MINUTES

SENATE LOCAL GOVERNMENT & TAXATION COMMITTEE

DATE: Tuesday, March 19, 2013

TIME: 3:00 P.M.

PLACE: Room WW53

MEMBERS PRESENT: Chairman Siddoway, Vice Chairman Rice, Senators Hill, McKenzie, Johnson, Vick, Bayer, Werk and Lacey

ABSENT/ EXCUSED:

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

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

MINUTES: **Senator Vick** moved to approve the minutes from February 26, 2013. **Senator Lacey** seconded the motion. Motion carried by **voice vote**.

H 138 **Chairman Siddoway** welcomed Representative Luke Malek to the podium to present **H 138**, relating to plats and vacations and acceptable methods of copying a plat. **Representative Malek** said this is a simple bill. He said it is about silver emulsion, which is common in film photography imaging. He said when a plat is recorded with the county, a copy is required as well. By current statute, that copy has to be made using silver emulsion, but silver emulsion has actually become quite rare. He said there are now other means for reaching the goals that processing procedure was meant to reach, which is longevity of an indelible image that would last throughout time. The provision in **H 138** would allow for other means to be used to create an original plat filing copy at the time of recording with the counties. **Representative Malek** said this issue was brought to his attention by officials in Bonner County who had to do 300 plats but couldn't find any silver emulsion. He said he ran this by county clerks throughout the state, and they all seemed to be fine with the language.

Senator McKenzie asked what kind of materials are used for a plat to be "coated with a suitable substance to assure permanent legibility" and how much it would cost. **Representative Malek** replied he can't name them specifically, but there are several different options that can be used that were discussed as the legislation was drafted.

MOTION: **Senator Werk** moved to send **H 138** to the floor with a **do pass** recommendation. **Senator Lacey** seconded the motion. Motion carried by **voice vote**.

H 242 **Chairman Siddoway** invited Representative Stephen Hartgen to the podium to present **H 242**, relating to property taxation and business inventory exempt from taxation. **Representative Hartgen** said he would give a brief overview and then defer his time to Brad Wills with Build Idaho. He asked the Committee to refer to the schematic that he said describes the purpose of the legislation. He said there are four stages that property goes through. First, it is agricultural or forested use, which is considered 'nonuse.' Next it is platted and the value is assigned and the typical taxes are quite low.

In Stage 3, a developer would 'improve' the property, often placing infrastructure such as streets, roads, water, sewer, electrical, and such, the costs of which are borne by the developer. Then the land is sold off a bit at a time in the form of housing lots or commercial development, at which time it reaches its full value.

Representative Hartgen said **H 242** is a modification and clarification of H 519 that passed last year. It seeks to extend an exemption, not 'eliminate' an exemption, on the Stage 3 land that some counties were treating as fully developed, when really the land is vacant except for improvements. He said **H 242** makes three changes to statute: 1) Clarification as to how the land is titled and that a transfer of title within the same ownership group would 'not' constitute a transfer for purposes of a sale, and thereby is 'not' taxed at a higher rate; 2) Assessment of the value of the property, which will be described further by Mr. Wills; and 3) Application process and how to handle appeals if they should arise. **Representative Hartgen** deferred to Mr. Wills.

Brad Wills said he is with Build Idaho, which is an organization of land developers in Idaho, and he also represents the Idaho Building Contractors Association. He said the bill that passed last year had temporary rules on it, but there was not enough statutory clarification so there were implementation problems. **Mr. Wills** said the Idaho State Tax Commission decided to not present a permanent rule for this exemption and recommended that this exemption be clarified through the legislative process.

Mr. Wills said even though a few counties, like Ada and Bonneville, did a good job implementing the legislation from last year, there are four problem areas that need clarification: ownership issues, valuation methods, application process and the appeal procedure. He said there was confusion regarding conveyance. He said the problem with valuation is that different methods were used: using only a percentage; or, valuating the land by first giving value to the bare ground without the site improvements and then giving value 'with' the site improvements, and the difference was the value of the exemption. He said the latter is what was intended with last year's legislation.

Mr. Wills said there is new language to help with the application process. He said it would be redundant to have to reapply each year, because there were two triggers that would cause ineligibility for the exemption, as when a structure is started on the property or it is actually sold to a third party. The last problem led to specifying the appeal process. He said in Kootenai County last year, there were exemptions approved, but there was no opportunity to appeal the value they were given. He said the appeals process mirrors existing law. **Mr. Wills** said this bill provides enough clarification for counties to be able to appropriately implement the law this year.

Chairman Siddoway asked Mr. Wills to address how they decided on the percentage of valuation for the exemption becoming 75 percent and if the counties were involved in that decision. **Mr. Wills** replied they had many discussions last year about the temporary rules on how to reach value and they could not provide the clarification. He said several counties, including Canyon and Kootenai, decided to use a percentage basis and not look at the raw land. Other counties, like Ada and Bonneville, did look at the raw land value and came up with different valuations. **Mr. Wills** said the counties were not part of the 75 percent valuation determination.

He said in conversation with Canyon County Assessor Gene Keuhn and Ada County Assessor Bob McQuade, they discussed coming up with a percentage, but he said that does not treat everyone equally, because some counties do not increase the value for the exemption, so they would have to give a percentage based on something they hadn't already given. **Mr. Wills** said the idea came up to use comparative market value, which is what developers and home-builders asked the counties for, but the counties don't agree with limiting it to that.

Mr. Wills said he added the idea that if they 'can't' because they don't have the "comps" (comparative market value) then they could use a percentage. He said Canyon County used 35 percent; Kootenai County used 75 percent; Ada County averaged 75 percent; Bonneville County averaged 87 percent; and, Twin Falls averaged 90 percent. He said the percentage is a default he would rather 'not' use, because he said the intent of the language last year was if land was fully developed or only raw land. He said he thinks that is truly the only way to come up with a fair value for the exemption. He said the counties did not come up with that 75 percent number; he said 'he' came up with it by extrapolating the percentages counties around the state were using. He said half of all the exemptions last year were 75 percent or more.

Chairman Siddoway asked about the transfer of ownership. He said it seemed that last year one of the big selling points of the bill was when the land, regardless of what "stage" it was in, was transferred to another entity, it would lose the exemption. He said now it appears that has gone by the wayside. **Mr. Wills** said Chairman Siddoway is correct about last year. He said the language says "title to the land is conveyed from the land developer." **Mr. Wills** explained the developer is the company that develops the land, invests the money and is able to carry it as business inventory. He gave an example: if a bank needed a developer to change ownership of property to one of their LLCs that was better funded, the developer can move that land from one entity to another without affecting the treatment of the inventory. He said if the developer went under and the bank took over the property, the exemption does not follow the land. He said that is still the case, so they needed to define how to allow the developer, in the course of his business, to move ownership from one entity to another. It is more of a distribution rather than a taxable transaction. No money is actually exchanged and there is no "sale." **Mr. Wills** said he and Alan Dornfest of the Idaho State Tax Commission came up with the language last December to define if a property is sold to a third party. The exemption does not stay with the property if the developer sells it in any way from himself: the exemption is lost.

Chairman Siddoway asked about a situation he said could raise concerns about "double dipping." He said he received a letter from a proponent of **H 242** that described how a company could get tax benefits for making a change of ownership when they were the principle entity of both companies. For example, changing from Mudd Lake Builders, Inc. to Mudd Lake LLC. He said they would do that so they could get a tax break. He asked **Mr. Wills** to explain.

Mr. Wills answered the tax benefit would not be a property tax benefit. He said a good example would be for estate planning for an older gentleman who moved property from personal account to an LLC that he owns. He said to do that, the man must convey and title it from one entity to the other, and he therefore would lose the exemption for that portion of the year. He is still the land developer and still holds the inventory on that land. **Mr. Wills** explained where the 50 percent comes in is in the IRS related party threshold, that anything more than that is a different entity, and as long as it is kept under 50 percent, that prevents the abuse of the exemption going to someone who does not deserve it.

Senator Lacey said he was involved in this discussion and supported it last year. He said he has been a developer and is familiar with the costs involved, and part of the reason for the bill was the down economy. He said he's familiar with how much money is put in the ground that can't be seen until it is sold. He said this bill is for a developer who transfers property to an LLC that the developer owns.

Senator Lacey said he doesn't see in the bill where it precludes selling it to someone who paid the developer a higher value. He said when a developer puts thousands of dollars into the ground and sells it to another developer, the seller would charge for the work that was done, and that means to Senator Lacey that the value has gone up. He asked Mr. Wills if that seems correct to him.

Mr. Wills said yes, that is a third party sale which means it is an unrelated party, one who is not related to the original person. That would be a conveyance of title that would preclude the exemption.

Senator Werk asked about the time requirements for appeals. He asked if the requirement dates are the same as would apply to other taxpayers if going to the board of equalization. **Mr. Wills** answered that it mirrors the language of any exemption appeal process, so the dates are in statute, which are April 15, May 15 and the fourth Monday in June. He said where it varies is they could appeal both the decision 'and' the valuation.

TESTIMONY:

Chairman Siddoway invited Brent Adamson, Boise County Assessor and Vice Chair of the Idaho Association of Counties (IAC) Legislative Committee, to the podium. He said he is here to oppose **H 242** and provided a letter in opposition. (See Attachment 2.) He said he met with Mr. Wills and others to discuss corrections to last year's bill, but they realized they couldn't fix it in rule, and they came to an impasse. **Mr. Adamson** said they don't have a problem with the conveyance, as the new language means an original land developer may get to keep the exemption longer than they did with H 519. **Mr. Adamson** said they also didn't like the wording for the appeal process in the original draft, but that has been fixed and they do not have a problem with the appeal process in **H 242**.

Mr. Adamson said the biggest concern is the 75 percent exemption, and they do not support the bill because of it. He said IAC did a survey among their counties after last year's assessment roll, asking how many applications were there, what was the average takeoff for site improvements, how did it go and what was the discussion. He said there was a minimum of four percent removed from current market value of the platted land to a maximum of 90 percent. He said the average was between 35 and 42 percent. He said Canyon County used the same process that Boise County used. They could not find a completely undeveloped platted lot that was sold to be able to apply market value, so instead, they went to the developer applicants and asked them how much they spent to help them determine the site exemption. He said every applicant, even those who did not qualify, provided him with all their data.

Mr. Adamson said they took that data and figured out what site improvements cost the developers at the time the subdivision was platted. He said they calculated what that number was as a percentage to the value. He said they took the percentage, not the dollars but the percentage, and moved it forward to today's value. He said just moving a hard value does not address the issue that market values go up and down. He said obviously, markets have been going down, which necessitated the builders to come forward with this exemption. **Mr. Adamson** said the 75 percent exemption is rather high. He said, as Mr. Wills shared, that percentage may have fit half of the counties. He said his guess was that it may actually be 75 percent of the total 'parcels' and not total counties, but he would discuss that with Mr. Wills later.

Mr. Adamson said he believes the 75 percent exemption should be given a sunset clause, or at least bring that figure down to take into consideration highs and lows in the market. He said either way, they want that number fixed, but the rest of the bill is fine.

Senator Rice asked how many different ways the assessments are being done. **Mr. Adamson** answered that each county does set values differently, because it is difficult to find an equal-looking lot with equal amenities in Ada County that sells the same in Boise County, which is a difference between urban and rural, as well. He said when he did estimates, he arrived at about 33 percent as a calculation for takeoff of value. He said he moved that forward to current value and took that off, and that resulted in zero appeals granted. He said percentage-wise, Boise County took the largest hit in the percentage of the value of the loss. **Mr. Adamson** said the pictures provided of the four stages of value represents what 'that county' does, and there is not another county that does it that way.

Senator Johnson gave an example for Mr. Adamson to consider. He said, "If I have a development and on it there are two lots that are the same size, but one overlooks the river and the other is on the other side of the street. Is it safe to presume they'd have different market values, and if so, what would be the effect of the 75 percent value on those two lots." **Mr. Adamson** said, yes, it is safe to say that, which is another reason they don't like the 75 percent value, because it is not related to the market. He said 75 percent off an $80,000 lot is much different than 75 percent off a $30,000 lot. **Senator Johnson** asked if it is fairly reasonable to assume the cost to develop those lots is approximately equal. **Mr. Adamson** said in consideration of improvements such as underground utilities, telephone poles and sidewalks, it would probably be identical.

Senator Werk said it seemed the procedure for assigning a value without "comps" available could be promulgated by the Idaho State Tax Commission, if they were given the authority to do that. **Mr. Adamson** said he is not sure if the Tax Commission could do that. He said Idaho is a state driven by market values, so market value is an easy way to determine value. However, the comparative market values, "comps," are not always easy to get. He said absent market value, they have to do something else, and one thing they can do is look at cost. He said that can be done a lot more with commercial buildings than with residential. He said if developers want an exemption, they need to come to the assessor and tell them. The assessor will ask them for the cost, and the developers would provide that information.

Vice Chairman Rice said he is struggling with the concept of just adding the cost of the improvements. He said developers buy land, develop the lots, put in the improvements, and sell the lots. He said it doesn't make sense for developers to sell the property only for the cost of the improvements, so there would not be lots that were being sold as just 'improved.' **Vice Chairman Rice** asked how that would be a fair assessment of the difference in value. **Mr. Adamson** said market value is just that: someone putting something up for sale and someone being willing to buy it. He said the problem is when there is only one or just a few lots in a subdivision, that doesn't dictate market value of the property. It is only "a sale."

Mr. Adamson said they had many discussions with Mr. Wills about the intent of H 519, and they struggled writing a rule that met the statute. He said they couldn't make something up, so they had to go with what the law said, and that is how they arrived at the practice of cost.

Chairman Siddoway invited Steve Cope, President of SKC, to the podium. **Mr. Cope** said he has a project that was under water last year and still is this year. He said he spent many hours with Canyon County assessors having the same discussion as the one being heard today. He said there needs to be clarification of the statute, and he believes it should be based on market value. He said there were not a lot of good comparisons, but he did come up with some and put the market value of ten percent of the assessed value. He said his effort didn't carry any weight.

Mr. Cope said he disclosed his numbers to Canyon County, and the county only used 35 percent exemption. He said his number substantiated that his land was 17 percent of value, so that should have substantiated an 83 percent exemption. He said when he left last year, he was thinking and still believes that 90 percent was what was presented in testimony last year, and he said he believes that to be a fair number, as it represents across the board, and it would still give the opportunity to have market value if there is a comparable sale. **Mr. Cope** said this legislation provides for 75 percent exemption if there is not a comparable sale. He said for the future, this is an excellent bill because it will give people like himself the ability to go forward with less risk with the product that is available for sale. He said he still thinks the exemption should be higher, but he can live with 75 percent and he's glad there is at lease something in writing to protect the original intent of the bill.

Chairman Siddoway invited Jeremy Pisca, representing Idaho Building Contractors Association and the Idaho Association of Realtors, to the podium. **Mr. Pisca** said he thinks the discussion has gone off track a bit, since the bill doesn't have to do with "market value." He said it has to do with the amount of "exemptions." He said his personal involvement with the legislation was during negotiated rule-making with the Tax Commission after the passage of H 519. He said what was apparent to him was there were some assessors who did not want to move the ball and solve the issues. He said at one point they threw their hands in the air and said if they can't negotiate, then they will have to go back to the legislature and clarify the intent. He said he is baffled because the goal has not changed, which was to get a comparative market analysis. He said when his house gets assessed, assessors go and look at other properties of like kind to come up with a valuation. **Mr. Pisca** said if there is a 20 acre parcel with site improvements, compare that against a 20 acre parcel without site improvements, and the difference in the that valuation is the amount of the exemption. He said he thought that seemed pretty simple, and he doesn't understand why some find that so difficult.

Mr. Pisca said what they experienced was varying levels of difficulty in some counties, although not all counties. He said some counties very much met the spirit of the intent of the original legislation. He said his clients told him other counties were intentionally throwing up hurdles to make it more difficult to comply. He said they were told to open up their books, tell what they paid for asphalt, gravel, concrete, and all those things, none of which has any bearing on the amount of the exemption. He said different developers pay different costs, because some are more savvy than others, or maybe because one developer also owns a gravel pit and gets his gravel cheaper.

Mr. Pisca said the only problem with this bill from the assessors' standpoint is that 75 percent exemption. However, he said, the legislation says 'first' to find a comparative market analysis and compare the property against similar properties. If other properties cannot be found, as may happen in some smaller counties that may not have the amount of volume for that comparison, 'only then' does the exemption go to the 75 percent rule. He said that is simply a fall back.

Mr. Wills was invited back to the podium for a summary. **Mr. Wills** said he would stand for questions. **Senator Johnson** asked him about the transfer portion of the bill. He asked if an exemption goes from an LLC to a corporation, who retains the rights to the property, and when the property is sold in the future, who sells it, the land developer or the corporation. **Mr. Wills** answered only the landowner is eligible for an exemption; it follows the physical owner of the property. The landowner and the company are the same person, so when it is sold, the last owner on the title is the one selling it. **Senator Johnson** asked when the land is sold, whose name is on it, the corporation or the LLC.

Mr. Wills said when the land is sold, the last owner with the title is from whom the title will be conveyed to the third party. **Senator Johnson** asked if a property is sold from party A to party B, who is party A. **Mr. Wills** answered a developer does not 'sell' a property from himself to himself; it could be an internal transfer or a "distribution," but not a "sale." A "sale" is only to a third party, someone unrelated to oneself. **Senator Johnson** asked if a property is transferred to oneself to a different name, as in from ABC LLC to ABC Inc., and ABC Inc. is the entity with the title and then sells it to a third party, is it ABC Inc. that sells it or ABC LLC. **Mr. Wills** answered that ABC LLC and ABC Inc. are the same people, but the title would go from ABC Inc. to the new third party owner.

Senator Werk asked about the conveyance or transfer of a property from an original entity or developer. He said statute requires that the owner retain at least 50 percent of that ownership stake. If the developer picked up a property and did some extensive improvements, and Mr. Jones joins the company at 49.9 percent ownership stake and gave Mr. Smith a bundle of money, the value of the property and the exemption remains the same, even though Mr. Smith has seen a large realization of profit in that transfer. **Senator Werk** asked if he is understanding that correctly. **Mr. Wills** answered that a better example is a husband and wife who own something together and then get divorced. The husband is the original owner so the property goes with him. He said in Senator Werk's example, if a company owns an asset, and whether he sells 25 or 30 percent of it, it is unrelated to the exemption. As long as the ownership doesn't change more than 50 percent from the original owner, the property retains that exemption. As soon as that trigger is pulled, then the owner loses the exemption.

Mr. Wills explained further. He said if a business owner sells 50 percent of the company to Senator Johnson and the other 50 percent to Senator Lacey, they now own the company, but no title of property has changed hands, only the company changed hands. **Mr. Wills** said they closed that loophole by including the language "original developers" who put in improvements.

MOTION: **Vice Chairman Rice** moved to send **H 242** to the floor with a **do pass** recommendation. **Senator Vick** seconded the motion. Motion carried by **voice vote**. Vice Chairman Rice will carry the bill on the floor.

H 243 **Chairman Siddoway** said Representative Mike Moyle was unable to attend today, so he invited Jay Larson, CEO and President of Idaho Technology Council (Council), to the podium, to present **H 243**, relating to sales taxation and application software accessed over the internet. **Mr. Larson** said the Council is an industry organization focused growing innovation and knowledge in a knowledge-based economy in Idaho. He said they represent about 40,000 jobs in Idaho companies.

Mr. Larson said the discussion today is about "cloud services." He said Rick Smith, who has years of tax law experience with Hawley Troxell, will speak more about that and Jeff Sayer, Director of the Department of Commerce, will share more about the importance about this industry and this legislation. **Mr. Larson** defined cloud services as when a customer pays a subscription for a service to a provider that has a server the customer can access for computing services, storage services, processing services and analytical services. The method by which they access it is over the internet or wireless service. **Mr. Larson** said the legislation has been carefully crafted as a "definition" and not an "exemption," as recommended by dozens of industry companies and through extensive dialogue with the Idaho State Tax Commission (Commission).

Mr. Larson said last fall, the Commission made a ruling on cloud services to say they should be considered a tangible good and as such should be subject to sales tax. He said that ruling was "news to our members" who have not been paying taxes on cloud services because, like other services, such as legal and accounting, those services are not taxed. **Mr. Larson** said this legislation clarifies that cloud services 'are' a service and 'not' taxable. He said one of the top initiatives for the Technology Council is to grow a stronger software community, which is one of the fastest growing industries. He said they also want to make sure there is fair, consistent tax policy applied across the cloud services arena.

Mr. Larson said software is very important because cloud computing is something that will continue to be used in the future. He said several companies will testify today that they use this medium to convey its products and services to its customer base. He asked the Committee to support the **H 243**, the cloud services clarification legislation.

Senator Hill asked for Mr. Larson's help going through the language of the bill. He said there are technical terms like "electronic download" and "storage media" and he wants to be sure he understands those terms. **Mr. Larson** said he would defer to Rick Smith with Hawley-Troxell representing the Idaho Technology Council who would be the resident expert on that. **Mr. Smith** said he has worked with the Council and negotiated with the Tax Commission to draft this bill.

Mr. Smith offered some background. He said the Sales Tax Act was enacted in 1965. It was enacted primarily to tax 'tangible' personal property, either the sale or use of that tangible personal property in Idaho. It was 'not' primarily directed to tax services nor to tax transactions in other states. He said the issue of services and other states is directly presented by this legislation. He said the original version of the sales tax act made no reference to computer software, as it was 1965. He said it was 1983 when the computer software definition came into statute as part of the definition of tangible personal property. He said it was "legal fiction" in his mind because software was "out there in 1's and 0's" arranged in a way to allow computers to operate. He said it is 'not' really tangible personal property, but that is what was decided back then. **Mr. Smith** said the legislature still decided to tax "canned software" and chose not to tax other types of software, like "custom" software. He said "right from the get-go, the legislature divided software for purposes of taxation, into two types: taxable and nontaxable – canned and custom."

Mr. Smith said there was a question about whether this change should be part of a definition or an exemption. He said it is their position that it should be part of the definition, because that is how it has always been, outlining what type of software is taxable or not. He said fast-forward to the 2010 decade, with cloud software that no one even ever thought of in 1965 or in 1983. It is software that is remotely accessed, often in a different state. The user has no control over the formulation, building or operation of the software itself. It is just a matter of the user putting "input" into the software and getting "output" from it.

Mr. Smith said there has been much controversy with the Tax Commission over whether or not the software is taxable. He said the Council believes it really is a 'service' as it is something accessed outside the state, and the software doesn't permit one's computer to operate. It only allows the user to perform functions that otherwise might be performed by employees or consultants of the user, so it is very much like a service. He said also, there is no 'transfer' or 'use' of this software 'to' the user. The software resides on the server of the seller and developer of the software. He said this legislation will clarify this in the statute by refining the definition of software to relieve controversy between taxpayers and the Tax Commission.

Mr. Smith said this is the second version of this bill. He said the original bill would have exempted 'all' remotely accessed software, regardless of whether comparable software could be obtained in another fashion. He said they sat down with the Tax Commission to work toward agreement, and those discussions resulted in **H 243**. In response to Senator Hill's question, he said the language was added as a result of those discussions. **Mr. Smith** said if he can be so bold as to summarize the concerns of the Tax Commission, he would describe them here: the Commission was concerned this legislation appeared to be an attempt to protect a business-type transaction, so they didn't want to include entertainment applications as something that could be covered under this statute. That is why entertainment is carved out from this exclusion. Secondly, he said, from a tax policy standpoint, they were concerned about an exemption for something when the function performed on a remotely accessed software could also be performed by a disc, software, or download from the seller, in which the transaction would regularly be taxable. He said the Tax Commission did not believe that to be fair, so **Mr. Smith** said that's why the legislation provides if the remotely accessed software could be also be purchased or downloaded in a form that would otherwise be taxable, the remote access would be taxable.

Mr. Smith said the question has been asked about what other states are doing for this concept, and he said, "Frankly, the other states are all over the map on this issue." He said some exempt 'all' forms, even downloaded software. Some states are doing what Idaho is doing, such as Kansas, California, Nevada, Vermont, Illinois, Alabama, Missouri, Wisconsin, Nebraska, Iowa, Florida, Rhode Island, and Virginia. A few states, like Washington and Utah, do tax cloud services. He said there is 'no uniformity' to how other states are handling this. He said they believe that clarifying it and providing a better market for it in Idaho will be key to the growth of the industry in this state.

Senator McKenzie asked how this law will work in actuality, and he gave an example from his own business. He said Quickbooks can be purchased at a retail store, downloaded to a server, or accessed online, noting that the functionality is similar on each, except there are a few things that can be done online that cannot be done with the downloaded version. He asked if he was correct that all three of those options appear to be taxable events. **Mr. Smith** said he believes that is correct. If functionality is very similar or the same, he believes all three would be taxable under this bill.

Senator McKenzie asked what would be an example of remotely accessing software that could not be downloaded. **Mr. Smith** said he is not a software expert, but he said his understanding is there are 'a lot' of software applications that are remote where the developer does not offer online or tangible disc form. He said he guesses that will be the trend of the future. He said there are more and more advantages to cloud computing, including increased capacity, because the computers are operated by the developer. One big advantage of accessing the program remotely is the computer capacity of that seller's entire network is way beyond one's own capacity.

Senator McKenzie said that is the trend for his firm, in that every function that can be purchased can also be done online. He said but unless it is custom software, which is already exempted, he would like to understand some examples of how this would apply beyond the entertainment area. He is looking for how to apply this to business software that is not custom and cannot be downloaded. **Mr. Smith** said he would like to defer to some of the software experts who are available to speak later.

TESTIMONY: **Chairman Siddoway** invited Jeff Sayer, Idaho Department of Commerce (Department), to the podium. **Mr. Sayer** said he is here to support **H 243**, in an effort to create context as to why software is so important to the state of Idaho. He directed the Committee's attention to the handout of the bar graph. (See Attachment 3.) He said the software industry is one of two the Department is nurturing and encouraging to grow. He said there is a robust group of people in the Treasure Valley and across the state who see this as one of Idaho's future opportunities. **Mr. Sayer** said one reason the Department supports their efforts is that the median income is substantially higher than base industries in Idaho. He said more importantly, Idaho needs to create a friendly environment for software companies. He said something he says frequently is, "A software job in Idaho is one of the hardest to get and one of the easiest to lose." He said this industry is very mobile, and the Department is working very hard to attract those companies to Idaho, as well as working to support the ones that are here to grow and be successful. **Mr. Sayer** said **H 243** is a clarification that can support existing companies and draw the attention of companies in the rest of the world to establish that Idaho is "software friendly."

Mr. Sayer said this bill passed the House very favorably, and within a week, the Department received a call from one of the largest cloud software companies in the nation applauding Idaho's efforts and asking for ways they can now engage in conversations with Idaho to increase their partnership in this state. He said that is the level of visibility this issue is getting across the country, and he said the Department of Commerce adds their "wholehearted endorsement" to this bill.

Senator Hill asked if a software provider company is doing business in Idaho, this bill will only exempt them from sales tax within the state of Idaho, and any sales outside the state of Idaho are still subject to sales tax of the purchaser's state. He said this will help software developers outside of the state just as much as it helps software developers in the state. Mr. Smith approached the podium to answer the question. **Mr. Smith** said it is complicated because a lot depends on where the sale occurs. If a sales transaction occurs in Idaho by a software developer, then this legislation would help the software developer. He said that is not the position the Tax Commission has taken. He said their position is the sale occurs at the location of the buyer. If that is the right way to interpret the law, and he said states go both ways on this, then this legislation wouldn't be necessary with respect to those types of transactions, because the software seller in Idaho would not be taxed. He said if this legislation passes, a software transaction from a seller in New York to a buyer in Idaho would not be subject to tax unless it has nexus in Idaho. If the legislation does not pass, the Idaho user of the software might be subject to tax on a use tax basis.

Senator Hill asked if this legislation makes that clear or if it is still so complicated that those issues haven't been addressed. **Mr. Smith** said he thinks it is complicated under 'existing' law, but not under this clarification.

Senator Werk said "the pitch" being made is that this is great for software developers in Idaho, but software developers in Idaho don't pay this tax, the users do, so the beneficiaries of the definition that the Committee is being asked to pass aren't software developers in Idaho or anywhere else, except for users of their product will no longer have to pay tax. He said he is trying to understand how he is helping the software industry in Idaho by simply allowing limited amounts of companies that are going to use these "services." He said it seems most of the market for a software developer in Idaho is all over the world. He asked who is directly benefiting from what is being done in this legislation. **Mr. Sayer** said what he can say is the genesis of this whole effort has been a handful of key software companies who were being assessed some fairly large penalties from the Idaho State Tax Commission. He said he hears what Senator Werk is saying but some of Idaho's best companies were being assessed significant amounts, so

this clarification helps them remedy that concern. He said going forward, if the user pays tax, the company still has to assess the tax, and it leaves them at a disadvantage with their competitors who do not have to assess that tax.

Senator Werk asked if he heard Mr. Sayer say that software developers are large 'users' of these cloud based services. **Mr. Sayer** replied what he meant is if the user has to pay the tax, the developer will assess that cost as part of their transaction, and that would leave them at a disadvantage to the company that did not have to assess that tax. **Senator Werk** asked if it is considered to be a use tax that would be the responsibility of the purchaser to remit to the Tax Commission. **Mr. Sayer** said he would have to defer to the actual companies, as that is where he gets vague.

Senator Hill said with respect, he would disagree with Mr. Sayer. He said he likes the bill, but he doesn't want to sell it as an economic tool, because he thinks the sales tax is assessed where the purchase is made, which is what Mr. Smith just said. He said if he has a manufacturer inside Idaho, he will still have to assess the tax or the user will have to pay the use tax. He said it doesn't put him at a competitive advantage or disadvantage. A buyer in Idaho, whether purchasing from an Idaho company or one outside the state, will be subject to the tax the way the Tax Commission does it now, or not subject to tax under this bill. He said he doesn't see the competitive advantage that Mr. Sayer is describing.

Mr. Sayer said he fully respects that perspective, and suggests deferring that same question to the companies because they can speak to the details of that. He said what the Department does know is there is a definite assessment being made, historically, retroactively, on the existing companies that is causing a barrier. He said this clarification bill will create a "software friendly" environment in Idaho.

Chairman Siddoway invited Doug Bates, Founder and Chief Financial Officer of Clearwater Analytics, to the podium. **Mr. Bates** said his investment portfolio reporting company is based in Boise with most of their 230 employees, and they also have offices in New York City and Scotland. He said they serve about 4,000 institutional clients around the world, including Micron and United Heritage Insurance, as well as Citibank, Apple Computer, JP Morgan and others. He said services they provide include investment portfolio accounting, compliance, performance and risk reporting services. **Mr. Bates** said Clearwater's services are provided entirely over the internet and as such would be considered a Software as a Service (SAAS) or "cloud-based" business. Mr. Bates' presentation can be read in its entirety in the written testimony he submitted. (See Attachment 4.)

Senator McKenzie asked if the service itself, through accessing software, is comparable to software that accountants in Idaho can download and are providing the same service, doesn't the exception to the exception cover that; or, if it's custom to one's business, isn't that already covered under the custom software exception to tangible personal property. **Mr. Bates** answered he thinks they have to be careful using the term "download" because no one "downloads" from the cloud. He said similar to services of an accountant or attorney, his company provides a service that is supported by software held in database registers within the cloud that can be anywhere in the world, but none of their clients can download that service.

Senator McKenzie said his question was not focused on the "download" issue, but rather the custom software provision. He asked if clients access custom software that Clearwater developed, isn't that already covered under this bill in the custom software exemption. **Mr. Bates** said he didn't know and would have to defer to the tax experts on that.

Chairman Siddoway invited Caroline Merritt, Boise Metro Chamber of Commerce (Chamber), to the podium. **Ms. Merritt** said the Chamber includes 1,800 members, many of which have a vested interest in this issue, either as providers as cloud-based services or as companies who access these services.

She said the Chamber has significant concerns that imposing a sales tax on cloud-based services could have a "chilling effect" on their ability to retain existing Idaho companies or recruit new technology companies to Boise. Ms. Merritt's presentation in support of **H 243** can be read in its entirety in the written testimony she submitted. (See Attachment 5.)

Chairman Siddoway invited Jonathan Parker of Holland and Hart to the podium. **Mr. Parker** said he is representing his client Internet Truck Stop, founded and headquartered in Idaho. Mr. Parker's presentation can be read in its entirety in the written testimony he submitted. (See Attachment 6.)

Chairman Siddoway pointed out that everyone on the sign-in sheet who signed up to testify is in favor of this bill. He asked if anyone in the audience had travelled a long distance to be here to testify, because the Committee is out of time and the members are late returning to the floor. Jody Cedrick of Zenware approached the podium. **Mr. Cedrick** said his company is a local company. He said wanted to address Senator McKenzie's question. He said he provides two software solutions, one called Zentouch, which is an enterprise class cloud-based software that they provide to service industries like HVAC (Heating, Ventilation and Air Conditioning), plumbers and electricians. He said they have full access to their software anywhere, strictly as a service on their mobile devices. He said if a client discontinues his service, he shuts down access to their company the day they end service. He said their software is designed to manage and host all the software that the clients use as a service. They own nothing and when they discontinue use of the software, they are cut off.

Mr. Cedric said it provides a great environment for them to use software that they otherwise could not afford. He said if they were to buy something off the shelf, it would cost them a minimum of $50,000 to buy an equivalent software that he provides them at $50 per month per technician. He said that provides a huge advantage to small businesses within Idaho and outside of Idaho. He said he hopes that clarifies things a bit.

Senator McKenzie said he thinks that is a taxable event to them, if they can buy it. **Mr. Cedric** interrupted and said they can't buy it because he doesn't distribute it. **Senator McKenzie** said he thought he understood Mr. Cedric said they could buy a comparable product for $50,000. **Mr. Cedric** interrupted and said they could from a competitor. **Senator McKenzie** said then it comes under the comparable computer software that performs the same function. **Mr. Cedric** interrupted with the question, "How so, because..." and **Senator McKenzie** reiterated that Mr. Cedric just said they could buy a comparable computer software that performs the same functions, and they would have to pay a competitor $50,000. **Senator McKenzie** said if that exists, then it is a taxable event, which is the same situation with the Boise Chamber comments. He said if companies are getting access to products rather than buying them, but if they could buy them, it is a taxable event. He said he thinks this bill is a good principle, but if the exception swallows up what is trying to be accomplished here, he thinks a lot of people will be surprised that they have taxable events they didn't expect. **Mr. Cedric** said he would disagree with the Senator on that. He said nonetheless, he thinks this is a great bill that defines cloud services.

ADJOURNED: **Chairman Siddoway** said the Committee is out of time and will reconvene this week. He adjourned the meeting at 4:43 p.m.

Senator Siddoway
Chairman

Christy Stansell
Secretary