

MINUTES
SENATE LOCAL GOVERNMENT & TAXATION COMMITTEE

DATE: Wednesday, February 21, 2018

TIME: 3:00 P.M.

PLACE: Room WW53

MEMBERS PRESENT: Chairman Johnson, Vice Chairman Bayer, Senators Hill, Siddoway, Rice, Vick, Patrick, Burgoyne, and Nye

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 Johnson** called the meeting of the Local Government and Taxation Committee (Committee) to order at 3:02 p.m.

H 462 **Relating to Forest Lands Taxation.** **Emily McClure**, representing Riley Stegner and Associates, presented **H 462**. **Ms. McClure** explained that taxpayers who own 5,000 acres or more of forest land are taxed differently than other types of property; they pay county property taxes according to a formula developed by the Committee on Forest Land Taxation (CFTM). She provided information on how this formula is calculated, which includes the productivity classification of a parcel of land.

Ms. McClure indicated that during the economic recession, the price of timber plummeted; as a result, the value of forest land decreased dramatically. To address the economic strain this had on timber-rich counties, the Idaho State Tax Commission (Commission) and the CFTM set a floor and ceiling for forest land values for a period of ten years. **Ms. McClure** outlined the agreement that was made with landowners and codified in Idaho Code § 63-1705(3). This section addresses values of forest lands for taxation purposes. She stated current law does not provide a consistent process for county assessors to follow when changing a parcel's productivity classification.

Ms. McClure explained as the economy began to recover, landowners in some counties received assessment notices reflecting increases in valuations due to a reclassification of the property. **H 462** will require the Commission and the CFTM to review and revise the rule for forest land productivity classification. **Ms. McClure** stated the intent is to provide a consistent process for all counties, including notification to landowners, qualifications for those performing forestry measurements, and standards for documentation and retention. Productivity classifications will remain at their 2016 levels until the rule is approved by the Legislature.

TESTIMONY: **Jim Riley**, representing Riley Stegner and Associates, spoke in support of **H 462**. **Mr. Riley** discussed how landowners in northern Idaho benefited from their agreement with local government during the economic recession (see Attachment 1). He indicated that, as the economy began to recover, some landowners saw a significant increase in the taxable land values of their property. **Mr. Riley** stated this was a result of assessors changing productivity classifications without regard to the terms codified in Idaho Code § 63-1705(3). This section specifies that annual changes in forest land values will not increase or decrease more than five percent from the prior year. He pointed out that the process for changing productivity classification is not uniform by county, and landowners are not always notified of these changes.

DISCUSSION: **Senator Rice** asked if the *Bonner County Daily Bee* is the main newspaper in a northern Idaho. **Mr. Riley** said this is the principal newspaper in Sandpoint, Idaho.

Senator Siddoway asked how many acres have been affected. **Mr. Riley** stated it varies by county. He will provide this information to the Committee.

Senator Burgoyne requested that Ms. McClure return to the podium. He asked her to comment on the correspondence from the Idaho Attorney General's Office regarding **H 462** (see Attachment 2). **Ms. McClure** agreed with the determination of fair market value for assessment purposes. However, she pointed out that when assessors do not follow consistent procedures, a fair market value cannot be determined. **Senator Burgoyne** asked if she felt the Attorney General's opinion concluded that **H 462** is unconstitutional, or if this legislation would be any less valid than other relevant statutes. **Ms. McClure** responded no, this statute would not be less valid; the Legislature has the authority to pass retroactive provisions.

TESTIMONY: **Mike McDowell**, Assessor, Kootenai County, spoke in opposition to **H 462**. **Mr. McDowell** stated he is a member of the CFTM. He said that, while the CFTM did agree to limit the increase or decrease per acre for each productivity class, there was no agreement to limit the proper classification of forest lands. Kootenai County, in its effort to update forest land classification, has found prior classifications to be inconsistent and inaccurate. **Mr. McDowell** stated that Kootenai County has followed established methodology in this regard. He felt the moratorium will provide an advantage to special interest groups, and that such a provision may be unconstitutional. An appeals process is available to landowners; to date, no industrial landowner in Kootenai County has appealed classification changes made over the past two years.

Senator Rice asked Mr. McDowell if he would accept a blanket increase of productivity classifications for all parcels across the county. **Mr. McDowell** felt these changes should be based on on-site evaluations; a blanket change of any kind would be a concern.

Seth Grigg, Executive Director, Idaho Association of Counties (IAC), spoke in opposition to **H 462**. **Mr. Grigg** stated the IAC opposes productivity classifications remaining at 2016 levels, with no sunset provision to ensure that rule promulgation is completed in a timely manner. He felt this moratorium has the potential to interfere with county assessors' statutory obligations to conduct annual appraisals.

DISCUSSION: **Senator Burgoyne** asked if passage of **H 462** would preclude county assessors from conducting annual valuations. **Mr. Grigg** affirmed. He then questioned the legality of instituting a moratorium.

Senator Rice commented that the counties seem to agree that problems exist within the appraisal process to warrant a moratorium. **Mr. Grigg** responded the qualifications themselves, rather than the appraisers conducting the fieldwork, need to be reexamined. In his opinion, it is not feasible for counties to require all appraisers to be professional foresters. **Senator Rice** then asked Mr. Grigg why he felt negotiated rulemaking would not be successful. **Mr. Grigg** expressed concern that if an agreement is not made during negotiated rulemaking, there will be little motivation for industry to act if values are frozen at 2016 levels.

Senator Vick asked if there have been cases where productivity classification changes were not supported with sufficient documentation. **Mr. Grigg** replied there have been instances in Bonner and Kootenai Counties of incomplete records. In these cases, land values were reverted back to previous levels and parcels were reevaluated. **Senator Vick** then asked if a landowner can appeal only in the year the valuation was changed. **Mr. Grigg** said that a landowner may appeal a valuation to the county Board of Equalization at any time.

Senator Patrick commented that an established floor and ceiling on forest land values would help counties set budgets. He asked Mr. Grigg to comment on variability in relation to county revenues. **Mr. Grigg** replied the disagreement stems from how stakeholders interpret the five percent valuation increase or decrease designated in statute. The IAC interprets that five percent is dependent upon the various productivity levels, rather than the parcel itself, which are established annually by the Commission.

Chairman Johnson asked Ms. McClure to provide closing comments. **Ms. McClure** commented that landowners feel they have been treated unfairly. Attempts have been made to reach an agreement with counties without legislative intervention.

MOTION: **Senator Burgoyne** moved to send **H 462** to the floor with a **do pass** recommendation. **Senator Rice** seconded the motion.

DISCUSSION: **Senator Hill** stated he will support the motion with the understanding that the moratorium will be addressed in the interim. **Chairman Johnson** agreed. He also felt this issue should be addressed by the CFTM rather than the Legislature.

Senator Nye expressed concern regarding the Attorney General's opinion addressing the legality of this legislation.

Senator Rice commented that, in his opinion, a short-term moratorium is appropriate to ensure that certain processes are accurate and fair to taxpayers.

VOICE VOTE: The motion passed by **voice vote**.

H 463

Relating to Income Taxes, 2018 Conformity. **Senator Hill** presented **H 463**. This legislation will conform the Idaho income tax code to changes made to the Internal Revenue Code (IRC) that affect tax year 2018. This bill will also create an Idaho child credit of \$130 per child; reduce all personal income tax rate brackets by 0.475 percent; and reduce the corporate income tax rate by 0.475 percent. **Senator Hill** described each aspect of conformity that will affect tax year 2018, including a standard deduction increase, the elimination of personal and dependent exemptions, and various business income tax changes (see Attachment 3).

DISCUSSION: **Senator Nye** sought clarification regarding the fiscal impact. **Senator Hill** explained that Idaho taxpayers will pay \$97.4 million in taxes if the State conforms to the federal tax code and does not incorporate subsequent tax relief. **Senator Nye** asked if Idaho is mandated to conform this year for tax year 2018. **Senator Hill** stated the Idaho Legislature elects to conform to certain provisions each year.

Chairman Johnson asked Ken Roberts, Chairman of the Commission, to comment on the administration of conformity. **Commissioner Roberts** began by stating the Commission does not take a position on tax policy. He explained how the Commission will administer relevant tax policy in the upcoming year, which will include: 1.) developing a communications plan for taxpayers; 2.) updating tax forms and withholding tables; 3.) conducting taxpayer trainings; 4.) making changes to tax processing software; and 5.) conducting administrative rulemaking.

Senator Hill returned to the podium to address the tax reduction provisions in **H 463**. He stated this was an ideal opportunity to reduce the tax burden on Idaho taxpayers. **Senator Hill** explained that all personal income tax rate brackets, as well as the corporate income tax rate, will be reduced by 0.475 percent. This will decrease revenue by \$144.5 million and \$15.1 million respectively. This legislation will also create a child tax credit of \$130 per qualifying child, resulting in a revenue reduction of \$42.3 million. **Senator Hill** commented the last major income tax rate reduction occurred in 2012. **Senator Hill** then provided examples of how this legislation will impact tax liability by income and family structure; he indicated that large families will pay more than under the current tax system. He felt that a reduction in tax rates will stimulate the economy, attract business to the State, and create jobs, which are all positive outcomes for Idaho families.

Senator Hill also addressed conformity to the Section 199A provision regarding pass-through entities. Beginning in tax year 2018, pass-through entities will be eligible to deduct 20 percent of business income. **Senator Hill** acknowledged that Idaho does not have the same need to create a pass-through deduction as the federal government. However, he expressed concern that eliminating the pass-through deduction will discourage pass-through businesses, which constitute 80 percent of business in Idaho, from settling in Idaho. In conclusion, **Senator Hill** stated that, while **H 463** is not a perfect bill, it will benefit Idaho families and help make Idaho more competitive in relation to surrounding states.

DISCUSSION: **Senator Rice** asked if the 20 percent deduction for pass-through entities applies to professional services, such as lawyers and accountants. **Senator Hill** responded that the deduction does apply but is dependent upon income levels; the deduction is phased out for joint income levels between \$315,000 and \$400,000. **Senator Rice** disclosed a possible conflict of interest under applicable law, pursuant to Senate Rule 39(H).

Senator Vick sought clarification of the 20 percent deduction phase-out. **Senator Hill** explained the deduction is completely phased out at certain income levels.

Senator Patrick inquired if farm cooperatives are eligible for the pass-through deduction. **Senator Hill** indicated that the federal government is currently working to address this issue. **Senator Patrick** asked Senator Hill to explain how the Legislature will address potential changes at the federal level of conformity-related provisions. **Senator Hill** indicated that provisions of conformity are addressed annually, and that the Legislature will have the opportunity to reexamine this issue next year.

Chairman Johnson questioned why the State should conform to 199A, for the sake of simplifying the tax code, when it does not conform to other federal credits and incentives. **Senator Hill** replied that, historically, Idaho only conforms to federal definitions of income and deductions; Idaho implements its own tax rates and tax credits.

Chairman Johnson stated a C corporation (C corp) is taxed twice, while an S corporation (S corp) is taxed only once. He asked if this provides enough of an incentive for small businesses to not conform to 199A. **Senator Hill** responded his main concern, when considering conformity to 199A, is how small businesses perceive Idaho's tax system. **Chairman Johnson** then stated that a C corp and S corp, with the same amount of taxable income, are taxed at the same rate under Idaho's current tax structure. Given the pass-through deduction, however, the effective tax rate of an S corp would be lower. In his opinion, this is not transparent tax policy. **Senator Hill** agreed, but felt that this is a good way to incentivize, rather than subsidize, small businesses in the State. Corporations receive medical, retirement, and other benefits that are tax-exempt.

- TESTIMONY:** **Alex LaBeau**, President, Idaho Association of Commerce and Industry (IACI), spoke in support of **H 463**. He commented on the economic benefits of this legislation as applied to businesses and individual taxpayers.
- DISCUSSION:** **Senator Vick** asked Mr. LaBeau to comment on perceived inequities associated with the pass-through deduction. **Mr. LaBeau** replied that he has not received any feedback from IACI members regarding this issue.
- Chairman Johnson** asked Mr. LaBeau to comment on a statement IACI published on December 6, 2017, which stated, "There is sound practical logic for treating companies that operate under the corporate filing the same as the pass-through companies." **Mr. LaBeau** replied this statement referred specifically to keeping personal and corporate tax rates the same. The effective rates are different for individual companies depending on the type of business and its qualified deductions. **Chairman Johnson** then asked if conforming to 199A may result in C corps reorganizing into S corps, and the potential impact this would have on future tax revenues. **Mr. LaBeau** felt it would depend on a company's tax liability.
- Senator Nye** asked Mr. LaBeau to comment on current and future economic growth in Idaho. **Mr. LaBeau** said that growth in the State is reflective of many factors, including an effective Legislature.
- TESTIMONY:** **John Watts**, representing the Idaho Chamber Alliance, and **Pam Eaton**, representing the Idaho Retailers Association, spoke in support of **H 463**.
- Julia Page**, representing the Idaho Organization of Resource Councils, spoke in opposition to **H 463**. **Ms. Page** felt that conformity and tax relief should be addressed in separate legislation.
- DISCUSSION:** **Senator Burgoyne** commented this legislation will result in a tax increase for families with three or more children. Furthermore, the proposed policies will also result in a tax shift; all other tax groups will subsidize tax cuts for the top one percent of earners. In his opinion, such policies will not foster economic growth or support small businesses in Idaho. In regards to the 199A provision, **Senator Burgoyne** commented that pass-through entities, some of which are quite large, already enjoy an advantage with respect to corporations, which have double the tax liability. In conclusion, **Senator Burgoyne** felt the net reduction to State revenue is too costly, and will take funding away from education, public safety, and other essential services.
- Senator Rice** observed the nature of conformity this year is historically different due to the passage of federal tax reform. Conformity, in this instance, will result in a tax increase for Idaho taxpayers. In his opinion, waiting until January 2019 to address conformity for tax year 2018 will result in over-withholding and greater difficulty in projecting next year's budget. The same difficulties will arise if tax relief is not addressed, as well. **Senator Rice** felt the proposed legislation is a reasonable approach that will benefit Idaho taxpayers and businesses.
- Senator Patrick** stated he will support this legislation. He commented that, as a small business owner, the 199A provision is important because it allows him to reinvest money in his business and his employees.
- Vice Chairman Bayer** commented on the changing landscape of tax policy across the State, particularly in the business arena. He stated if this legislation passes, it will be necessary to consider tax policy from a different perspective in the future.

Chairman Johnson cited a report from the Idaho Center for Fiscal Policy (see Attachment 4) and spoke to the uncertainty of establishing assumptions regarding conformity-related business provisions. With respect to the 199A provision, he felt this will be a carveout with few economic benefits. **Chairman Johnson** recognized that conformity will result in a tax increase for some Idahoans, and that subsequent tax relief is warranted. As a legislator, his goal is to create stable, transparent tax policy; **H 463** does not achieve these goals.

Senator Vick commented on the merits of a flat tax rate; however, the complexity of federal tax code would make this difficult. He acknowledged certain tax inequities for large families, and he felt the elimination of sales tax on groceries will help lessen the impact to Idaho families in the future.

MOTION: **Senator Rice** moved to send **H 463** to the floor with a **do pass** recommendation. **Senator Patrick** seconded the motion.

ROLL CALL VOTE: A roll call vote was requested. **Vice Chairman Bayer, Senators Hill, Rice, Vick,** and **Patrick** voted **aye**. **Chairman Johnson, Senators Siddoway, Burgoyne,** and **Nye** voted **nay**. The motion passed.

ADJOURNED: There being no further business at this time, **Chairman Johnson** adjourned the meeting at 5:25 p.m.

Senator Johnson
Chairman

Jennifer Carr
Secretary