MINUTES

SENATE LOCAL GOVERNMENT & TAXATION COMMITTEE

DATE:	Thursday, January 16, 2014
TIME:	3:00 P.M.
PLACE:	Room WW53
MEMBERS PRESENT:	Chairman Siddoway, Vice Chairman Rice, Senators Hill, Johnson, McKenzie, Vick, Bayer, Werk and Lacey
ABSENT/ EXCUSED:	None
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) meeting to order at 3:04 p.m.

Chairman Siddoway stated there was an error on yesterday's agenda and the property tax bills would not be considered until February.

RS 22491 **Chairman Siddoway** invited Vice Chairman Rice to introduce **RS 22491**, relating to property exempt from taxation. **Senator Rice** said this bill adds oil and gas wells to the list of exemptions that do not require an application or processing by the county commissioner. He said the purpose is to save paper and time.

MOTION: **Senator Hill** moved, seconded by **Senator Vick**, to send **RS 22491** to print. The motion carried by **voice vote**.

PASSED THE GAVEL: Chairman Siddoway passed the gavel to Vice Chairman Rice for the consideration of pending rules.

DOCKET NO. 35-0102-1302 **Vice Chairman Rice** invited to the podium McLean Russell of the Idaho State Tax Commission (Commission).

McLean Russell thanked the Committee for the opportunity to present the rules. He stated that the proposed changes to Rule 36 address the nature of signs as real property or tangible personal property and in some cases both. He said a sign includes the component that advertises the business, as well as any of the specific pieces of it, all the way down to the foundation.

Mr. Russell said if it was determined that any portion of the sign is real property then subsequently the individual installing the sign would have a use tax obligation. He stated that the purpose of the changes to Section 3 was to make sure that a contractor installing a sign understands that it may consist of a "mixed transaction" and that it may include both the sale of tangible personal property and a sale of real property. He stated that Section 3A explains that both the materials and the labor that go into the creation of a sign are part of the taxable sales price. He said Section 3B explains that in some cases, part of the sign structure may be a fixture to real property, and subsequently, the installer was acting as a contractor improving real property and so was responsible for sales and use taxes on the purchases installed on that part of the sign.

Mr. Russell said Subsection 4 is more specific and concerns road signs or informational signs relating to roadway information: traffic signs, stop signs, speed limit signs, etc. He said that road signs become real property upon installation and that an installer of a road sign is acting as a contractor improving real property and is the consumer of the material that is being used.

Senator Lacey asked why road signs are included when they do not add to the value of the property and belong to the city, county or State. **Mr. Russell** replied that this rule is only applicable in the sales tax realm. He stated this is how the tax is currently being administered and that adding it to the rule was to ensure the contractor was aware of the tax responsibility incurred on the installation of that property.

Chairman Siddoway inquired on the history of road signs in a right-of-way owned by the state, and asked if they have been previously taxed. He said if that has been the case, it seemed that under the current sales tax law, there is a loss of six percent to those highway projects that are in an area that are being shifted from the Idaho Department of Transportation to the general fund.

Mr. Russell said he found a district court case from 1981 in which the Commission had imposed a use tax liability upon a contractor who had received materials from a government entity and installed them into real property and was consequently held subject to tax on the value of those materials. He said the district court upheld the imposition of that tax.

Chairman Siddoway asked about the amount of money collected by the cities, counties and state from this tax. **Mr. Russell** responded that he did not know and it would take a significant amount of analysis to produce a figure.

Senator Werk asked if there would be sales tax on the asphalt that a contractor purchases to build a road for a state agency. **Mr. Russell** replied yes, there would be sales tax. **Senator Werk** asked if the post and the sign are also taxable items. **Mr. Russell** clarified that sales tax is not a property tax and that once sales tax is imposed, it is done. Property taxes are recurring. The post and sign that are used are subject to the use tax.

Senator Lacey noted Sections 3 and 4 indicate labor is taxed and said if he employed a mechanic, he would pay sales tax on the parts, but not the labor. He asked if that was a change. **Mr. Russell** replied that the only tax on labor would be the labor required to fabricate the sign and that any labor to improve real property is not taxable.

Senator Siddoway asked for an explanation of the difference between the use tax and the sales tax and their relative amount. **Mr. Russell** explained that the sales tax and use tax "go hand in hand" and that if one applies, the other does not and that six percent was the rate for both. He said that the same exemptions apply to both and that the purpose of the use tax was to catch the things that the sales tax misses.

Vice Chairman Rice inquired if the Idaho Department of Transportation or the state of Idaho was party in the 1981 court case referenced by Mr. Russell. **Mr. Russell** responded that neither agency participated and that the case was between the Commission and the contractors. **Vice Chairman Rice** then asked if the state of Idaho bought a case of paper from an office supply retailer, would that retailer pay sales tax on that product prior to selling it to the state of Idaho. **Mr. Russell** replied that the retailer would not, because the state of Idaho has an exemption on all of its purchases according to the sales tax code.

Vice Chairman Rice then asked how a sign would be taxed if the State produced the sign and then merely hired a contractor to install it. **Mr. Russell** replied that the contractor would owe use tax on the value of the fabricated sign.

Senator McKenzie asked about Section 3A in which both the material and the labor required to fabricate the sign are taxable and therefore the tangible price of the personal property is taxable, resulting in the entire price being taxable to the customer, regardless of the value of the materials, labor, profit and overhead. **Mr. Russell** responded that the parts of the sign that remain tangible personal property after they are installed, and the labor that went into fabricating them, are subject to tax.

Chairman Siddoway asked about the disposition of the rule in the House of Representatives and what the ramifications would be if they held the rule in committee and then ultimately passed the concurrent resolutions required to nullify the bill as far as the Commission is concerned.

Mr. Russell deferred to Commissioner Ken Roberts. **Mr. Roberts** stated the House Committee took an action to not approve this portion of the rule and also made a decision to approve the entire docket. Subsequently, it was unclear what direction the House would take on the rule. He said the purpose of the rule was to provide clarity to the industry who installs signs and that it was the prerogative of the Legislature to grant an exemption, but without the rule, there is still some ambiguity.

Senator Vick asked why they put labor in the section of rules. **Mr. Russell** responded that it is common in the production of custom tangible personal property to break out labor and materials in order to make it clear what they are charging for, and the rule clarifies that if you are producing tangible personal property, they must be charged sales tax on the whole amount.

Senator Hill stated the Committee needed to know that the rule was in accordance with the current statute and asked Mr. Russell to clarify the statute.

Reading over the statute, **Mr. Russell** stated that since 1965, there has been a Subsection A appended to it that states if "you" are constructing real property, "you" are the consumer of the material and all sales and "used by" are taxable. In Section 63-3615 the definition of "use" includes the exercise of any right or power over tangible personal property by any person in the performance of a contract.

Mr. Russell explained that, regardless of who the contractor is working for or who owns the property, the contractor is using the materials.

Vice Chairman Rice stated that Section 63-3609 specifically excludes from that definition any property that is for resale. **Mr. Russell** responded by pointing out Subsection A, in the same paragraph, where it states that all sales, or use, are taxable, whether or not such persons intend resale. **Vice Chairman Rice** then stated that Section 63-3615 indicates that's the case unless such property would be exempt to the title holder and he requested clarification. **Mr. Russell** responded that it was a reference to the production exemption which stems from a court case in which a contractor was installing equipment and it was found that the equipment used to install the production equipment was exempt.

Mr. Russell said the rule has been in place for at least 20 years and was re-coded in 1993. He stated that in Rule 12, a contractor who is improving real property and buys tangible goods cannot avoid tax because the goods will be built into a structure which will belong to, or be used by, an exempt entity. Also, he explained, contractors and subcontractors may not avoid paying sales or use tax due to a contract which allows invoices to be made out in the name of the exempt entity and designate the contractor as an agent of the exempt entity.

Mr. Russell summed up the statute by stating that the contractor is the entity that is subject to the tax and not the exempt entity that is having the real property improvements performed on their behalf.

MOTION: **Senator Lacey** moved to reject **Docket No. 35-0102-1302**. **Vice Chairman Rice** asked for a second, and there was not one.

DISCUSSION: When there was no second, **Chairman Siddoway** stated that he considered most of the hesitation from the Committee to be the belief that "we are taxing ourselves" meaning the State is taxing itself. **Chairman Siddoway** said since the Committee is unsure of the fiscal impact to the various entities and the ability of the Commission to separate the private basis versus county basis, the motion to reject is probably in order and proper; however, he said he does not want the Committee to get into the situation where it ends up with a parliamentary procedure problem where what is intended is not the outcome.

Mr. Roberts of the Commission stated that if the Committee finished the docket and if the members had an affirmative vote on the current motion, they would need a motion to approve the docket and then they could reject or save that particular rule.

Senator McKenzie stated that he is conflicted because there is already the statute that taxed improvements to real property, which includes fixtures, and that in general, road signs become real property upon installation. But, he said, what does not seem logical to him is where it was stated that, because material and labor are taxable, therefore the entire price was taxable. He said, because whenever you tax any good, everything that went into the price of that good is taxed. He said it was not necessarily corollary that if you tax material and labor, you tax the whole price.

Mr. Roberts stated if it was the Committee's desire to compile fiscal impacts of making the change to Rule 36, the Commission would do everything in its power to get the answers the Committee needs to make a decision.

Senator Werk stated that it would be beneficial for the Committee to have a little more time to make a decision and make a substitute motion to hold the rule at the call of the chair to allow the Committee to consider other information before making a decision.

Senator Bayer clarified that the motion would be specific to **Docket No. 35-01012-1302**, to which **Vice Chairman Rice** responded that it was Rule 36 of **Docket No. 35-0102-1302**. **Senator Bayer** commented on the language of rules and that the process of amending the rules should be given due prudence, as he has seen rules enacted where a committee did not take formal action and where subsequent resolution was not followed up on. He stated that he would like to know the action that has been taken by the other committee on this rule.

Senator Hill asked the Commission to return in order to help the Committee understand the issue better with some examples, because the rejecting of the rule might have further implications than road signs. **Senator Vick** stated his understanding is that a rejection would only result in reverting to existing rules.

SUBSTITUTE MOTION: **Senator Lacey** moved, seconded by **Chairman Siddoway**, to table discussions of Rule 36 of **Docket No. 35-0102-1302**, subject to the call of the Chair. The motion carried by **voice vote**.

Vice Chairman Rice then requested that **Mr. Russell** continue through the docket, now with Rule 37. **Mr. Russell** said last year H 15 added a sales tax definition for "primary" and "primarily" for tangible personal property. He said that for many sales and use tax exemptions, one of the determining factors of whether or not an exemption will apply is the primary ongoing use of the tangible personal property.

Mr. Russell explained that the new definition of "primarily" takes into consideration the combined taxable uses of a piece of personal property and the combined nontaxable uses of that property, and whichever combination is greater determines whether or not the exemption applies. He gave an example from Section 2a in which the two taxable uses of an aircraft, one being the owner's personal use and the other being flight instruction, when combined exceed the nontaxable use of the aircraft, which is providing charter flights for hire. He said this resulted in the use of that plane becoming subject to tax.

Mr. Russell moved on to Rule 41. He explained that the only change is in Subsection 10. He said during the last two legislative sessions, two bills were passed, one of which exempted free beverage samples, and the other exempted free food samples. He said the Commission audit staff expressed concern that there would be confusion when there was paid tasting. He said, therefore, Section 10 clarifies that sales tax must still be collected on the charges to participate in a paid tasting, and the provider of the samples can purchase what is being given away for resale and exempt. **Senator Vick** asked if sales tax is to be charged on the price of the attendance. **Mr. Russell** responded that is correct.

Senator Johnson asked about the example Mr. Russell gave for Rule 37. He asked if the tax was in relation to the use of the aircraft for the three services he described or the initial sale of the aircraft. **Mr. Russell** responded that it was referencing the ongoing exemption from use tax.

Mr. Russell also stated that charges to transport passengers and freight for hire are not subject to sales tax due to a federal preemption on those sales. He said that sale, lease, purchase or use could be subject to sales or use tax, and to maintain an exemption that was claimed originally, it would need to be resale inventory. If it is taken out of resale inventory, it becomes subject to use tax.

Vice Chairman Rice then said in the first example, one of the uses was a "common carrier" and that it was stated that federal law prohibits taxation of that use and he asked that if it was less than 50, were they going to tax it despite federal law. **Mr. Russell** replied what federal law preempts is the charges to the passengers or to the owners of the freight that are hiring the transportation.

Vice Chairman Rice then asked if they were taxing them for selling it to the common carry passenger as a use, despite the fact that taxing that sale to the customer is prohibited by federal law. **Mr. Russell** responded that the tax is imposed on the owner of the aircraft. **Vice Chairman Rice** then clarified that if they paid the sales tax when they purchased the aircraft, they would not incur a use tax when they conducted their flights. **Mr. Russell** responded that is correct.

Vice Chairman Rice asked if the first five years of an aircraft use were exclusively exempt use and their collective value was substantially greater than the taxable use in the sixth year, would the whole airplane still be taxed. **Mr. Russell** replied the new law does not look at the value, rather, how it is used and how much it is used. **Chairman Rice** asked if the statute used the 12 month period. **Mr. Russell** replied that, in general, the statute does not address the audit period for review, which are mostly addressed by rule, and by the Commission's practice and procedure.

Vice Chairman Rice stated they were now considering Rule 46, relating to coatings on tangible personal property. **Mr. Russell** explained that this is a significant change and there had been much confusion and the rule was the result of numerous requests for clarification. He said it is intended to apply to coatings across the board.

He stated that Section 1 addresses the general overview of spray-on bed liners. Section 2 clarifies that the coating itself is tangible personal property. Section 3 states the charge for the coating materials is subject to tax. Section 4 gives examples of when labor charges are nontaxable the majority of the time, including when a previous coating is removed and replaced, or when a previous coating on used tangible personal property is covered with a new coating.

Mr. Russell continued with Section 5, which gives examples of when labor is taxable. He said when tangible personal property is sold, many types of labor are taxable. Section 6 states the material and the labor charges must be separately stated, or the whole charge is always going to be taxable. Section 7 further explains that tangible personal property is considered to be used if it is put to the use for which it is intended. Section 8 clarifies that coatings held in inventory by a retailer are taxable. Section 9 states that an applicable exemption can be claimed.

Senator Lacey asked what the difference is between Subsections 4 and 5. **Mr. Russell** answered that the difference is repair labor as opposed to brand new personal property.

Senator Bayer asked about the revenue impact of the new rule. **Mr. Russell** responded that there would be both a positive and negative revenue flow. The positive revenue flow would be the sales tax and the negative revenue flow would be under the Commission's current approach, which states that labor to apply a re-coating is often taxable and would no longer be under the new rule. **Senator Bayer** asked about the impact to business in the State. **Mr. Russell** responded that business owners are happy to have the consistency and clarity.

Senator Lacey asked about the history of the rulemaking. **Mr. Russell** responded that there was a lot of confusion and inconsistency among businesses and that he had no recollection of opposition to the rule.

Vice Chairman Rice then asked Mr. Russell to proceed with Rule 79. **Mr. Russell** said there was an Idaho Supreme Court decision from 1991 that excluded property primarily used to install real property from the production exemption. He said that was the guidance the Commission had used and they were of the opinion that it should be included in the rule.

Chairman Siddoway requested examples pertaining to Section 6. **Mr. Russell** responded that a posthole digger would be subject to tax. **Senator Lacey** asked if there is an exemption on farm equipment. **Mr. Russell** responded that yes, there is.

Mr. Russell then moved on to Rule 114, relating to sales under the Federal Supplemental Nutrition Assistance Program (SNAP) and Federal Special Supplemental Food Program for Women, Infants and Children (WIC). **Mr. Russell** stated that in making the changes, they met with representatives from the retail grocery industry who pointed out that most of the language was out-of-date and no longer applied.

Mr. Russell then explained Rule 130, relating to promoter sponsored events. **Mr. Russell** stated that Sections 1 and 2 outline the promoter's responsibility regarding the distribution of Form ST-124. He said that under the old system the form only had to be filled out once every 12 month period, but it was unclear when that period began or ended, so now the form is to be filled out at every event. He said Section 3 explains that it is the promoter's responsibility to notify the Commission if a participant fails to complete the form. **Mr. Russell** said Section 4 clarifies the documentation the promoter must submit to obtain their one dollar income tax credit for every participant who submits Form ST-124.

MOTION: **Senator Bayer** moved, seconded by **Senator Lacey**, to hold **Docket No. 35-0102-1302** subject to the call of the Chair. The motion carried by **voice vote**.

DOCKET NO. 35-0109-1301

Vice Chairman Rice invited Mr. Russell to review **Docket No. 35-0109-1301**, relating to wine tax administrative rules.

Mr. Russell explained there was one change to Rule 12 that affects wine direct-shippers. Some wineries have a special license to ship wine directly to individuals in greater quantities than they otherwise could in a single shipment. The rule clarifies that shipments into other states will not incur Idaho state sales tax.

MOTION: **Chairman Siddoway** moved, seconded by **Senator Johnson**, to approve **Docket 35-0109-130**. The motion carried by **voice vote**.

DOCKET NO. 35-0110-1301

Mr. Russell then presented **Docket No. 35-0110-1301** relating to cigarette and tobacco products. **Mr. Russell** stated the rule was updated to address confusion pertaining to the tobacco products tax, which is based on wholesale prices as the taxable price. **Mr. Russell** said Section 3 reflects a change from H 7, which clarified the tobacco products tax, and the calculation of that taxable price applies to sales of tobacco products by anyone, not just manufacturers. He stated that Section 3a has been added to clarify that certain nontaxable charges cannot be unreasonably inflated. Section 3b states that a distributor based outside of Idaho, who is either required to hold one of these permits to collect the tax or voluntarily registers for the permit, must calculate the wholesale price like any other Idaho tobacco products distributor.

MOTION: **Chairman Siddoway** moved, seconded by **Senator Hill**, to approve **Docket No. 35-0110-1301**. The motion carried by **voice vote**.

DOCKET NO. 35-0114-1301

Mr. Russell then presented **Docket No. 35-0114-1301**. He stated the first six rules are the standard rules advised by the administrative coordinators office. Rule 100 clarifies that the fee does not apply to the sale of any wireless device, only the service, with the exception that the device and the service are sold together, then the entire item is subject to tax. Rule 200 establishes which retailers are required to collect the fee. Rule 300 establishes when an out-of-state sale is not subject to the fee and explains the seller must retain the documentation to support the sale.

Chairman Siddoway moved, seconded by **Senator Hill**, to approve **Docket No. 35-0114-1301**. The motion carried by **voice vote**.

RETURNED THE GAVEL: Vice Chairman Rice returned the gavel to Chairman Siddoway.

ADJOURNED: There being no further business, **Chairman Siddoway** adjourned the meeting at 4:35 p.m.

SECRETARY'S NOTE: These minutes were originally recorded by Committee Secretary Marchelle Fias. Upon her departure, Majority Staff Assistant David Ayotte assisted with them.

Senator Siddoway
Chair

Christy Stansell
Secretary