Department of Financial Management, distributed several graphs to the task force showing how the economy is changing to a more service oriented economy. These graphs are available at <http://www2.state.id.us/legislat/03intcom.html>. The first graph makes it clear that consumer spending has grown exponentially since 1959 and should continue to grow until 2024 and beyond. It also shows that spending on services has been growing much faster than durable or nondurable goods.

The second graph shows how the market shares of durable goods, nondurable goods and services have changed over time. In 1959, consumers spent about 40% on services. By 2003 that has increased to about 60%. Goods, on the other hand, have decreased from 60% to 40% of consumer spending. This trend is expected to continue. Part of the reason for this increase is the aging population. As the population ages the need for health care and residential care also goes up.

Mr. Santos continued with Idaho data that included the number of jobs (nonfarm employment) in the state. This is also available in a graph. It shows that service related jobs have increased about 323% since 1972. He explained that this is counted by the Department of Labor. They asked an employer how many employees do you have at any certain time. Employee, for this method, means that they have worked at least one hour and have been paid at least one dollar during the week the survey is conducted. This does not include the self-employed, farm workers, military or family members who are unpaid. **Mr. Santos** pointed out that although employment is growing at different rates over time, most of the sectors of our economy continue to grow. He explained that in 1972, services accounted for about 16% of all jobs in Idaho. By 2003, that was 27%.

Representative Raybould asked of the 59.50% increase in services, how much of that is due to increased health care costs. This would be the dollar increase rather than the services provided. **Mr. Santos** said he would get that information for the committee.

Jason Hancock, Budget and Policy Office, was introduced to discuss the history of changes to the Idaho Sales Tax rates. He also distributed a handout that is available at <http://www2.state.id.us/legislat/03intcom.html>. This handout shows the history of Idaho sales tax since 1965. **Mr. Hancock** explained that this information only reflects current law, it does not assume changes that might be made in the future. This information contained in the handout is also included in the "Fiscal Facts" book that is printed by the Budget and Policy Office.

The second page of this handout shows that tax burden of different taxes based on income and population to the citizens of Idaho. It shows that Idaho ranks 39th in sales tax burden based on population and 31st based on income for the year 2000. **Representative Henbest** asked how a state with a younger population versus an older population would affect the data for tax burden based on population. **Mr. Hancock** stated that something like that could skew the data due to the fact that the number of people in the workforce affects the amount of taxes being paid.

In a graph showing Idaho Gross State Product by Industry from 1990 to 2000, **Mr. Hancock** explained that the areas that the sales tax exemption parts of the economy would include services. This has grown 125% in the last 10 years. Other areas would include transportation and utilities which has grown 92% over that same time period. Construction has grown 168%. The retail trade has grown about 98% and this would be the best representation of what is actually subject to sales tax. In his opinion, the statement that a tax on goods represents a stagnant part of the economy is not correct. This sector has grown, just not as quickly as some other areas of the economy. **Representative Jaquet** asked if the retail area includes losses due to Internet sales. **Mr. Hancock** said this just shows growth in that sector, it does not include what is lost due to Internet sales. He commented that revenue has been lost to remote sales for many years before the Internet became a factor, it has just accelerated those losses. This chart shows the retail trade that is taking place in Idaho.

Mr. Hancock continued with a chart showing the projected ten year employment growth trends by industry. This chart shows the retail trade increasing by 29% employment growth. The service sectors include the other services with a growth of 44%, health services at 56%, business services 144%. This chart again would indicate that while retail trade is growing, it is not

growing as fast as other sectors. As a result of this, one can expect in the future that retail trade will be a smaller proportion of our economy than it is today.

Dewey Hammond, State Tax Commission, distributed a booklet containing a state by state survey of services and which states tax them. The other two items are the same information he presented at the last meeting using 5% sales tax rate instead of 6%. This information is available at <http://www2.state.id.us/legislat/03intcom.html> . **Mr. Hammond** clarified that the dollar figures presented for amount of sales tax being avoided at 5% is the estimate of sales and use taxes avoided based upon current economic behavior. When a precise piece of legislation to change the taxation is crafted, it is likely that a far different number will be reached.

Mr. Hammond explained that there are 164 service categories, Idaho taxes 29 of them.

The information he distributed includes a study done in 1996 by the Federation of Tax Administrators that includes all 164 of these service categories by SIC code and what is taxed in what state. This was updated in 2000 and the Idaho State Tax Commission updated it to 2003.

Mike Nugent, Legislative Services Office, in response to a question from **Senator Bunderson** stated that Idaho seems to be the only state currently looking at the service sector regarding sales tax.

Judy Brown, asked if there is information available regarding states that have a local option sales tax, to give a sense of what rate consumers are actually paying. **Mr. Hammond** said he does not have that information but that a separate study showed Idaho to be about the only western state that did not have a local option tax. **Senator Bunderson** added that local option taxes are an issue when dealing with remote sellers. Sales tax rates in states that have local option taxes in accordance with the Streamline Sales Tax Agreement would have to conform their tax structure so remote sellers would only have to pay one rate and the state would then allocate the tax accordingly. **Mr. Dan John**, in response to a question from **Representative Henbest** explained that with sales tax there are some states that allow local areas to tax things that the state does not. He would think due to the complexity of services that this would not be true. Idaho does allow resort cities to tax up to the Idaho base rate but nothing over and they cannot tax anything that the state does not tax. **Representative Jaquet** asked for information on other states that are looking at expanding their sales tax base. **Mr. Randy Nelson, Associated Taxpayers of Idaho**, stated that he had information that some states have recently expanded some sales taxed services. He specifically said that Illinois did remove some exemptions. He said he would try to get more information for the committee.

The next item on the agenda was to go through the service exemptions. **Senator Bunderson** stated that while there are many unique issues for each of these exemptions, there are also many that are similar and we may hear the same information for more than one exemption. These exemptions are separated into categories that are available in the information from the State Tax Commission at <http://www2.state.id.us/legislat/03intcom.html> .

1. Professional Services

Mr. Bob Aldridge, an attorney in Boise, spoke to the committee regarding Professional Services. He commented that his position is not the position of the Idaho State Bar and that they have taken no position in this matter. One of the main criteria he has seen in working with the legislature in the past on tax bills is to keep them as simple as possible. He urged the committee to look at a method of simplifying the taxation system that adopts overall clear and concise theory.

In terms of legal services, **Mr. Aldridge** stated that they are already partially taxed. There is a use tax imposed on things charged to the client such as copies and the like. Attorneys are required to file annual returns to the State Tax Commission for these items. On the other hand, services themselves are totally exempt. His personal view is that the exemption of those services is not necessarily logical. While the baby boomers are affecting the health care service area, as they age, they will also affect the legal community as well through elder law care. **Mr. Aldridge** cautioned that the allowances for Medicaid are very specific and if state sales tax is added to care, Medicaid will probably not reimburse for this. Clients that need these services are generally impoverished already and this would just be adding more expense that may not be reimbursed. He deals with a lot of Medicaid work for clients and 40% of that was done pro bono.

In terms of general legal services that main burden imposed by sales tax would be the creation of another layer of employees to take care of the collection and payment of these taxes. In his opinion, this is not a huge burden but this cost would realistically be passed on to the consumer. **Representative Henbest** said that since legal offices pay use taxes on hard copies and the like, most offices would have some infrastructure for reconciling with the Tax Commission. **Mr. Aldridge** agreed that most offices already have in place the basics that would be necessary if a broader sales tax was put into effect. **Representative Raybould** asked what the additional cost would be to administer collection of this tax that would be passed on to clients in addition to the sales tax. **Mr. Aldridge** answered that in larger firms it would probably be very minor because they already have people in place that are doing this on a smaller scale.

Senator Bunderson asked if adding a sales tax to legal services would hurt the competitiveness of the industry. **Mr. Aldridge** said that by and large most states have very different laws and the Idaho State Bar has recently adopted some criteria for dual admission to allow attorneys to practice across state borders. Most of the services that would be a problem would be things like trusts or estate plans. These would be difficult for the State Tax Commission to keep track of.

Mr. Pete Skamsner, NFIB, asked how they would handle contingent fee payments. **Mr. Aldridge** answered that it would be on a cash basis not an accrual basis. Therefore, when payment is received would be when the sales tax is paid. In response to another question dealing with out of state clients, **Mr. Aldridge** said that this problem already exists when there are out of state beneficiaries. In this case if there is sufficient nexus in Idaho, then sales tax is due. This is a detail that will be very complex. He would assume also that if the services are performed in Idaho, regardless of where the client is, the sales tax would be charged. In his opinion, this is logical.

Representative Jaquet commented that one of the barriers she thought of to taxing the legal community was the production exemption to provide fairness and equity to different sectors. **Mr. Aldridge** said those are the types of details that will need to be worked out. Items for which sales tax is already being paid should be segregated out.

Mr. Aldridge, although he is not in favor of being taxed, given the great expansion of the services industry logically legal services are a legal area of taxation.

Rex Hanson commented that the question of if legal work done for government entities would be taxable would also have to be answered. **Senator Bunderson** agreed that definitional questions will have to be answered at some point. **Ken McClure** cautioned that taxing services is a problem because services are intangible. At what point are they taxable? If an attorney does something for an out of state client, when is that taxable? This raises many questions. **Senator Bunderson** agreed.

Mr. Skamsner also cautioned the need to go slowly in this area. Florida tried to tax services in the form of national advertising shown in the state. All this did was to cause national advertisers not to advertise in Florida. There are always unintended consequences to consider.

Mr. Alex LeBeau, Association of Realtors, said that his organization is in the process of developing a comprehensive analysis of services related to real estate and what the impacts of a sales tax could be to the industry. This will be available for the committee as soon as it is completed. **Senator Bunderson** said that would be very helpful and encouraged other groups to do the same.

Senator Bunderson stated that in his opinion a tax on professional services would be less regressive due to the fact that generally more affluent people use these services to manage their affairs. **Mr. Aldridge** agreed but pointed out the Idaho State Bar has a number of programs for lower income people to receive free or reduced rate services based on income criteria.

Mr. Skamsner stated that if you look at the entire list of professional services, adding a 6% increase to their prices would be quite a burden for many and will cause people to go elsewhere to do business. **Senator Bunderson** agreed but if the other taxes these businesses paid were to go down, that would be a different story. The question for this task force is not necessarily to generate money but to broaden the base and lower the rate. This is not a one edged sword.

Representative Jaquet asked about nexus and the question of where the services occur and who pays the tax. **Mr. Dan John** answered that if someone is physically in Idaho during the service, they would have nexus here. Also if an Idaho resident buys service in another state, they will probably be subject to a use tax. This is another complicated issue.

Representative Henbest asked if the task force could get information on Washington's history of taxing services. **Mr. Nugent** commented that Washington has no state income tax and that Idaho has drafted legislation in the past that mirrors their tax on services. He would get copies of that for the task force as well as a recent history of how their tax works. He stated he would also get information on New Mexico and Florida.

2. Construction

Mr. Bob Corbell was introduced to discuss the problems with placing a sales tax on construction projects. He stated that construction companies are exempt from sales tax on labor. Labor, in many instances, is 40% of the cost of construction. Adding sales tax to the component would raise the price of homes. Another problem would be the issue of fair competition. Idaho contractors already pay sales tax on materials while Oregon contractors come to Idaho with materials already purchased and build houses without paying any sales tax anywhere. The Oregon contractor can already bid a job at a lower price because he does not pay sales tax on his materials. If Idaho adds sales tax to labor that would further decrease Idaho contractor's competitiveness. Adding sales tax would also cause small employers to have to add additional employees and equipment in order to collect and remit this sales tax to the commission.

Idaho law dealing with Public Works requires a contractor, working in the state of Idaho using public money to build something, hire 95% of their employees in Idaho. There is no real enforcement for that and so Idaho loses employment taxes, sales tax and there is no way to know if an income tax return is filed either.

Representative Raybould commented that perhaps the legislature should look at a way to tax out of state contractors bringing materials into Idaho. **Mr. Corbell** said the problem with that is where that tax could be imposed.

Mr. Corbell continued that an area with a lot of potential is out of state contractors doing public works projects with less than ½ of the employees being residents of Idaho. There is no enforcement in this area. **Mr. John** said contractors are subject to the use tax on those materials they bring into the state. If the tax commission knows who they are and what they are bringing in. This just needs to be reported to the commission and it will be checked out. There is a special construction audit group that focuses solely on out of state contractors. This consists of eight people that focus on public works and private projects. They bring in about \$1.8 to \$2 million trying to help level the playing field. This is not all of the money that should be paid but it is quite successful.

Mr. Michael Gifford, Associated General Contractors, stated that his organization agrees that there is a problem with materials entering the state and not having sales tax paid on them. He commented that a possible solution to the 95% employee rule for public works project might be a type of certified payroll being filed.

Currently, a company named Buck Knives is moving from California to the Idaho panhandle. In terms of economic development, it would be unfortunate to have to add 6% to the cost of their new building by adding a sales tax. This would hurt the state's competitiveness in attracting new businesses. **Mr. Gifford** added that the company will pay a use tax on about 40% to 60% of the cost of their new structure for materials. They will not pay a sales tax on labor at this time. In response to a question from **Representative Crow**, **Mr. Gifford** said this business will add about 100 to 200 employees to the area.

Mr. Corbell commented that if there was a method, particularly for public works projects, for 100% of their payroll to be reported and to have Idaho state taxes withheld from that payroll, there would be an increase in the tax income of the state. **Mr. Gifford** added that federal transportation jobs have to turn in a weekly payroll report before funds are released. **Mr. Nugent** stated that he would get information from public works on how this is handled.

Representative Jaquet stated that even though sales tax on labor would increase the cost of housing, the tax collected would help fund education and schools in neighborhoods so there would be a trade off. **Mr. LeBeau** said that his organization would include the impact on housing in their study.

Ms. Pam Eaton, Idaho Retailers Association, said that adding sales tax to construction labor impacts large retailers who build their own stores. Adding 6% to the cost of a building might make them reconsider building in the state.

Mr. Skamser said that people in the construction business such as specialty subcontractors and remodelers are concerned that what they do is discretionary and if costs go up, people will choose not to have the work done. He also pointed out that most homes are financed and the sales tax increase in costs figured over a thirty year mortgage is an expensive way to pay taxes.

Representative Henbest asked if **Mr. LeBeau's** study will include how or if broadening the tax base would help the infrastructure of a community. **Mr. LeBeau** said this study will mainly involve the impact of a sales tax on people's ability to buy homes. **Representative Henbest** asked for staff analysis of whether new construction through property taxes, income taxes and so on pays it way without sales tax being added. **Mr. LeBeau** stated there is a national homebuilders study done by the National Association of Realtors that shows how much money is put back into the community as a result of new construction. **Mr. Nugent** said that the pertinent statute for this area would be the development impact fee statute in Title 67, Idaho Code. There is a large debate as to what the development impact fee should pay. Should it be education, roads, police and so on. This could be the area to include fees for new construction.

3. Business Services

This category includes office services, employment services, building services, employment agencies, facility services and security agencies. No additional information was presented for this category. It was decided that the information that has been discussed for previous exemptions would apply here.

4. Information Services

Mr. Ron Williams, Idaho Cable Telecommunications Association spoke to this exemption. He stated that the two appropriate criteria for the committee to use in looking at this exemption were competition and equality.

When considering a sales tax in this area, the task force needs to take into account local franchise fees paid by cable companies and the 911 fee the cellular companies pay before imposing additional sales taxes. Franchise fees paid are about 5% of their gross revenues and they are far in excess of what the actual cost of using the right of ways is. These are paid to local government and constitute a large part of their budget. On the other hand, their primary competitors do not pay these fees putting cable companies at a competitive disadvantage. Applying a sales tax only to cable TV and not to direct broadcast would make that disadvantage greater. He cautioned adding a sales tax to only one type of provider over the other. This is also the case with Internet providers.

Ms. Judy Brown asked if someone buys a video as opposed to subscribing to a cable movie network, what is the logical reason for taxing one but not the other. **Mr. Williams** said that in this instance the sales tax applies to tangible personal property. A cable TV signal does not fit this definition. He also stated that cable TV is more than just a form of entertainment. There are public obligations that Congress mandates up to 1/3 of cable channels be available for public or government access or education. These are given away free to universities or cities and such. **Mr. Tom Ryder, JR Simplot Company**, stated that the misuse of the statute in this case is what is the consumer purchasing. They are actually purchasing an intangible entertainment source when buying a video tape. The fact that it costs \$15.00 for that entertainment source and the packaging costs about \$3.00 is a misapplication of the statute by the taxing authorities and the courts. There is a line of court cases relating to this issue and there is good tax theory that the only tangible that is being taxed is the \$3.00 video tape package, not the actual movie. For ease of administration, taxing authorities like to tax the entire package. In response to a question from **Senator Stegner, Mr. Ryder** said that the easiest thing to do is to tax the good because it is tangible. Idaho is one of a few states that taxes admission to forms of entertainment. **Mr. Williams**, in response to the same question, answered that he does not understand the inconsistencies in what the state taxes, such as admission to sporting events, movies and concerts. In his opinion, it would be better tax theory that if services are not taxed, those events should also not be taxed. **Senator Stegner** commented that his assumption is that the economy is more entertainment oriented than ever before and because of that shift this segment is being looked at as an additional area that should be taxed. He asked for opinions in the shift in the commerce of Idaho toward entertainment and services in general. Should Idaho, as a state, be looking at the equity in broadening the tax base to include some of these intangibles that were not taxed in the past. **Mr. Williams** stated that is a policy decision to be made by the legislature. He did say that when looking at extending the sales tax, an easy thing to do is to extend it to things considered discretionary such as entertainment. In doing this care needs to be taken that adding taxes to certain forms of entertainment does not bias people's choices. An argument could be made that a tax would be better applied to nondiscretionary things like telephone and electricity because then everybody pays their fair share and it does not influence how the market behaves. **Mr. Williams** said that he would be more in favor of all services being taxed uniformly rather than a pick and choose type of application.

5. Repairs

This tax would be on labor charges association with repairing or installing tangible personal property that are generally not taxable today as long as they are separately stated in a bill.

Representative Jaquet commented that, in her opinion, a tax on this service would be more regressive than some others because lower income people have less expensive cars that would be more likely to need repairs or maintenance. **Representative Raybould** said this also seem to a penalty to the consumer for having their car breakdown. **Senator Stegner** stated that this exemption deals with taxing labor as did the construction exemption so the argument would probably be the same here. **Mr. Dar Olberding, Idaho Grain Producers**, stated that adding 6% sales tax to repair bills would hurt Idaho repairmen, especially those close to the Oregon border. **Mr. Skamser** stated that his members were asked about putting a sales tax on labor and services and they were virtually all against it. **Senator Bunderson** encouraged **Mr. Skamser** to repoll his members and ask them if imposing a 3% sales tax on services resulted in a lowering of all sales tax to 3% would they be in favor of it. The goal of the task force is to see if the state should broaden that base in order to lower the overall rate. **Ms. Eaton, Idaho Retailers Association**, commented that they are in the process of studying this exemption because retailers use services to run their business. At first glance it would seem that costs will be passed on to consumers.

Representative Henbest reminded everyone that the concept here is to broaden the base and lower the rate. Retailers are paying 6% sales tax on some of the items they consume to run their business. Would offsetting that to 3% and adding 3% to services even things out. That is the essence of what the task force is trying to decide. **Senator Bunderson** added that retailers who are competing with remote sellers that do not collect or charge sales tax would be able to compete more closely if the sales tax were lowered to 3%. **Representative Raybould** commented that if tax collection remains the same by broadening the base and lowering the rate, there will be a need to look at who the tax burden will shift to. Does the state want to narrow the number of taxpayers that are paying more tax or make it so there are more taxpayers paying less tax.

6. Transportation Services

Representative Raybould asked if this category would include freight on agricultural products leaving the state. **Mr. John** said that would be included at this time, but exceptions can always be made. **Senator Stegner** asked if the state has the authority to tax interstate transportation. **Mr. John** said probably as long as it originates in Idaho. Only one state does this currently.

Mr. Tom Ryder spoke to the fact that freight is one of the very significant costs the JR Simplot Company faces in shipping things all over the country. Much of the reason production facilities are moved east of Idaho is due to additional freight costs. If a sales tax was also added to that cost, it would make the state less competitive with other areas. It would especially hurt small, locally owned and operated businesses that owns and operates their own trucks in Idaho. **Senator Kennedy** agreed with the argument that adding a cost to freight would cause problems in Idaho but asked how that was overcome when the tax on transportation of manufactured homes was imposed. That would be an inconsistency.

Mr. Brad Hoaglund, Idaho Haygrowers Association, commented that if a producer can truck his own hay to a buyer, he might be able to pass those costs on. On the other hand, if there is a middleman or a broker, those costs come out of the pocket of the producer. There is also the issue of the world market of commodities and keeping the state competitive. **Senator Stegner**

added that he sees a significant problem with products that are transported by the producer himself. It doesn't make sense to ask a farmer to pay taxes on his own transportation costs. It is a difficult situation and would be difficult to enforce. **Senator Bunderson** stated that the question is how to spread the tax load so that no one is inordinately disadvantaged.

**Wednesday
September 10, 2003**

The meeting was called to order at 10:00 a.m. by **Senator Bunderson** to continue information gathering on the issue of sales tax exemptions on services. He stated that a more thorough matrix of the pro and con arguments for each will be available on the Internet sometime before the next meeting.

Mr. John clarified that the number listed in the transportation exemption does include all transportation including people and freight. For information purposes, they could be separated and looked at individually. **Representative Henbest** asked how difficult it would be to administer taxes in all of the different areas. **Mr. John** answered that the issue of moving freight is a more difficult area to administer a tax to than moving people. In rural areas the movement of freight is done by small owners that may only use their trucks during harvest season. Collecting taxes in these situations would be much more difficult. In response to a question from **Senator Bunderson**, **Mr. John** said that he would get the information regarding the breakdown of the transportation of people versus the transportation of freight. **Mr. John** added that while there is a federal tax on airline tickets, there is no prohibition from the state adding their own tax, especially on intrastate flights.

7. Educational Services

This exemption includes elementary and secondary schools, colleges and universities, libraries, vocational schools, driving instruction, flight schools and modeling schools. **Senator Bunderson** commented that many of these services are governmental services and **Mr. John** agreed. For the record it was stated that private education is not taxed. This includes ballet schools or charter schools.

8. Personal Services

This group includes laundry and dry cleaning, barbers and beauticians, shoe repair, funeral services, massage parlors and escort services. This group pays sales tax on the goods they purchase to do business. It was stated that the only production exemption that exists for this group involves new dry cleaning equipment that had to be changed due to EPA regulations.

Senator Bunderson asked if this group's competitive advantage would be compromised if a sales tax was imposed and if applied to this group would it be consistent with others.

Representative Henbest said that if professional services are taxed, in her opinion, personal services should be included. She also looks at many of these services as discretionary thus making a tax less regressive. **Mr. John** added that most of these services already sell products of some sort so they should have a mechanism in place to collect sales tax.

9. Lottery & Pari-Mutuel Betting

This exempts the sale and purchase of lottery tickets and pari-mutuel betting from sales tax. It also exempts any equipment used in lottery operations from sales tax.

Mr. Roger Simmons, Idaho Lottery Commission, commented that one problem with charging a sales tax on lottery tickets involves lottery vending machine sales. These machines are set up to collect paper money only and do not give change. Twelve percent of lottery ticket purchases come from these vending machine that are mostly in larger stores such as Albertsons and the like. Most of these stores would probably not sell lottery tickets without these machines. In order to keep these machines in stores, the lottery might end up paying the sales tax out of other profits. This would, in turn, take money away from other programs such as education.

Another problem involving sales tax has to do with what is known in the industry as "churn". This involves buying another ticket with a winner, a straight across trade. If a consumer has to pay sales tax to buy another ticket, they might be more likely to keep the money. It would make a \$1.00 winner worth 94 cents. Again, in this case, the lottery might decide to eat the cost and pay it out of the profits. **Representative Jaquet** asked if the lottery decides to pay the sales tax out of profits, couldn't they take it from the part of their budget for administrative or advertising expenses instead of from the 21% that goes to the schools. **Mr. Simmons** stated that the 21% is not profit but adding a cost for sales tax would decrease that 21%. Also the lottery is running very close to budget in those areas already.

Representative Jaquet asked if lottery tickets are considered amusements, entertainment or gambling. **Mr. Simmons** said that he considers them a voluntary tax that people choose to pay when they purchase a ticket. He added that if there was not a lottery in Idaho, people would purchase tickets elsewhere.

In response to a question from **Senator Stegner**, **Mr. Simmons** explained that Idaho is just the opposite of many states. Idaho sells 65% scratch tickets and 35% Powerball or online tickets. Of the total amount of lottery ticket sales, 12% comes from vending machines. Adding a sales tax to the online ticket sales is a possibility but there is still the issue of churn.

Ms. Judy Brown stated that if this is thought of as a voluntary tax and only 28% to 31% goes back to education, it is actually very inefficient. **Mr. Simmons** said he understood what she was saying but reminded everyone that 65% of the money paid in to the lottery goes back to the players in winnings. **Ms. Brown** continued that if this is the case, the lottery should also be considered entertainment in which a person is buying a chance to win. She added that adding a sales tax to lottery tickets would cause a transfer of tax revenue from the school fund to the general fund and this would be distributed around the state differently. **Mr. Simmons** agreed.

It is just taking money from one pocket and putting it in another.

Representative Henbest asked if selling lottery tickets helps the business competitiveness of retailers in the marketplace. **Mr. Simmons** answered that there are very few stores that want to

sell lottery tickets that are turned down. All retailers have the opportunity to sell lottery tickets. In his opinion, it is beneficial to stores to sell lottery tickets because it does attract business.

Representative Jaquet asked if lottery tickets would fall in the same category as pinball and other electronic amusements. **Mr. John** stated that Idaho called that category amusement devices and that is already taxed through a fixed fee. The lottery is not the same. **Mr. Simmons** said that he does not think any other states tax lottery tickets but would get that information for the task force. **Mr. John** added that the ticket machine used to sell Powerball tickets is also different than a pinball machine and that equipment used in the lottery is exempt by statute in Idaho. **Senator Kennedy** asked, without the argument that taxing lottery ticket sales takes money from education and puts it in the general fund, is there any legitimate reason why if services are going to be taxed, lottery ticket sales should be excluded. **Mr. Simmons** the argument dealing with the shift from education to the general fund is the main reason lottery ticket sales should not be taxed. **Mr. Nugent** explained that when the legislation dealing with the lottery was written, the legislature made a policy decision to model the funding similar to that of the state liquor dispensary. They tried as much as possible to have the expenditures not be ongoing. The decision was made to keep the income from the lottery going to only the permanent building fund and the school district building account.

Representative Shirley Ringo, asked if raising the price of the lottery tickets themselves would be an option. **Mr. Simmons** said there would probably be a threshold where the sales would drop off. He added that the higher priced tickets have roughly the same or better odds than the \$1.00 tickets.

Senator Bunderson asked what competitive impact Indian gaming has on the lottery due to the increase in the size and number of Indian gaming operations and referenced Orofino (Nez Perce lands) where they lottery was required to remove 29 lottery machines when the tribes casino was built. **Mr. Simmons** answered that no study has been done on that issue. They have been waiting to see how things fall out. He added that lottery tickets are sold on Indian reservations other than the Nez Perce reservation and that he intends to continue negotiating with the tribes. It is his understanding that the tribes do contribute some funds to education in the state through an existing compact. **Senator Bunderson** stated that the Department of Education informed him that the tribes have contributed to three school districts, North Idaho College and one tribe gave \$40,000 for a track in another school district. That is the extent of their contributions to education. Comparing that to the lottery distribution is quite different. In his opinion, it seems irresponsible that the lottery commission has not done a study of this issue to protect it's competitive edge over Indian gaming.

Mr. Duayne Diderickson, Les Bois Park, was introduced to discuss the issue of charging sales tax on pari-mutuel betting. He explained that horse racing tracks and Les Bois Park specifically pays about 4% to the Idaho State Racing Commission out of every dollar that is wagered at the race track. Part of this money does go to the school fund. Adding another 6% would make 10% that is taken out of every dollar bet. This is a substantial amount and since the race track could not eat that increase, it would have to be passed on to the consumer. Adding sales tax, in his opinion, would upset the competitive advantage and force consumers to go to the Internet or to tribes where the same thing is offered. If Les Bois Park were to close that would mean the loss of

246 jobs in this area plus cause breeding and training farms in the state to move to other communities closer to racing facilities. **Mr. Diderickson** explained that 80% of the funds are returned to the bettors, this is based on a blended take out. Approximately 20% comes out of the amount bet and is disbursed to purses, breeders, the state, schools, management and such. The state or racing commission gets a maximum of 4% of every dollar bet based on a formula. The commission uses these funds for administration, veterinarians, testing, racetrack needs and so on. **Senator Stegner** asked if changing that 4% amount is a possibility. **Mr. Diderickson** said the legislature would have to make the decision to change it.

Senator Stegner asked if the Racing Commission is set up in the same manner as the Idaho Wheat Commission. **Mr. Diderickson** said that commissioners are appointed by the governor and the commission is self supporting. It does not receive any general fund money.

Representative Henbest asked if Internet betting on simulcast races has impacted revenue. **Mr. Diderickson** said that due to a law that was recently passed, the 4% can now be collected from these betting sites due to better tracking abilities. Simulcast betting is charged in the same way a bet at the track is.

In response to a question from **Senator Kennedy**, **Mr. Diderickson** explained that raising the minimum bet to \$2.05 from \$2.00 in Ontario caused the track to go out of business in eight months. **Senator Bunderson** clarified that the reason Ontario raised prices was strictly to increase profits and that the track was probably already in financial trouble before that was done.

Senator Kennedy asked what type of competition to Les Bois Park there is in the Boise Valley. **Mr. Diderickson** answered there is probably not a lot of direct competition but they are looking for disposable income. This means they want people to spend discretionary funds on horse racing instead of concert or other sporting events.

10. Agricultural and Industrial Services

This exemption includes agricultural soil preparation, planting, cultivating, harvesting, farm management, forestry management and mining.

Mr. Dar Olberding, Idaho Grain Producers, explained that soil preparation is considered customer work and includes combining, bailing, harvesting and land preparation. At the present time there is no tax structure there to collect on and charging a tax would probably drive a lot of this activity underground. It would also cause an unfair competitive advantage in border areas. Much of this type of work is done with neighbors in trade for other work, how would this be categorized? In his opinion a tax in this area would be very difficult to impose and cause a lot of headaches for the amount of revenue it would raise. **Senator Bunderson** agreed that the impact of this would be minimal. **Mr. Hoaglund** explained that when this service was exempted in 1965 the philosophy was that production of a commodity produces a raw material. That raw material will be processed into something else and the taxing will occur at that point. When you look at taxing soil preparation, fertilizing or any of the inputs that go into producing a crop, you raise the cost to the grower for that particular commodity. He reminded the task force that the price of a world wide commodity such as grain, is priced based on the world wide market. This means that

Idaho growers are competing with growers all over the world and adding a sales tax could effect our able to compete on a level playing field.

11. Miscellaneous Services

This includes personal services not included else where such as pet care, photo finishing, parking lots and garages. It was discussed that if other personal services are taxed, this category should also be included.

12. Media Measurement Services

This exempts the sale and purchase of any television, radio, newspaper or other media measurement services.

Mr. Larry Benton, Idaho State Broadcasting Association explained the public benefit of the current production exemption for broadcast equipment. He stated that from its inception, the broadcast industry's primary mission has been the delivery of public service to its viewers. Idaho broadcast stations provide significant public service including news, public affairs programming, documentary programming, cultural programming, public service announcements, closed captioning for the hearing impaired and second audio programming(SAP)/descriptive video service (DVS) for the blind. Idaho stations donated approximately \$39 million in air time for public service announce focusing primarily on local issues.

Unlike cable television or direct broadcasting satellite, these local services are universally available free to all citizens, not just those who can pay or live in urban areas. With federally mandated transition to digital broadcasting, local broadcasters have been required to fund millions of dollars of upgrades before mass deployment of digital televisions to consumers. These initial investments and continued upgrades to rural translators and other facilities will render great benefit to the next generation of all Idahoans.

It is the position of the Idaho State Broadcasting Association that Idaho citizens have benefitted substantially from (1) the public service programming provided free to all and (2) the substantial initial investments in federally mandated, next generation digital technology and recommends that no change to the existing tax policy as it relates the broadcast industry be made.

13. Health and Medical Services

Doctors, dentists, hospitals and nursing home services are the principal elements of this category.

Mr. Bob Seehusen, Idaho Medical Association stated that his organization has many concerns about a sales tax on medical services and they definitely do not support the idea. These additional costs cannot be passed on as they can in other industries. Medicaid and Medicare services do not allow balance billing so if costs go up for sales tax, billing the patient for them is not allowed. Reimbursement levels are fixed and that is that. In order to balance bill for additional cost, federal law would have to be changed.

Two-thirds of all insured people in Idaho are insured by either Blue Cross or Regence/Blue Shield. These companies also fix their fees with increases given periodically based on increased costs to physicians. While the cost of providing care increases from 4% to 6% a year, reimbursement rates do not keep pace. Adding a sales tax to this would only increase the burden. **Mr. Seehusen** clarified that cost shifts occur very seldom for physicians.

Representative Jaquet commented that there is a physician in her area that simply charges a flat monthly fee to patients for complete health care service. He does not accept any insurance but by paying this fee, patients are offered very personal service. **Mr. Seehusen** said this is something that is happening in the medical community but it is a very small portion of it.

Representative Raybould asked if charging sales tax for medical services would result in a copay situation for medicaid/medicare patients. **Mr. Seehusen** clarified that Medicare/Medicaid prohibits balance billing of patients for costs that are not included in their reimbursement. These programs set a maximum charge that includes a copayment. The physician can only charge that amount.

Mr. John stated that he would get information for the task force on hospitals in other states that are taxed. He added that most Idaho hospitals are not for profit so they just increase their costs.

Senator Bunderson clarified that taxing health and medical services is problematic for the following reasons:

1. If such a tax is imposed, there is a question with collectability relative to medicaid and medicare as well as not for profit institutions.
2. Insurance companies fixed fee schedules would not cover additional sales tax in their reimbursement rates.

Mr. Seehusen agreed and said this is not just a problem to providers but also to the uninsured because they are responsible for the entire bill for their health care already and this would be another additional cost to them.

He also clarified that since all insurance fees are set by contract, more people might not be able to live with those reimbursement rate and ultimately choose not to participate. Then they can charge whatever they want and pass the costs on to the patients.

Mr. Skamsner stated the 60% of small businesses currently do not provide insurance coverage for employees due to cost. A major impact of sales tax on health care would hit these uninsured people.

14. Social Services

This category includes adult and child day care, and adoption.

Senator Stegner commented that this category in many ways fits into medical services and would assume that both would be treated the same way. **Representative Henbest** added that most of these services do not seem to be discretionary and would be very hard to tax.

Senator Bunderson stated that he will work with **Mr. Nugent** to set up a matrix that list the pro and con arguments for taxing each of these exemptions. This will be available on the Internet sometime before the next meeting to allow everyone time to study it and make comments or suggestions.

It was decided that the time frame of the task force needs to be clarified for the next meeting which will include a discussion of the remaining exemptions as well as the matrix of what was discussed today.

The next meeting was set for November 3 and 4, 2003. The meeting was adjourned at 12:30 p.m.