

MINUTES  
**SENATE LOCAL GOVERNMENT & TAXATION COMMITTEE**

- DATE:** Wednesday, February 19, 2014
- 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:** 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 meeting of the Local Government and Taxation Committee (Committee) to order at 3:01 p.m.
- MINUTES:** **Chairman Siddoway** called for the consideration of the Minutes from previous meetings, noting that the Minutes of January 22, 2014 were not on the agenda but are ready for consideration, as well.
- MOTION:** **Senator Johnson** moved, seconded by **Senator Werk**, to approve the Minutes of January 16, 2014. The motion carried by **voice vote**.
- MOTION:** **Senator Lacey** moved, seconded by **Senator Hill**, to approve the Minutes of January 29, 2014. The motion carried by **voice vote**.
- MOTION:** **Vice Chairman Rice** moved, seconded by **Senator Lacey**, to approve the Minutes of January 30, 2014. The motion carried by **voice vote**.
- MOTION:** **Senator Werk** moved, seconded by **Vice Chairman Rice**, to approve the Minutes of January 22, 2014. The motion carried by **voice vote**.
- Chairman Siddoway** asked the Committee to make note of a handout provided regarding Rule 205 and he recommended the members review it. **Senator Hill** asked that a copy of the RS about this issue also be provided.
- H 402** **Chairman Siddoway** invited Michael Chakarun, Tax Policy Manager with the Idaho State Tax Commission (Commission) to the podium to present **H 402** relating to income taxes and a computational method for the calculation of Idaho net operating loss (NOL) when a taxpayer recognizes Real Estate Mortgage Investment Conduits (REMIC) excess income inclusion (EII).
- Mr. Chakarun** described **H 402**. He said part of the duties of the Commission is to make recommendations to remedy injustice and irregularities in the tax code. He said this bill is a joint effort of the Commission and the Idaho Bankers Association. He said the bill addresses a problem that occurs when owners of REMIC's incur an NOL in a tax year and are also required to include as income an amount called EII and pay tax on that income.
- Mr. Chakarun** said because EII is taxable income for federal purposes, it is taxable by Idaho because the Commission conforms to the Internal Revenue Code. He said the problem arises if the taxpayer with EII has an NOL caused by other business activity. He said on the federal return, the taxpayer includes the EII as income and pays tax on that income, but the taxpayer is allowed to carry back or carry forward the NOL.

He said, however, that Idaho law is not clear on the loss carryover/carryback issue. He said an argument can be made that since the EII is reported as income on the Idaho return, no NOL even exists, and the NOL disappears and is lost forever. He said the issue has been an audit issue in prior years and the Commission and taxpayers have agreed to follow the federal tax treatment.

**Mr. Chakarun** said to avoid future audit issues and eliminate uncertainty, the bill adds new code Section 63-3021A to clarify that the taxpayer will not lose the NOL because of the EII and preserve the NOL carryover/carryback for these entities. He said the bill also provides a mechanism to compute the NOL. He said the modification to Section 63-3027 is to add language on how the EII and NOL are treated for multi-state companies.

**Senator Hill** asked about the definition of EII, saying he can't find one in statute.

**Mr. Chakarun** said it is a federal concept that has a long history with the federal treasury. He said it is how an entity with an NOL and its income interplay with NOL calculation deduction at the state level. **Senator Hill** said he still doesn't understand what EII is well enough to explain on the floor of the Senate and asked for more clarification, maybe from a federal level.

**Mr. Chakarun** said he would do his best, and ask Rex Smith from Hawley Troxell for further information if needed. He said EII is a calculated amount that is based on average daily accruals of the income from REMICS. REMICS are Real Estate Mortgage Investment Conduits, or pools of mortgages that have been pooled together and then sold, and there is always one residual owner, which is the one to which the EII is attributed. It is a formula in the Internal Revenue Code that results in a minimum tax that these entities have to pay.

**Senator Lacey** asked why EII is not included somewhere in this legislation. **Mr. Chakarun** said it is referenced in the new section of code, but it is not defined because it throws back to federal law. He noted that the individuals who work with this concept on a daily basis know very well how this works, and it is a very limited number of taxpayers involved.

**Senator Johnson** commented there is no fiscal impact noted. He asked if there is a gain or loss to the State or to individual taxpayers in relation to this legislation.

**Mr. Chakarun** said the Commission has been doing it this way and this provision is now officially conforming to federal law what has been done in practice. **Vice Chairman Rice** asked why it isn't just part of the annual conformity bill. **Mr. Chakarun** said the State NOL statute doesn't line up with federal statute so this has to be done separately.

**Chairman Siddoway** invited Rick Smith with Hawley Troxell, representing the Idaho Bankers Association, to approach the podium. **Mr. Smith** said he sees this as a technical corrections act to clear up ambiguity and confusion in statutes and this is one of very few times he is in complete agreement with the Commission.

**Senator Hill** asked him to explain EII. **Mr. Smith** said EII is only relevant at the federal level. He said it is an example of how sometimes terms are only used at the federal level and therefore not defined at the state level. He said it is a minimum income amount that is determined for the residual owners of REMICS, which is like an LLC or partnership. He said residual owners are like the equity owners of this LLC, whereas the regular interest owners are like the debt holders. He said this is one of the most complicated federal calculations he's ever seen, but they are made to determine the amount of income that these residual interest holders have to recognize in a tax year as a minimum amount.

**Mr. Smith** said regardless of other deductions or losses the taxpayers may have, this amount has to be reported and have tax paid on it. He said that is an unusual feature of federal law. He said it is reported as adjusted gross income on a federal return and so gets carried into the Idaho return, and then conformance stops there because Idaho has different NOL provisions than federal code does. He said that is what creates the ambiguity that this bill will correct to help taxpayers. He said that whatever the excess income is, when it shows up on a return, it doesn't wipe out the NOL that the taxpayer could have otherwise.

**Vice Chairman Rice** asked to confirm his understanding of the provision in § 62-3021a. He said he thinks it means when income from a federal return is EII, which is a form of alternative minimum taxable income, that instead of using that amount, they get to use the actual loss they have that year instead, and they can use that loss and carry it forward and back. **Mr. Smith** answered that is close. He clarified by offering an example. He said if a taxpayer has a \$1,000 EII for a given year, and there is also a \$100,000 NOL from the taxpayer's business, this provision says that \$1,000 EII still must be reported, but the \$100,000 NOL can be carried forward or back, the way NOLs can be. He said in this provision, NOLs will not be lost because other income is being reported for that year. **Vice Chairman Rice** then asked if his understanding is correct in that the taxpayer can take that EII, which the federal government says is used instead of actual income, and can still use the NOL just like normal, so it allows the taxpayer to offset with actual losses. **Mr. Smith** said yes, that is correct.

**Senator Hill** asked to take it one step further. He asked if the taxpayer has to pay state income tax on EII as part of his taxable income. **Mr. Smith** said yes, that is correct and that is what has been part of the problem, because the EII shows up and carries over into the Idaho return.

**Chairman Siddoway** asked what industries have these problems. **Mr. Smith** answered it is primarily the financial industry and banks that take up the residual interest in the REMICS. He said REMICS are popular devices for the pooling of and sale of mortgage backed securities, which was probably part of the debacle in 2008.

**MOTION:**

**Senator Werk** moved, seconded by **Vice Chairman Rice**, to send **H 402** to the floor with a **do pass** recommendation. The motion carried by **voice vote**.

**H 440**

**Chairman Siddoway** welcomed Alan Dornfest of the Idaho State Tax Commission (Commission) to the podium to present **H 440**, relating to property taxes and provisions for assessment of operating property of rate regulated electric utility companies. **Mr. Dornfest** said this is a Commission bill to codify a valuation procedure for appraising operating property. He said it is the Commission's responsibility to assess the value of the properties of such companies. He said the procedure being codified was used in 2013 in a settlement with Idaho Power Company. He said there has been ongoing debate and dispute on how to compute loss of value due to obsolescence when the cost approach is used as part of the valuation process. He said in addition to the dispute with Idaho Power Company, the Commission has also been in court with Rocky Mountain Power, also known as Pacificorps, over this issue. He said the methodology found in **H 440** reduces the prospect for ongoing disputes by providing for less reliance on the cost approach.

**Mr. Dornfest** said this provision will "weight" the different approaches - cost, income, and stock and debt approach. This provision gives more weight to the income approach. He said cost approach cannot be weighted more than 20 percent of the total value, which gives more weight to the income approach. He said by doing this, it takes into account and gives consideration for what the effect of obsolescence is, which has been the point of contention between the Commission and the companies.

**Mr. Dornfest** said there is no additional obsolescence, as it is now "built-in" to the 20 percent weighting of the cost approach. He said this eliminates the argument and codifies the approach that was used in the 2013 case. He said similar methodology was used in the case with Rocky Mountain Power. He said they are aware of no objections.

**Vice Chairman Rice** asked Mr. Dornfest to walk him through the difference between the results using this formula versus using the entire value of the company. He asked if the point is to find the value of the property, rather than the value of the company.

**Mr. Dornfest** said yes, the Commission is trying to find the value of the operating property of the company. He said the bill does not change that, nor does it change the reliance on the different valuation approaches. He said this just changes the "weighting" applied to those approaches. He said he asked the appraisal staff to compare their initial appraisal under the systems they had been using previously that had a higher weighting on the cost approach against the results of applying this methodology, and they say this approach lowered the value by about 7.5 percent for Idaho Power. He said please recognize that this has been under dispute and in court. He said there was no way of knowing if the final outcome wouldn't be a number far lower. He said experts in appraisal differ in their approach to the valuation of those companies.

**Vice Chairman Rice** said his question is more about what the difference is between the result this methodology comes up with and the entire value of the company.

**Mr. Dornfest** said he doesn't think he could attempt to answer that because the Commission only considers the value of the operating property of the company.

**Chairman Siddoway** asked if it would help if there was an understanding of how operating property is valued for taxation. **Mr. Dornfest** deferred to Steve Fiscus of the Commission's property tax division.

**Mr. Fiscus** said when looking at valuing a company, the Commission looks at valuing the assets. He said they look at the value of the assets using three approaches to value: market, cost and income. He said there is a value that may be attributed to a company, but that is exempt because it's intangible, and intangibles are exempt in Idaho. He said all that is being done is changing the bottom line of the assets because the values aren't just averaged, they are weighted. He said using a cost approach could be \$1 billion, whereas using an income approach could make it \$750 million. He said the Commission doesn't just add the two figures and divide them; they are weighted. He gave an example of how this bill would compute it. He said this bill means 20 percent of that weight would go on the \$1 billion from the cost approach, and 80 percent of the weight goes on the \$750 million from the income approach, and that comes up with the value of the assets of the company.

**Vice Chairman Rice** said yes, that helps.

**Senator Hill** asked if the lawsuit from the utility companies was because they didn't like the weight the Commission was placing on these approaches. He asked if the Commission lost the case because the statute wasn't clear and what was being challenged were the rules, and if the statute had been more clear they would have avoided the lawsuit.

**Mr. Fiscus** said he was closely involved in this case and can answer that. He said the Commission did lose in 2008 and 2009 cases with PacifiCorp, but there has not yet been a trial with Idaho Power. He said the Commission and Idaho Power got together to review the reasons for the appeal. He said the appeal was not necessarily based on the weighting. He said that came into it later.

**Mr. Fiscus** said the case was based on how to measure the concept of economic obsolescence, which is a factor that is outside of these approaches. He said sitting down with Idaho Power to come up with this methodology, the agreement was that by placing 80 percent weight on the income approach, the economic obsolescence is removed, because it is related more to the cost approach. He said that is the agreement and what the Commission used to move forward.

**Senator Hill** said he's not sure which was better for the State or the utility company, because that's not relevant to him. He said if this Committee decided to amend this bill to 50-50 instead of 80-20, would that be justifiable or would that result in another court case. **Mr. Fiscus** said yes, that would result in another court case because the structure of this methodology was the main focus for eliminating the court cases. **Senator Hill** said he understands that and is trying to consider the reasoning of the court, and whether it was considered unfair or if it was because there was not a specific statute.

**Mr. Fiscus** said the court did not make a determination on the statute, because the appraiser in the Commission has always had flexibility for the weighting, while trying to use industry standards. He said the court's decision for the 2008 and 2009 cases was based upon a calculation that took into consideration loss from the revenue shortfall, which is the allowed rate of return and the actual rate of return. He said that formula looks at the inability to generate the allowed rate of return.

**Chairman Siddoway** invited David Langhorst of the Idaho State Tax Commission (Commission) to the podium. **Mr. Langhorst** said he was involved in the negotiation that resulted in the settlement. He said every year the Commission staff assesses operating property, and every year there is a cycle where the taxpayers have a chance to appeal. He said there have been four or five different lawsuits each with two companies. He said they have put off settling those to let them go through the courts. He said considering that rate of lawsuit filings, every year the Commission would be adding two more lawsuits, and there was the potential of spending millions of dollars on that. **Mr. Langhorst** said the code does not say "you shall appraise in this way" but it says "you shall appraise and find the market value" and apply property tax to that. He said this new bill does prescribe a way. He said this is not the only place where finding market value is defined in code.

**Mr. Langhorst** said in appraising assets, the Commission appraisers were defending their valuation, and the companies hired appraisers to defend their valuation, all over this concept of "obsolescence." The Commission considered what was happening with litigation in other states, and the settlements don't fall on one side of the fence or another. He said it looked like Idaho's litigation could go on for a long time, so that was a motivator to sit down with the companies and work out a mutually agreeable way going forward.

**Mr. Langhorst** said the weighting in this methodology is 7.5 percent, and in other methods it could be a difference of as much as 28 percent. He said if this bill is not passed, the whole issue will open up again. If it is passed, it is the Commission's opinion that this is a minor adjustment and least harmful to taxpayers.

**Vice Chairman Rice** asked what is the fiscal impact to counties and cities.

**Mr. Fiscus** answered he does not have the exact number, but in one case with Pacificorps, it could mean \$4 million in possible pay-backs if the Commission lost in court. He said going forward, those districts will be repaying about \$1.8 million instead. He said going forward with this bill, Idaho Power has said it would not seek a refund for those four years and will instead waive that refund if there is agreement on this bill. He said the 2013 value for Idaho Power has been set using this formula so the shift has already taken place to the taxpayers.

**Mr. Fiscus** said two other large companies will see that shift this year. He said it will be a decline in the value, but that may be offset in the future as the plants grow and the companies invest. He said even with less weight on the cost approach, if they are adding plants, their value will still increase. He said he doesn't see that as being "significant" but it is not as large as it would be if this bill had not been done.

**Senator Hill** said sometimes the Legislature passes laws because there has been a court decision and there needs to be statutes brought in line with that decision. He said his understanding is that is not necessarily the case with this bill, but instead the statutes are being brought into line with an agreement that has been entered into with the Commission and the plaintiffs.

**Mr. Fiscus** answered, yes, that is correct, but the courts were still involved. He said the Commission took on this decision for this methodology because the Commission cannot order taxing districts to refund dollars, so these decisions are going through the court system. He said the Commission is not modeling this language after a court settlement, but instead modeling after the settlement between the Commission and Idaho Power. **Mr. Fiscus** said he also wanted to mention that the counties were involved in this process.

**MOTION:**

**Senator Hill** moved, seconded by **Vice Chairman Rice**, to send **H 540** to the floor with a **do pass** recommendation. The motion carried by **voice vote**.

**H 442**

**Chairman Siddoway** welcomed Alan Dornfest with the Idaho State Tax Commission (Commission) to the podium to present **H 442**, relating to property tax administration and revisions of operating property assessments, occupancy tax and yield tax. **Mr. Dornfest** stated this is a technical correction bill sponsored by the Commission. He said Section 1 amends Idaho Code § 63-110 to allow the State Board of Equalization (Board) to conclude no later than the fourth Monday of August. That Board consists of the Tax Commissioners. He said this replaces the current requirement to meet "on" the fourth Monday of August, which in most years is not meaningful and has resulted in logistical problems for the Commissioners. He said they try, for example, to attend the assessors' conference which begins that same day or the very next day each year.

**Mr. Dornfest** said the change in this bill would make it possible for the Board to conclude when their annual business is done. He said that business consists entirely of hearing operating property appeals and equalizing local assessments. He said appeals are filed in early August and local equalization issues are identified by that time as well, and it is extremely rare for the number of issues before the Board to require action on the fourth Monday. He said the bill does not affect their ability to meet through to that day.

**Mr. Dornfest** said Section 2 relates to two issues with the occupancy tax. He said the occupancy tax is prorated based on the prorated value of improvements, such as homes, dating from first occupancy during a calendar year. The tax substitutes for property tax in these cases and is computed based on the underlying levies of taxing districts, just like for property taxes.

**Mr. Dornfest** said the bill makes two changes: 1) The bill clarifies that provisions in Idaho Code § 63-602Y which calls for a prorated property tax for property exempt on January 1, but subsequently is taxable, would not apply to improvements subject to occupancy tax. He said this could be the case for a newly constructed home, for example, in which the land is taxable, but the home is not taxable until it is occupied. He said if someone moves in on July 1, occupancy tax comes in for the half of the year. This is so the Commission doesn't double tax the same property. He said he doesn't believe this has happened, but this bill precludes that possibility.

**Mr. Dornfest** then explained the second change. 2) The bill adds language to ensure that taxpayers are not only notified of their occupancy tax appraised value, but are also notified of their right to appeal. He said they will be given a specific time frame for filing the appeal. He said the appeal has always been permitted, but no statement of appeals rights has been required on assessment notices, and this bill corrects that missing element.

**Mr. Dornfest** said Section 3 amends Idaho Code § 63-1706 to provide taxpayers with notice indicating the amount of yield tax they owe. He said the yield tax is in lieu of the property tax on forest land and this option to pay the tax after harvest, rather than each year, can be chosen by the landowner. He said the current statute requires the assessor to notify the county treasurer of the amount owed by the taxpayer and requires the taxpayer to pay at the same time property taxes are due. He said, unlike traditional property taxes, there is no notice sent by the treasurer to the taxpayer, which became an issue in one county last year. He said that gap is closed in **H 442**.

**Chairman Siddoway** asked about the occupancy tax. He asked for clarification if a home is occupied by July 1 would be taxed for half the year at half the value. **Mr. Dornfest** clarified with an example that if the property had a \$100,000 value, the taxpayer would be charged tax on \$50,000.

**MOTION:** **Senator Johnson** moved, seconded by **Senator Hill**, to send **H 442** to the floor with a **do pass** recommendation. The motion carried by **voice vote**.

**ADJOURNED:** There being no further business, **Chairman Siddoway** adjourned the meeting at 4:02 p.m.

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Senator Siddoway  
Chair

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Christy Stansell  
Secretary