Idaho's Income, Sales, and Property Taxes:
A Review of Executive and Legislative Committees' Suggested Reforms, 1978-1994.

by
Patricia Dailey and Stephen Cooke*

A. E. Research Series No. 94-5

May 20, 1994

*Patricia Dailey is a research associate and Stephen Cooke is an assistant professor in the Department of Agricultural Economics and Rural Sociology, University of Idaho, Moscow, ID 83843.

In partial fulfillment of a grant from the Northwest Area Foundation, St. Paul, MN.

Idaho's Income, Sales, and Property Taxes: A Review of Executive and Legislative Committees' Suggested Reforms, 1978-1994.

Patricia Dailey and Stephen Cooke*

May 20, 1994

* Patricia Dailey is a research associate and Stephen Cooke is an assistant professor in the Department of Agricultural Economics and Rural Sociology, University of Idaho, Moscow, ID 83843

In partial fulfillment of a grant from the Northwest Area Foundation, St. Paul, MN.

Idaho's Income, Sales, and Property Taxes: A Review of Executive and Legislative Committees' Suggested Reforms, 1978-1994.

Executive Summary

This survey reviewed the recommendations of four Idaho Legislative Interim Tax Committees (1984, 1986, 1988, 1994), two Governor's Blue Ribbon Tax Committees (1978, 1988), and the Governor's Tax Package of 1993. The recurring income tax reform proposal is that the State income tax structure converge with the Federal structure, including the quarterly collection of estimated income tax payments. The consistent proposal for sales tax reform is to expand the sales-tax base to services. There is also some questioning of the production-agriculture input exemption from the sales tax. The constant theme of property tax reform is limiting the use of the property tax to fund schools, health, and welfare. There is also a general concern about the tax-exempt status of some property from the property tax roles.

There is considerable agreement between Executive and Legislative studies as to the general recommendations for tax reform. The frequency in which these proposals reoccur suggests the difficulty the Governor and the Legislature have in finding mutually acceptable resolutions of these policy concerns. The problem is the devil lives in the details.

Idaho's Income, Sales, and Property Taxes: A Review of Executive and Legislative Committees' Suggested Reforms, 1978-1994.

This report summarizes the recommendations of the various Executive and Legislative tax study committees between 1978 and 1994 as they attempted to respond to calls for reform. In 1993 and 1994, the Governor and the Legislature proposed specific legislation, which is presented as the most current thinking on the need for reform in Idaho's tax structure.

Governor's Blue Ribbon Committees

A. 1978, Governor Evans' charge: to make taxes more fair, easier to understand and less burdensome.

B. 1988, Governor Andrus' charge: to improve effectiveness and overall fairness of Idaho's system of taxation.

Legislative Interim Tax Committees

A. 1984 Legislators' focus: to conduct a study of the state's tax structure in all of its aspects.

B. 1986 Legislators' focus: the division of responsibility between state and local governments for raising revenue including, but not limited to, the implementation of local option taxes and/or modification of the property tax law to transfer responsibility for raising revenues to local governments; make recommendations to allow greater local government decision making.

C. 1988, Legislators' focus: to study the state's tax structure.

Tax Proposals Introduced as House Bills

A. 1993, Governor's Tax Policy Package: the goals were equity improvements, property tax reduction, and state help to fund local public services.

B. 1994, Legislators' focus: to take public testimony on and recommend changes in the state's tax structure.

Data for this paper was obtained from the actual recommendations of each committee. Minutes of committee meetings, provided depth to the description of actions suggested. Recommendations from each committee are presented under four major tax areas: income tax, sales tax, property tax, and other tax related matters. The appendix contains photocopies of specific committee recommendations.

I. Income Tax Proposals

1978 Governor's Blue Ribbon Tax Committee

To make income taxes easier to understand, less burdensome, and fairer, the 1978 Blue Ribbon Committee made three recommendations. First, they recommended increasing income tax efficiency by rate simplification. To increase efficiency, it was suggested that the state income tax calculation within each bracket be reduced to a specific percent of the federal income tax. This would reduce tax administrative, and other overhead expenses. To reduce the burden of the state income tax within income categories, more tax brackets were urged within the low, medium, and upper income brackets (4, pp. 57-59).

Second, they recommended decreasing the loss of income tax revenues through additional corporate audits. They recommended that corporate audits be self-financing, i.e., the money collected as a result of a corporate audit be used to cover the expense of future audits. Thus, the number of corporate audits would vary in relation to their revealed need. The committee recommended that skilled corporate auditors be paid commensurate with their experience (4, pp. ix-x, 30).

Finally, to both make collection simpler and enforcement easier, the committee agreed that corporations' annual license fee and their income tax should be merged into a single payment. The committee also endorsed the idea that the corporate income taxes of a company operating in several states be apportioned among those states (4, p. x).

1984 Interim Tax Committee

To improve the effectiveness and overall fairness of Idaho's income tax, the 1984 Interim committee, made three recommendations. First, to minimize administrative costs, the Idaho income tax should continue to closely follow the Internal Revenue Code. Secondly, Idaho's personal income tax liability should be prorated for individuals with out-of-state income. The Committee suggested further study on the issue of whether estimated quarterly payments of state income taxes should be made similar to those paid to the federal government (8, p. 25; 3, p. 167).

1986 Interim Tax Committee

Since the focus of the 1986 Interim Committee was on local-option taxes, property taxes, and local government decision making, state income tax recommendations were not made.

1988 Interim Tax Committee

With an overview of the state's tax structure in mind, the 1988 Interim Committee recommended changes to strengthen the state income tax. First, they proposed that the state income tax conform more closely to the federal income tax rules by increasing the personal exemption to the federal level. When a federal audit showed that an individual's federal tax liability had to be adjusted, the Committee recommended the liability, refund, or credit be reflected on their state income taxes as well. A minimum corporate gross-income tax, i.e., before business credits, was suggested (2:Nov, p. 3; 3, p. 64).

1988 Governor's Blue Ribbon Tax Committee

In an effort to improve effectiveness and overall fairness of Idaho's income tax, the 1988 Governor's Blue Ribbon Committee suggested that following the federal code makes administration easier and more acceptable to the taxpayers. The Committee also suggested moving to adopt the federal personal exemption and dependency deduction amounts for the state. They recommended that individuals should make quarterly estimated tax payments to the state consistent with federal estimates (5, p. 7).

Another recommendation was that corporations should pay corporate income taxes on interest income from investments in local, state and municipal bonds (5, p. 7).

1993 Governor Andrus' Tax Package

The goals of Governor Andrus' 1993 tax package were tax equity, property tax reduction, and more state funds for local public services. It was proposed that the grocery sales tax credit on state income tax be doubled. Also, it was proposed that those individuals who pay estimated quarterly federal income taxes, also pay estimated quarterly state income taxes (6, pp. 3-4).

1994 Interim Tax Committee Bill (HB-856)

Subsequent to taking public testimony on the state's tax structure, the 1994 Interim Committee drafted House Bill 856 that would require the payment of estimated quarterly income taxes to those people required to do so by the federal government. It also reduce the grocery credit on state income taxes, and extends the income tax payment schedule (7, pp. 2&5).

II. Sales Tax Proposals

1978 Blue Ribbon Tax Committee

The 1978 Blue Ribbon Tax Committee endorsed the increased reliance on sale taxes for two reasons. First, the sales tax was found to be the least objectionable tax to Idahoans. Second, broadening the sales tax base would provide a more responsive form of tax revenue to the demands of growth since sales taxes are more directly linked to economic activity than either the income or property tax.

The Committee recommended using the sales tax more broadly by taxing services. Taxing goods while exempting services was seen as discriminatory, favoring the consumption of services. The Committee's argument was that as incomes rose, expenditures on services would tend to rise. Thus, taxing services would reduce the usual regressivity of the sales tax, i.e., low income people paying a larger percentage of their income on sales taxes than high income people. Also, the expanded base could lead to an overall lower tax rate (4, pp. 65-66).

Since there is a sales tax on food, the Committee recommended extending the grocery tax credit to low income consumers as a negative income tax payment. The lowest income individuals were precluded from receiving compensation for their payment of sales tax on food since no income tax was owed (4, p. ix).

1984 Interim Tax Committee

The 1984 Interim Tax Committee proposed that the sales tax base be broadened to include services and that the sales tax rate be reduced from 4.5% to 4.0%. The suggested services to include in the base were laundry and dry cleaning services; parking lots and garage services; professional services in computer and data processing; public relations services; bookkeeping; and repair services (8, pp. 24 & 25).

It was noted that there was a difference in the minimum length of residency for determining whether to charge people the local option "resort cities" sales tax. The committee recommended that hotel/motel room sales tax, resort cities tax, and travel and convention room tax all should have the same residency length requirement to determine when people are charged (8, p. 27).

The Committee recommended that further study was needed on the idea to shift from the current retail sales tax to a gross receipts tax concept. The Committee also suggested a study the sales tax exemptions and their rationale (8, pp. 24-25).

1986 Interim Tax Committee

To increase local revenues, the 1986 Interim Tax Committee proposed that Idaho cities have the authority to charge local option taxes. However, through a survey questionnaire, it was concluded that there was little support among local officials for either a local option sales or income tax. There was even less support for local option taxes if local officials also had to forgo state revenue sharing funds in order to gain local option taxing authority (9, p. 37).

The Committee recommended that counties and/or cities be allowed to levy either local option sales or income taxes with the requirement that such taxes be used only for specifically stated projects (1:Oct., p. 4).

1988 Interim Tax Committee

The 1988 Interim Tax Committee recognized the need to alleviate the constant requests for sales tax exemptions. This could be accomplished by clarification of the codes and laws by specifically defining a non-profit corporation. This would eliminate confusion about which groups or businesses are exempt from paying sales tax. For example the Committee's need for clarification arose in conjunction with their suggestion to eliminate the sales tax exemption for Boy Scout encampments. They recommended further study on possible taxation of catalog sales (3, p. 63).

The Committee also felt the need for a method of identifying persons entitled to production exemptions from the sales tax. Such a method, once agreed upon, would take the pressure off retailers who had to enforce the production exemptions and would help reduce litigation (2: Nov., p. 49).

1988 Blue Ribbon Tax Committee

Since the sales tax was easy to administer, responsive to changes in the economy, and grew with income, the 1988 Blue Ribbon Tax Committee recommended that the sale tax base be expanded by eliminating exemptions. The elimination of sales tax exemptions would reduce the opportunity for abuse while allowing a sales tax rate reduction. The committee felt that many of the exemptions represented indulgences to various special interest groups. The Committee recommended that exemptions be retained if and only if: 1) they were required by federal restriction, 2) their removal would clearly and directly impeded the competitiveness of Idaho businesses, or 3) their continuation was warranted on grounds of compelling social equity (10, pp. 3-4).

The Committee suggested that a sales tax on services would increase the sales tax base, improve fairness, and add stability to the state's tax structure. The Committee urged that services connected with sales be taxed beyond those being taxed, eg., hotel lodging, outfitters, and guides. Because this may cause a significant change on individual businesses and taxpayers, the committee recommended study, but with a set date in mind. They wanted to implement a tax on services by 1991 (10, p. 4).

1993 Governor's Tax Package

The Governor proposed in 1993 to extend the sales tax to most utility sales. A 5% sales tax would be charged on phone service and cable television service, on all services for installation, repair, remodeling, cleaning, altering, construction, etc. of tangible personal property. The Governor also proposed eliminating the production exemption for agricultural inputs. Thus, a 5% sales tax would be charged on agricultural equipment, as well as utility services such as electricity, natural gas, heating fuels, and water (excluding irrigation water) (6, pp. 3, 13, & 16).

1994 Interim Tax Committee Bill (HB-856)

The 1994 Interim Tax Committee proposed increasing the sales tax base to raise revenue to fund school maintenance and operation. The Committee recommended the repeal of the sales tax exemptions on broadcast and publication equipment; precious metal bullion; INEL research and development; and lottery tickets. The Committee also proposed taxing services and items such as construction labor; agricultural and industrial services; transportation; repair labor; education services; sewer services; and vending machine sales (7, pp. 4-5).

III. Property Tax Proposals

1978 Blue Ribbon Tax Committee

The 1978 Blue Ribbon Committee's proposals for changes in property tax related to the administration, use, and burden of the tax. Administratively, the Committee did not feel that taxpayers understood their property tax bills, nor were the tax bills effective. They endorsed the clarification of property tax notices that were sent to taxpayers. The Committee suggested that the annual notice of estimated property tax should be presented in easy to understand language showing the percent taxation to market value without reference to mills or assessment ratios (4, p. iv).

Concern was expressed about the increasing use of property taxes. To limit the use of property taxes, this Committee advocated that local governments itemize and publicly present the need for large expenditure increases. The Committee also acknowledged the problem of proliferating tax districts. They suggested that special districts be formed if and only if the needed services could not be provided through private contract. By providing equipment, overhead, and services by private contract or though existing tax districts whenever possible, the Committee suggested that administrative expenses could also be reduced. The Committee advised that the use of property taxes should be restricted to local government services that protect, preserve, and enhance private property, eg., police, fire, and highway services. The Committee suggested that property taxes were less appropriately used to support education, health, and welfare services (4, pp. iv-v).

A national study listed Idaho as last in the nation in uniformity of assessments between counties. The Committee viewed the property tax in Idaho as falling unfairly on the homeowner relative to commercial and agricultural property. They suggested that adjustments were needed to even out the tax burden between different types of property. First, to get uniform assessment throughout the state, the Committee recommended that real estate sales prices be reported and made available to local tax assessors. Second, the Committee proposed that exempt property be reviewed annually by an assessor and the approximate values of all exempt property be published annually by county. Third, they proposed to exempt the first $10,000 of fair market value of residential property from the tax. Forth, they suggested that the agricultural property be calculated on its market value in use, i.e., speculative land value exemption. Fifth, they proposed a single assessment date for all property such that new construction would be included and be prorated based on its status as of that date. This, the Committee reasoned, would eliminate existing property owners having to subsidize new property owners throughout the time of construction (4, pp. iv-vii, 78).

The Committee believed that by reducing the number of services funded by the property tax and increasing the base for the tax, then lowered property taxes would result.

1984 Interim Tax Committee

The 1984 Interim Tax Committee stated that there was probably more citizen interest in the property tax at that time than ever before. The Committee's initial assumptions were that the property tax had problems of administration, uses, and burden including exemptions (3, p. 162).

To address the problem of administration, the Committee recommended that all appraisers be certified and that real estate market data be made available to local taxing authorities (3, p. 163).

To address the problem of use, the Committee urged that property tax revenue not to be used to fund social programs, eg., education, health, welfare, and indigent care. They argued that these programs cannot legitimately be claimed to benefit the property being taxed. They also suggested that the motor vehicle licensing and driver licensing programs should not be funded from property taxes. The Committee recommended a study of whether the state should fund a greater portion of public school costs. They noted that the sales tax was intended to fund education. There was concern that it was being used for purposes other than those originally intended (8, pp. 23-24).

To address the problem of exemptions, the Committee recommended that all real property should share equally in the tax burden without discrimination against any class of property owner. Further study was advised to determine which present exemptions from the property tax should be reduced or abolished. Additionally, study was needed to see if properties exempted from property taxes should still pay for services rendered (3, pp. 163-164).

1986 Interim Tax Committee

After reviewing alternative methods to fund local services, the 1986 Interim Tax Committee decided on the use of the property tax. They also recognized that there were problems in the use of this tax source that needed correction. For example, the amount of override levies for school funding, suggested to the Committee that the State was not fulfilling it's responsibility to education. The Committee concluded that the State needed to increase its share of public education funding and reduce the share from property taxes (1: Aug., p. 5).

To address the problem of proliferating special taxing districts, the Committee recommended giving counties more statutory authority to provide the services that special districts were being asked to provide. The Committee recognized that special taxing districts initial exemption from the revenue constraining effects of a 5% growth cap on existing taxing districts was the incentive for creating special districts. The Committee stated their belief that the 5% budget limitation was more of a burden for counties and school districts than it is for cities and highway districts (1:Aug., pp. 6-7).

The Committee recommended that cities and counties charge exempt property a fee for services, eg., law enforcement, fire, and public safety programs. To ensure that local governments would have no problems receiving revenues, the Committee recommended that this regulatory fee was to be exempt from statutory levy limits (1:Sept., p. 12).

1988 Interim Tax Committee

The 1988 Interim Tax Committee reiterated the need to develop an inventory of exempt properties including those for fraternal, benevolent, or charitable corporations or societies. These properties receive local government services but are exempt from the property tax. To allow local governments to implement their own tax policy, the Committee advocated to repeal the 5% budget cap on local governments, and replace it with a "Truth-in-Taxation" concept. If the official of a taxing district intends to increase its budget by more than some percentage of the previous budget, then the Truth-in-Taxation process would require the officials to publish the amount of the increase and explain why the increase was needed (3, p. 157).

As an administrative improvement to the property tax, the Committee proposed that county treasurers provide a process to accept money

date for the property tax (2:Nov., p. 53).

1988 Blue Ribbon Tax Committee

The 1988 Blue Ribbon Tax Committee advised that real estate transactions be reported to the county assessor and the state tax commission. The rationale was that real estate sales information on fair market values help assure that the assessors' judgments of property valuation are accurate. The Committee recommended that the reports on real estate transactions should be mandatory and confidential (5, p. 5).

The Committee believed that if a majority of the electorate participate in the decision to create taxing districts then fewer would be created. The result would be a decrease in the proliferation of tax districts. To encourage local public participation, the Committee recommended that all elections be held in conjunction with regular elections or that specific dates be provided by statute for the conduct of local taxing district elections state wide. The Committee also recommended a sunset provision for special tax districts after which the district's existence would have to be reconfirmed by the voters (5, p. 6).

Property tax exemptions were cited by the Committee as working to the detriment of fair taxation. The Committee recommended that a complete examination of exemptions and with the burden of proof be placed on the supporters of the exemption. The Committee suggested that an inventory of exempt property be taken and published annually in each county (5, p. 6).

To help clarify the effects of increases in property taxes on the individual taxpayer, the Committee recommended that a publication should be required that would explains the current property tax budget, the effect of a tax increase on an individual taxpayer, the reason for the tax increase, and subject to public input (5, p. 5).

1993 Governor's Tax Package

The 1993 Governor's property tax proposals included; increasing the property tax exemption to $55,000 or 55% of market value for assessment; reducing maximum school maintenance and operation levies from 0.4% property tax to 0.28%; and for the state to fund a portion of indigent care costs to counties (6, pp. 7-8).

1994 Interim Tax Committee Bill (HB-856)

The 1994 Interim Tax Committee proposed several changes in an attempt to reduce the burden of the property tax on homeowners and to prevent the school districts from suffering a catastrophic decline in funds when property values are adjusted downward.

The Committee recommended that the homeowners exemption be raised from the lesser of $50,000 or 50% of improvements to the lesser of $60,000 or 60% of improvements, i.e., from 50/50 to 60/60 (7, p. 3).

The Committee also proposed to increase the state share of public school maintenance (M&O) and thereby reduce the portion funded by local property taxes. To limit local school districts ability to increase property taxes after the State has assumed responsibility for an increased portion of the M&O fund, the Committee recommended that school districts can only increase their M&O budgets by the lesser of 10% of a school district's budget for M&O in the current year, or 110% of the actual supplemental levy certified by the school district in 1993 (7, pp. 1-2).

Changes were proposed for personal property taxation. All transportable personal property would be exempt from the personal property tax, such as tractors, and trailers. The Bill would also exempt 37% of personal property tax from a variety of areas, such as mining machinery, logging machinery, construction and farm machinery (7, p. 3).

Since previous property-tax-funded services may be supported by a newly defined and reduced property tax base, some taxing districts may have to raise rates above their statutory levy limits to balance their budgets. To accommodate this, the Committee recommended that all statutory levy limits were to be removed for tax year 1994 only so that new maximum rate limits can be determined (7, p. 3).

IV. Other Tax Proposals

1978 Blue Ribbon Tax Committee

Tax administration changes encouraged by the 1978 Blue Ribbon Committee were 1) to expand to an odd number the board membership on the Tax Commission of the Department of Revenue and Taxation, 2) to empower the Commission to set policy, and 3) to enable the Commission to appoint its own administrative staff. The Committee also suggested that the Board of Tax Appeals have geographical representation and have their pay raised commensurate to their duties and the time involved (4, p. x).

1984 Interim Tax Committee

The 1984 Interim Tax Committee recommended 1) that cigarettes and tobacco products be taxed on the same basis, 2) that changes be made in the disposition of revenues collected from distilled spirits, i.e., beer and wine be made, and 3) that all liquor account revenue be paid into the state general account for regular appropriation (8, pp. 26-27).

To reduce lost revenues, the Committee also suggested a study on whether services performed by the Department of Agriculture could be self-supporting (3, p. 171).

To prevent duplication and help streamline the system, the Committee suggested that each of the standing tax committees of the Legislature sit jointly with their counterpart from the other house during a regular session, every other year, to examine all of the tax and fee schedules under which agencies collect money (8, p. 28).

This Committee reviewed intergovernmental relations, particularly the State's five primary revenue-sharing programs with local government. They concluded that the school revenue sharing formula was well-balanced and recommended no substantive change in the school distribution formula (3, p. 173).

The Committee concluded that the liquor revenue-sharing formula needed adjustment and recommended that the state-owned liquor stores be sold to private industry (3, p. 174).

1986 Interim Tax Committee

To compensate for a shortfall in the states general account appropriation for the circuit breaker program, the 1986 Interim Tax Committee proposed exempting any levy made to compensate for the shortfall. The Committee also recommended exempting the occupancy tax revenue from the annual 5% budget growth limit.

The Committee recommended flexibility regarding the proper division of responsibility between state and local governments for raising revenue without making specific recommendations. They suggested that both local and state governments be adaptable to changing needs, conditions, and political forces. They concluded that "it would be inappropriate for a committee to try to fix a distribution scheme what would be good for all time" (1:Oct., p. 60).

To save money, the Committee also recommended that counties be allowed to buy used equipment (1:Sept., p. 10).

1988 Interim Tax Committee

To eliminate discrimination in workers-compensation rates, the 1988 Interim Tax Committee encouraged the study of workers-compensation insurance requirements for trucking and logging industries (3, p. 157).

1993 Governor's Tax Package

The Governor proposed making the circuit-breaker tax relief program available to low-income homeowners in addition to those over 65 years old (6, p. 3).

To eliminate an unfair advantage, the Governor also proposed that the state insurance fund pay an insurance-premium tax (6, p. 4).

Summary and Conclusions

This was a review of Executive and Legislative Tax Study Committee proposals from 1978 to 1994. The proposal related to the income, sale, property, and other tax categories. What can we learn from the type and frequency of proposals made over this sixteen year period?

Income Taxes

There are two reoccurring proposals in the income tax category. One is that the State income tax structure converge, in one-way or another, with the Federal structure ('78 Exe.; '84 Leg.; '88 Leg.; '88 Exe.). The other, and like the first, is that the State collect estimated income tax payment quarterly ('84 Leg.; '88 Exe.; '93 Exe.; '94 Leg.).

Grocery tax credits, on the other hand, is a study in contrasts. Two Executive Committees suggested increasing the grocery tax credit ('78 Exe. & '93 Exe.) while a Legislative Committee suggested reducing credit ('94 Leg.).

Sales Taxes

There is one over-riding theme in the sale tax category. The Tax study committees have consistently proposed expanding the sales tax base ('78 Exe.; '84 Exe.; '88 Exe.; '88 Leg.; '93 Exe.;

'94 Leg.). A lesser theme regarding sales taxes has been proposals that call into question some aspect of the agricultural production exemption ('88 Leg.; '93 Exe.; '94 Leg.).

Property Taxes

The top two issues that were most often mentioned by the Committees relative to property taxes were limiting its use and tax exempt property. Regarding limiting the use of the property tax, the general opinion of the various Committees suggests moving one or more of the school, health, and welfare services off the local property tax and onto the general fund of the State ('78 Exe.; '84 Leg.; '86 Leg.; '93 Exe.; '94 Leg.). The status of tax-exempt property concern was the focus of attention in four of the Committees ('84 Exe.; '86 Leg.; '88 Leg.; '88 Exe.). These issues perhaps reflect views over which there is chronic concern. And yet there was not a generally acceptable resolution for these issues by the Legislature and the Governor.

The second tier of property tax recommendations, based on reoccurrence in these Committee deliberations, were 1) property tax bill clarification ('78 Exe., '88 Leg., '88 Exe.), 2) property appraisal ('78 Exe., '84 Leg., '88 Exe.), and 3) residential property exemptions ('78 Exe., '93 Exe., 94 Leg.). These issues are less often mentioned in the tax committee recommendations perhaps because acceptable policies were found and acted on expeditiously.

Other Taxes Proposals

There was not a strong pattern of "other" tax issues across the seven sets of recommendations. Several issues do reoccur however. These issues are administrative efficiency ('78 Exe., '84 Leg.), intergovernmental revenue sharing ('84 Leg., '86 Leg.), and the circuit breaker ('86 Leg., '93 Exe.).

Conclusions

The Executive and Legislative Committees considered reduction in property tax burden and increased use of sales taxes in each report, which suggest this idea is particularly important. From 1978 to 1992 property tax as a percent of total revenue collected decreased from 37% to 31%, while sales tax's share of total revenue increased from 19% to 25%[1].

It is interesting to note how often the Executive and Legislative Committees felt the need to repeat previous Committees' suggestions. For instance, the 1978 Governor's Blue Ribbon Committee recommended that the use of property taxes be restricted to functions related to the care, preservation and enhancement of private property ('78 Exe.; '93 Exe.). This excluded specifically education, health, and welfare burden. This same problem was reiterated by the Legislative Interim Committees through intervening years ('84 Leg.; '86 Leg.; '94 Leg.).

Another example of the agreement between the Legislative and the Executive, the 1984 and 1988 Legislative Interim Tax Committee suggested paying estimated quarterly income taxes. ('84 Leg.; '94 Leg.). This recommendation was stated again in the 1988 Governor's Blue Ribbon Committee report and again in the proposed 1993 Governor's tax package. These examples suggest that, even

---

[1] Idaho Department of Revenues and Taxation, State Tax Commission, Monthly Matters, Aug 1993.

though from different political parties, the Executive and Legislative Committees often reach the same general recommendations for tax reform. The difficulty of passing legislation, upon which both branches of government from both parties, in general, agree, must lie in disagreement over the details. This illustrates why the devil lives in the details.

References

1. Committee on Local Government Revenues, 1986. Monthly Matters. Aug, Sep, Oct. Committee Minutes, Idaho Legislative Council, Boise, ID.
2. Committee on State Tax Structure, 1988. Monthly Matters. Oct. & Nov., Committee Minutes. Idaho Legislative Council, Boise, ID.
3. Committee on Taxation, 1993. Monthly Matters. Summary of Reports; Taxation Committees, May: 156-194.
4. Governor's Committee on Taxation, 1978. (Blue Ribbon Tax Committee) "Idaho Taxes: Comparative Analysis, Evaluation and Recommendations". Division of Financial Management, State of Idaho, Boise, ID.
5. Governor's Committee on Taxation, 1988. (Blue Ribbon Tax Committee) "Idaho's System of Taxation: Effectiveness and Fairness". Division of Financial Management, State of Idaho, Boise, ID.
6. Governor's Tax Policy Package, 1993. Office of the Governor, State of Idaho. Boise, ID.

7. House Bill 856 (HB-856), 1994. "Highlights." Idaho Legislative Council, Boise, ID.

8. Legislative Tax Committee, 1984. "A Study of the State's Tax Structure". Summary of Report, Idaho Legislative Services, Boise, ID.

9. Legislative Tax Committee, 1986. "Local Government Revenues". Summary of Report, Idaho Legislative Services, Boise, ID.

10. Legislative Tax Committee, 1988. "A Study of the State's Tax Structure." Summary of Report, Idaho Legislative Services, Boise, ID.

Report of the Governor's Committee on Taxation

Idaho Taxes

Comparative Analysis, Evaluation and Recommendations

Delivered To Governor John V. Evans September 1978

FINAL RECOMMENDATIONS FROM BLUE RIBBON COMMITTEE ON TAXATION

THE SYSTEM IS BASICALLY SOUND

The Governor's Blue Ribbon Committee on Taxation has concluded that a variety of changes in the structure and administration of the state's system of taxation would make it more equitable and understandable. This is particularly true of the property tax.

A tax system should not only generate revenue for the operation of government, it should also collect such revenue as economically and fairly as possible. Making the tax system equitable as well as practical and efficient poses difficult and complicated problems. The Committee recognizes this basic complexity and the difficulties posed in implementing the Governor's charge. Nonetheless, there is much room for improvement in Idaho's present tax structure. The Committee believes that adoption or implementation of its recommendations would contribute to the equity, understandability and practicality of the system.

Governors, legislators and tax commissioners have devoted considerable time and attention to the tax system throughout the history of the state. The work of this Committee represents a major indepth examination of the system. Idaho has generally been a leader among the states in recognizing and attempting to correct problems. The Committee's work indicates that both major and minor reforms of the tax structure may be needed, even though Idaho's tax structure is rated by experts as one of the best in the country and its ranking has been improving. Despite concentrating on problem areas in this report, the Committee has concluded the basic system of taxation in the state is sound.

THE PROPERTY TAX: IT CAN BE DONE MORE SIMPLY AND EQUITABLY

What was once the basic tax providing revenue for government services has become a complicated and inequitable source of funding for increased governmental functions. The property tax was created when property was essentially the only private form of wealth. As a result, a tax on property was an equitable tax. Since that time, investments have become greatly diversified. Many forms of wealth now escape taxation in whole or in part while wealth in the form of property continues to be responsible for a major portion of government revenues. In 1977, 846 taxing districts collected property taxes for purposes ranging from fire protection to mosquito abatement. The property tax has been additionally complicated by inflation, which has caused values of property to increase faster and at different rates; by growth, which has created new pressures to change the use of property; and, by court decisions which have changed the long-standing practice by which taxable values have been calculated. These pressures on the property tax system have created new problems and amplified old ones, such as:

- Should agricultural property on the edge of a city be valued according to its use as a farm or its market price as subdivision property?

- Should property taxes be used only for property-related services or should they be used for the new as well as old, unrelated functions of local governments?

- Should different classes of properties which are valued by different techniques be subject to different tax rates?

- Should inflation, growth, and different appraisal methods be permitted to result in a distortion of the distribution of the property tax burden as between different classes of property.

- Should the appraisal and assessment process be consolidated and automated to reduce inefficiency and time lag?

These are among the pressures and problems examined by the Tax Committee.

Simplicity - In his charge to the Committee, the Governor expressed his concern about the complexity of the existing structure of the property tax. "Democracy", he said, "works only when citizens can make informed judgements on public affairs. Today, there is no excuse for a tax system so complex that those judgements are not possible. Every citizen pays taxes. Every citizen has a right to be able to understand his taxes."

The Committee concluded that in many cases citizens fail to receive basic information about their property taxes. The information is often difficult to understand.

In most counties, property taxpayers do not receive a tax notice for mortgaged property. The Committee recommends that tax notices be sent to taxpayers as well as lending institutions.

Assessment notices stated in terms of mills, assessment ratios, and assessed values are confusing. The Committee recommends references to mills and assessment ratios not appear on assessment notices and that such notices project the estimated tax and the percent of taxation to the market value. In a recent survey, 78% of the people supported changes of this sort. Much of the complexity of the property tax system stems from the ever-growing number of exemptions from the tax. After a tax exemption has been granted, the property exempted is often ignored or forgotten. The Committee recommends that exempt property be reviewed by the assessor annually and an inventory with approximate values of all exempt property by category and by county be published annually.

The budget process followed by local governments makes public input difficult and permits poor fiscal practices despite the best intentions and efforts of local government officials. The process requires the 846 taxing districts to independently prepare budgets which are then published in local papers and examined in public hearings. The information that each provides in budget publications and hearings is often unfathomable. Budgets are designed to conform with standard accounting practices rather than to reveal the functions and activities of the taxing entity. The Committee recommends that budgets be presented on a program basis, corresponding with the functions of the taxing district, and that proposed non-personnel expenditures in excess of $10,000 be itemized. It further recommends that revenue generated in excess of that budgeted by a taxing district be allocated toward the next year's budget.

To cope with the large and growing number of taxing districts, the Committee recommends that special services be provided by private contract or with existing special districts, counties, or cities. In virtually every Idaho county thousands of dollars could be saved each year in administration, equipment, supplies, data processing and building overhead by contracting for services. No new special districts should be formed without first proving the services could not be provided by contract.

Equity - Of the considerable amount of material the Committee examined during its existence, two items are particularly illustrative of major problems in the administration and impact of the property tax. The first is the rapidly changing distribution of the tax burden between different types of property. In 1965 residential property constituted 18% of all taxable property in the state. By 1977 it had grown to 41%. In large part, residential property assumed the burden previously born by the utilities, whose share of the total over the same time period slipped from 27% to 14%. The percentage of the property tax burden on agricultural property fell from 30% to 20%. The share represented by commercial and industrial property has changed only slightly. This shift to residential property is primarily due to a 1967 Supreme Court decision in which the court ruled the long-standing practice of using different assessment ratios for different classes of property was unconstitutional since it failed to treat all classes uniformly. The Committee believes a number of other sources of differential treatment still exist, causing the burden of the property tax to fall unfairly on the shoulders of the state's homeowners.

The second item of information illustrates the great differences that exist in the quality of appraisals and assessments. Idaho ranks last in the nation in the uniformity of assessments within counties. The liklihood that neighboring pieces of property are valued comparably is less in Idaho than in any other state in the nation. There are many reasons why this is so. Idaho's counties in general are among the smallest in population in the country. It is difficult for counties so small to provide special training for their assessors and to provide needed materials and equipment. In addition, valuing property is often more difficult in Idaho than elsewhere. We have very diverse categories of property throughout the state and often within a single county. Our population and industry has been growing rapidly and many values have soared. Property use has been subject to sudden and radical change causing increased difficulties in achieving equitable assessment.

The Committee has concluded that the many inequities in the property tax are magnified by the heavy reliance placed on the tax. There are over 100 governmental functions for which property taxes can be assessed, many of which have only a remote connection to property. The Committee believes that as a general rule, the use of property tax revenue should be restricted to governmental functions related to the care, preservation, and enhancement of property. Such functions would include police, fire protection, highway services, capital improvements, property records, etc., but would exclude such governmental functions as operating budgets for education, welfare and health. The Committee believes that if the use of the property tax were so restricted, there would be little, if any justification for the many exemptions that now exist. The Committee concludes that the reduction of functions funded by property taxes, coupled with a broadened base, would result in property taxes sufficiently low in amount as to be acceptable to taxpayers and fair in relation to the services received.

In the absence of a major change, such as proposed above, the Committee concluded there are several things that should be done to improve the existing inequities in the property tax. The property tax is a complicated system with many small judgements and decisions leading up to a final determination of the tax. Although not all-inclusive, such decisions include: 1) determining a category in which to place a piece of property for appraisal, 2) the method by which its value should be determined, and 3) the frequency with which it should be revalued. Because of the great differences that exist between different types of property - for instance a utility power plant and a three bedroom home - it is not possible to value all pieces of property by the same scale or in the same manner. Some properties have an easily ascertainable market value because there are willing buyers and sellers. Other properties do not have what would be a comparable market value because there is no realistic chance that the ownership will ever change hands. It is important to recognize that the methods used for valuing property and determining taxes can not be identical for all types of property. At the same time, it is important to understand that the use of different methods may lead to different results.

ith this in mind and in the absence of changes such as those recorded earlier, the ommittee makes the following recommendations: 1) at least $10,000 of market value hould be exempted from the property tax for each living unit contingent upon valuaion of the property at full market value (the amount of that exemption should be djusted annually for inflation); 2) the state should enact a law which would allow axes for certain properties to be based on their actual use provided that additional axes for prior years be collected if property use is changed. This recommendation ould help resolve the problem of the farmer living on the edge of a city. As long s the property remained agricultural, it would be valued as a farm. However, should t change use and the owner realize the profits resulting therefrom, additional taxes or prior years would be collected. The same system could be used for residential roperty bordering commercial areas. With this change, the taxes resulting from he increased value would be deferred until such increased value is realized.

hile the Committee recognizes that different methods of determining value may be ustified, it calls attention to the differences that do exist. In general, value s established by the following methods:

utility (operating) property - a three-factor formula using <u>original</u> cost, capitalized income, and stocks and indebtedness. The value so arrived is then allocated to the state and ultimately to the counties in, at least in part, an arbitrary manner

commercial property - capitalized rental income

industrial property - replacement cost less a 30 to 40% depreciation allowance

agricultural property - capitalized average income over the last five years

residential property - sales of comparable property

ecause of the differences in types of property and the information available about ach, these differences in methods of valuation may be unfavorable. However, the ommittee calls attention to the fact that only residential property is valued according to the price it would bring on the market. Where possible, other property should e valued by this same means. Recognizing the impossibility of totally implementing uniform system of appraisal, however, the Committee has earlier recommended methods, uch as residential property exemptions, that would mitigate the inequities that urrently exist because of the use of different appraisal methods. Although property ay be treated differently at various stages in the taxation process, in the final esult, the exposure of the property to taxation, relative to its market value, should e the same for all types of property.

nother barrier that exists in bringing about equity relates to new property coming n the tax rolls. In a state growing as fast as Idaho, a significant amount of ew construction occurs each year. In general, this property is not subject to axation until the January 1st following its completion. As a result, existing roperty subsidizes new property. On the other hand, moving away from a single ssessment date such as January 1, complicates the assessor's work. The Committee ecommends there be a single assessment date for all property in the state and hat new property either be added to the rolls in the year it is completed and taxed on pro-rated basis for the remaining portion of that year or that a fee be assessed based on the percentage of the year such improvement was in existence. By House Bill 272, the Legislature funded a study of the widely varying assessment practices and in the 1978 session funded the first of a five-year implementation of the study's recommendations. The project calls for the development of a uniform parcel numbering system, the creation of a system to annually update property values, the creation of a uniform system of computer assisted appraisal and record keeping, stronger administration in field operations, and other changes. This represents one of the most important steps taken toward achieving equal treatment of Idaho taxpayers.

As a further aid to the assessment process, the Committee recommends legislation be enacted requiring that sales prices of real estate transactions, including contract sales be reported. The assessor is currently denied information regarding the price at which property sells. Idaho is one of only a few states that does not collect this basic information. Without it comparative sales studies are either impossible or incorrect.

A distortion in the equitable imposition of the property tax has resulted from state payments to local government to replace the revenues they were collecting from inventories when the tax on inventories, livestock, and timber was repealed. These state dollars go back to counties, cities, schools and special districts, with no relationship to population, need, local ability to pay or on what the tax would have produced if levied today. For instance, Clark County has .1 percent of the state's population but receives five times that percent of the Inventory Tax phaseout money. On the other hand, Madison County has 2 percent of the population but gets only half that share of the Inventory Tax phaseout money. In Blaine County. a levy of five mills would generate the same amount of money they get through the Inventory Tax phaseout. But in Clearwater County the levy would have to be 35 mills. Overall, the ten counties receiving the most Inventory replacement were able to reduce levies by 27%; the 10 receiving the least reduced their levies by ten percent. Twenty percent of Sales Tax receipts are used to replace the revenue loss from the exemption of inventories, livestock and timbers. One point seven percent of all Sales Tax revenues come from Blaine County, but the county receives only one pecent of the Inventory phaseout funds. Conversely, Custer County provides only .2% of all state Sales Tax revenues but receives 1.1% of Inventory phaseout funds.

THE SALES TAX

Virtually all services are currently exempt from Sales Tax, including such things as utility charges, rentals, dues, repairs, dry cleaning, barbers, bank service charges, parking charges, storage, pest control, advertising, professional services, bookkeeping, and commissions. The Sales Tax in most states is a tax on commodities rather than on services. This came about because of the seeming simplicity of taxing the retail sales of tangible personal property. In 1971, 20 of the 46 Sales Tax states taxed some services. Only six, however, had a broad service base. Neighboring Washington is one of those. Based on information presented by Dr. Ghazanfar of the University of Idaho, the Committee concluded that taxing services presents a number of advantages. Dr. Ghazanfar outlines them like this:

> "Discrimination reduced: The underlying philosophy of a sales tax is that it should cover as broad a base of consumer expenditures as possible, with exemptions only when specifically justified (e.g. exemption of medical services as a matter of social policy). Hence, the tax should apply to services as well as commodities, for services satisfy economic wants no

less than goods. There is no inherent feature of most services that precludes their inclusion. Taxing goods and exempting services is discriminatory.

Economic neutrality promoted: If the tax covers only commodities (or, as in the more usual case, commodities and only a few services), then the production and consumption of non-taxed services is encouraged because these services would be relatively cheaper than they would be if taxed. Thus, the policy of exempting services results in featuring an unneutral effect inasmuch as there is interference with the market mechanism of pricing, and as a result, distortion of allocation of resources in favor of services. A comprehensive base which covers services would be more consistent with the goal of economic neutrality.

Administration and compliance simplified: A number of services are rendered in conjunction with the sale of tangible personal property. Compliance and administration will be much simpler in these cases if the entire charge is taxable than if a separation between service and commodity is necessary; this is especially true for repair services.

Tax revenue gains: The argument here is quite obvious. Under a given legal rate, the tax revenue will be larger with a broader sales tax base than with a narrower commodities-oriented base.

Sales regressivity mitigated: Since expenditures on services tend to rise as incomes rise, taxation of services will tend to reduce the regressivity of the tax.

Responsiveness (income elasticity) of the tax improved: The argument here is that, as total personal income rises, total expenditures on services tend to rise faster than expenditures on commodities. Thus, if services are part of the base, the responsiveness (income elasticity) of the tax revenue will increase in relation to economic activity."

Although Dr. Ghazanfar mentions only that increased revenue could be generated by expanding the base, it would also be possible to lower the tax rate. If all services were taxed (excluding professional services and real property repairs) the Sales Tax could be reduced from 3 cents to 2.4 cents and still produce the same amount of money. If utilities and business-to-business services were left out of the base, the tax could be dropped to 2.8 cents without a reduction of revenue.

The Committee's interest in examining changes to the Sales Tax base is to make it more equitable. Although the Sales Tax is the least objectionable tax to Idahoans, its burden is distributed so that lower income people pay higher proportions of their income in Sales Taxes than do upper income people.

TAXING GROCERIES

The Committee also examined the effect of the removal of the Sales Tax on groceries. Of the 47 states currently using a sales tax, 23 exempt groceries. Washington exempted groceries by initiative this year. Another six states, including Idaho, offer a food credit against State Income Taxes.

Although people pay a Sales Tax on groceries, they receive a credit of $15 per person on their Income Tax. The credit is doubled for people over 65. The credit is intended to reduce the regressivity of the Sales Tax. However, it has a flaw. People with incomes so low they do not owe $15 in income taxes do not receive the full advantage of the credit. In this case, the credit is not serving some of the people for whom it was designed.

Revenue from the Sales Tax on groceries amounted to $19 million in fiscal year 1977. To replace this amount of money, the Sales Tax would have to be raised from 3% cents to 3.55 percent. The grocery credit program cost the state $12 million in the same year. If the grocery credit were eliminated at the same time that groceries were exempted, the reduction in revenue would be $7 million. In this case, the loss could be recovered by raising the Sales Tax to 3.2 percent or as previously noted, could be replaced by imposing the tax on certain selected services.

However, it should be noted that the removal of the Sales Tax from groceries presents administrative problems. First, there is the problem of defining what is and what is not food. Once defined by law, there is still the problem of enforcement. Grocery store checkers each make individual decisions regarding what is taxable. As a result, additional auditing is usually required to bring the practices of grocery stores into conformance with the law. If the Legislature continues the practice of offering a grocery tax credit in lieu of exempting groceries completely, then the credit system should be changed so that all people paying the Sales Tax on groceries are eligible for the full amount of the credit.

THE INDIVIDUAL INCOME TAX:

More than 70% of the income subject to taxation in Idaho is taxed at the highest rate or percentage imposed by law. This is the result of the minimum or low number of brackets and of the recent rapid escalation of wages and income.

The top bracket in the state begins when taxable income reaches $10,000 on a joint return and $5,000 for persons filing single returns. With the levying of the top tax rate at that low level, the "progressivity" of the Idaho individual Income Tax has been eroded. Although the spending power of people in the state has not increased greatly in recent years, the amount of their dollar income has increased by large amounts. The effect has been to lump most taxpayers into the same tax bracket, resulting in the middle and higher income taxpayers paying at the same rates. The Income Tax brackets have not been changed since the early 1930's.

Similarly, deductions and exemptions have not been adjusted.

The tax rate is progressive to about $10,000. The Committee recommends the adoption of more tax brackets and a greater difference in the rate applied to low, medium and upper income levels.

The appendix to this report contains several Income Tax tables, showing the effect of various changes in brackets and percentages of tax.

CORPORATE INCOME:

Audits of Corporate Income Taxes are hampered by a number of factors. Salaries for Senior Auditors at the Tax Commission are substantially below those of surrounding states and private industry. Because of this, it is difficult to keep experienced Auditors. Although corporate audits produce increases in tax revenues, financing of audit programs has been inadequate. About 12,000 corporations file Income Tax returns in Idaho. Twelve to fifteen corporations receive on-site audits each year. Another 700 are audited at the Tax Commission. The additional tax received from the audits averages $550,000 per auditor per year. The Committee recommends that Auditors of corporate returns should be compensated at a level commensurate with their experience and ability in order to retain competent people.

Only a small fraction of corporations have their tax returns audited each year, even though the average field audit produces $65,000 in additional income tax collected. The Committee recommends that some of the money collected as a result of these corporate audits should be earmarked to pay the costs of the audits so that the number of firms audited could be increased.

The Committee recommends that if a business operates in more than one state, even if some of its operations are conducted through subsidiaries, it should file its tax return as a single company and split its taxes between the states in which it operates. Otherwise companies can and do shift the reporting of taxable income to states with low taxes.

The Committee recommends that the Corporate Annual License Fee should be merged with the Corporate Income Tax. By this means, collection would be simpler and enforcement easier for both the fee and tax.

ADMINISTRATIVE CHANGES:

Management of the Department of Revenue and Taxation is presently vested in four people - the Tax Commissioners - who are jointly responsible for its day-to-day operations although they have designated separate areas to be the primary reponsibility of individual commissioners. The Committee believes administration would be improved by making the Commission an odd-numbered Board empowered to set policy and to appoint its administrative staff.

With reference to the Board of Tax Appeals, the Committee recommends:

1. The Board be expanded with proper geographical representation;
2. A quorum of the members from a general area of the state be present at hearings of appeals arising from that part of the state;
3. The pay for Board members be raised so it is commensurate with their duties and time involved; and
4. The Board should be provided with adequate staff to render assistance in meeting technical problems.

SS/lw
September 12, 1978

TAX STRUCTURE
SUMMARY OF REPORT
1984

The Tax Structure Committee was authorized by House Concurrent Resolution No. 33 "to conduct a study of the State's tax structure in all of its aspects".

Following the first meeting of the committee, it was apparent that the scope of the study resolution was almost overpowering, and that it would take an almost intolerable amount of time on the part of the members of the committee. Accordingly, the co-chairmen approached the Legislative Council and received permission to create five subcommittees, with a specific subject area for more detailed attention. The five subcommittees created were: Subcommittee on Property Taxes, Subcommittee on Sales Taxes, Subcommittee on Income Taxes, Subcommittee on Miscellaneous Taxes and User Fees, and Subcommittee on Intergovernmental Relations.

These subcommittees met fifteen different times during the course of the study efforts, and listened to hundreds of persons, received hundreds of pages of testimony, and considered hundreds of pages of research memoranda.

Each of the subcommittees prepared and submitted a report and recommendations. The Tax Structure Committee then met to receive the reports, coordinate the various recommendations, and adopt the final recommendations of the full committee. The final report contained findings, comments, suggestions and recommendations which had been through a rather extensive sifting and evaluation process.

The committee recommended:

1. Continued use of the property tax as a main support of local government, a decreased emphasis on the property tax in some instances.

2. The property tax remain as the primary source for the payment of voter-approved general obligation bond issues, and that each person offering to vote in a general obligation bond election be a registered voter of the county (or city) in which the election is held.

3. a. That the state fund a portion of the indigent care program.
   b. That the state fund a portion of the criminal justice system.
   c. That further study be made as to whether the state should fund a greater portion of public school costs.

4. All real property should have the same tax exposure in terms of its market value and all real property should share equally in the tax burden. All classes of real property must

be taxed uniformly and any discrimination against any class of property owner should not be allowed.

5. Several changes in the manner in which the property tax system is administered. These changes include:

a. A requirement that all appraisers in the county assessors' offices, and the members of the state board of tax appeals, be certified appraisers. By law, the appraiser certification process is encouraged, but not mandatory. By rule of the state tax commission, the appraiser certification process is mandatory for employees of a county assessor in order to continue employment.

b. A requirement that market data be made available to the taxing authorities.

c. A requirement that the motor vehicle licensing functions in the county assessor's office, and the driver licensing functions in the sheriff's office, be separately identified and funded from sources other than the property tax.

6. A comprehensive study be made:

a. To determine the feasibility of establishing a fee system to pay for services provided, or a payment-in-lieu of taxes program, for those properties exempted from property taxes.

b. To determine if all income producing property, including the income producing property of religious or charitable organizations, should be subject to property taxes.

c. To determine which of the present exemptions from property tax should be reduced or abolished.

d. To determine the feasibility of applying a gross receipts tax to utilities, which would be in place of an ad valorem tax on utilities.

e. To study why cities, counties, and taxing districts are exempt from sales taxes, and do not have to use the same cost accounting as the private sector in competitive bidding.

7. The rate of the sales tax be dropped from its four and one-half percent to four percent at the earliest opportunity.

8. That paragraph (k) and paragraph (r) of Section 63-3622, Idaho Code, be repealed outright, whether or not any other recommendations are acted on.

9. The exemption allowed for certain activities at the Idaho National Engineering Laboratory be repealed.

10. The exemption allowed on pollution control equipment be repealed.

11. The following types of sales, which are primarily sales of services, be made subject to the sales and use tax:

i. Laundry and dry cleaning services.
ii. Barber shop and beauty parlor services.
iii. Parking lots and garage parking.
iv. Charges for storage, other than that of goods held for resale or as materials to be used in production.
v. Professional services in the following categories:
Computer and data processing services;
Engineering, architectural, and surveying services;
and Management consulting and public relations services.
vi. Bookkeeping, collection, janitorial and similar services.
vii. Repair services provided on tangible personal property, such as:
Automobile repairs;
Car washes;
Electrical and electronic repairs;
Reupholstery and furniture repair;
Other miscellaneous repairs.

12. If the sales and use tax is applied to the services enumerated above, that the rate of the tax be carefully examined and reduced, if possible.

13. The primary sales tax exemption statute, Section 63-3622, Idaho Code, be "recodified", so that each of the several distinct exemptions is contained within a separate, stand-alone section of the Code.

14. That additional study be made of moving from the current retail sales tax concept to that of a gross receipts tax concept, such as is in place in the state of New Mexico.

15. That additional study be made of a proposal that would apply the sales and use tax at time of purchase to practically all sales at retail, but with the taxes paid on those transactions now exempt to be refunded, upon application.

16. The Idaho income tax law continue to closely follow the Internal Revenue Code.

17. The Idaho income tax liability of persons with out of state income be computed on the basis of total income, and Idaho's tax be prorated.

18. No change be made in the writ of mandate law.

19. Further study be made of whether the state should require quarterly payment of estimated income taxes, both individual and corporate.

20. The possibility of adopting the concept of calculating the investment tax credit as a percent of the federal investment tax credit be investigated.

21. The possibility of establishing a minimum alternative tax be investigated.

22. Additional attention be given to the definition of domicile of a taxpayer.

23. The study of tax matters be continued through the following interim.

24. A review of the jobs credit provision to determine if the provision is accomplishing what was intended.

25. Further study be made on the question of funding the state police function from the general account.

26. The committee was able to examine the motor fuels tax, the motor vehicle registration fees, operators and chauffeur's license fees, and other highway user revenues only cursorily. No recommendations for change on any of these items was made except that Section 49-158, Idaho Code, should be amended slightly to take out the requirement for a reduction in ad valorem tax charges when a county collects an administrative fee for a motor vehicle registration.

27. Relating to the tax on cigarettes and tobacco products;

a. The tax on cigarettes is expressed as a price per unit, i.e., 9.1 cents per package of twenty cigarettes; the tax on tobacco is expressed as a function of the value of the product, i.e., thirty-five percent of the wholesale sales price. By this measurement, the tax on tobacco products is higher on a per unit basis than cigarettes. The committee recommends that this "spread" between the taxes on these two kinds of products be narrowed, either by reducing the rate on tobacco products, or by increasing the rate on cigarettes.

b. The cigarette retail license requirement be repealed.

c. The license tax on cigarette vending machines be repealed.

d. The annual license tax for cigarette wholesalers be fixed at not less than one hundred dollars.

e. There is no requirement for a tobacco products retailer to be licensed. The committee recommended that this practice be continued.

f. A minor adjustment be made in two laws, the cigarette tax law and the tobacco products tax law, so that a tobacco products wholesaler is included in a cigarette wholesaler's license, but without any additional license fee for the tobacco products part.

28. No change in the rate of tax applied to distilled spirits, beer or wine, even though there are great differences

in the rates of these taxes when calculated on the absolute ethyl alcohol content of each. However, certain significant changes in the disposition of the revenues collected from these products was recommended:

a. All of the automatic transfers from the liquor account to non-general accounts on the state level be stopped, and that all of the liquor account revenue, except that dedicated for distribution to counties and cities, be paid into the general account for regular appropriation.

b. The same recommendation was made for the same treatment for revenues derived from the tax on beer and wine.

29. The state has allowed two kinds of local option taxes--the hotel/motel room sales tax for auditorium districts and the resort cities tax--and has imposed an additional tax, the travel and convention room tax for promotion of the tourist industry. When used, each is in addition to the regular state sales tax. Even though the wisdom of these separate and disparately applied taxes can be questioned, the committee made no recommendation as to application, rates or effect, except the length of residency in a motel/hotel room, and a campground site, be made the same in all of these laws for tax purposes; the auditorium district law, the travel and convention law and the state's sales tax law, should each be amended to contain the same requirement for length of residency for payment of the tax; and all publicly owned campgrounds should be made subject to the travel and convention tax.

30. An alternate source of funding into the water pollution account be implemented, since the inheritance tax, which has been one of the primary sources for this account, is rapidly diminishing.

31. Further study on:

i. Whether the promotional activities for certain agricultural commodities continue to be treated in the same manner as at present.

ii. Whether the licensing, inspection and regulatory functions performed by the department of agriculture be self-supported, to the extent possible, from the fees assessed against the regulated activity.

iii. Whether the license and inspection schedule of fees maintained by the department of agriculture should be tested to see if necessary, equitable, or sufficient to cover the cost of regulating the function.

iv. Whether the great number of small, dedicated accounts maintained by the department of agriculture should be continued, should be placed into the general account, or should be combined into a single account for the use of the department.

32. Additional study of the unemployment compensation taxes.

33. Additional study of the kilowatt hour tax.

34. That each of the standing committees, sitting jointly with its counterpart from the other house, deliberately set aside a block of time during a regular session and examine all of the tax and fee schedules under which the agencies collect money, and that this process be repeated every other year.

35. No substantive changes in the school distribution formula.

36. The state owned liquor stores be sold to private industry.

37. No change be made in the formula for distributing liquor revenues to counties and cities at the present time. The formula was substantially changed in 1982.

38. The automatic transfer (i.e., not appropriated annually) from the sales tax account for social security payments for school district personnel be stopped, and that this sales tax revenue be allowed to flow into the general account for appropriation.

LOCAL GOVERNMENT REVENUES
SUMMARY OF REPORT

The Legislative Council Committee on Local Government Revenues was created by Senate Concurrent Resolution No. 124 by the Second Regular Session of the Forty-eighth Idaho Legislature. SCR 124 directed the Legislative Council to establish a committee to undertake and complete a study of the "proper division of responsibility between state and local governments for raising revenue".

The Committee held meetings on August 1, September 10, and October 27, 1986.

Drawing on the experience of the last few legislative sessions, in which various proposals to change, add to, or abandon the several state laws which allow state collected revenues to be shared with local units of government, the co-chairman directed the staff to pose a series of questions to officials of local governments. The results were presented at the August 1, meeting; a summary of these results is on file in the Council office.

From the replies received, the Committee concluded that there is little support among local officials for either a local option sales tax, or a local option income tax, this reluctance to use local option taxes is even more pronounced if the units would have to give up state shared revenues in order to get local option taxing authority.

Several other observations can be made. One of these is that the "50/50" homeowner's exemption is a very popular exemption, even among the officials who have to struggle with budgets impacted by a loss of tax base from this exemption. Another is that the five percent budget limitation is viewed as a far more onerous burden for countys and school districts, than it is for cities and highway districts. And lastly, we were pleasantly surprised that the highway distribution formula is so well received.

The Committee met twice to consider suggested legislation. One of these meetings was a joint meeting with the County/City Mandates Committee; this meeting was necessary to avoid duplicating recommendations between the two committees, since the resolutions authorizing the studies really touched on the same subject--funding for local government programs.

The Committee concluded that it cannot really make a finite determination of the "proper division of responsibility between state and local governments for raising revenue". We think that is an arena of government in which changing needs, changing conditions, and changing political forces are such that the greatest flexibility is highly desirable. Our present structure grew out of this flexibility. There is no need to limit that flexibility.

RECOMMENDATIONS

The Committee recommends six pieces of legislation to the Forty-ninth Legislature.

Three of these proposed bills deal with fees for law enforcement, fire and public safety programs.

Two of these proposed bills deal with the limits on local governments' budgets; one would exempt any levy made to compensate for a shortfall in the state's general account appropriation for the circuit breaker program, and the other would exempt the occupancy taxes from the budget limitations.

The last proposed bill is a local option tax bill, which would authorize countys and/or cities to levy and imposed local sales taxes or local income taxes, but with a requirement that such taxes be used for a specific project.

To: Governor Cecil D. Andrus - 1988

From: Tax Study Committee

Aware of the changes which have occurred in the economy of Idaho and of the United States since 1965, the date of the last major change in our tax structure, and aware of the fact that our state must have a tax system adequate not only for the present but also into the next century, you formed a committee composed of persons familiar with the Idaho Tax Structure, many of whom had a part in the development and growth of that system, with Representative Antone and Senator Parry as observers and liaison to the Legislative Committees, a task which they performed admirably (providing most helpful insight to the committee), to report to you on the effectiveness and overall fairness of Idaho's system of taxation.

We, the members of that committee, are pleased to report to you and, in doing so, have, in general, approved our overall system with comments directed toward changes which, in our opinion, would be beneficial to the system and the people of Idaho:

CHARACTERISTICS OF AN EFFECTIVE SYSTEM

An effective system should be equitable, it should treat people in the same circumstances equally; if circumstances are not the same, treatment should be related to the degree of difference. Such a system should also have economic efficiency; it should not provoke change in the operation of a business simply to accommodate the tax system. The system should be easy to understand and administer and compliance should be inexpensive. Finally, taxpayers should be able to plan their affairs with relative certainty of their tax obligations.

We must also draw attention to the interaction between the federal tax system and local taxes. An increase in state income or property tax will be reflected in an increased deduction and a decrease in federal tax for corporations and individuals who itemize their deductions. An increase in a credit against Idaho income tax will reduce that tax deduction for federal purposes and therefore increase the federal income tax for corporations and individuals who itemize their deductions. Essentially, part of the burden of any such tax increase is borne by the Federal Government and part of the benefit of any Idaho Income Tax Credit is shared by the Federal Government.

IDAHO'S RECENT FISCAL HISTORY

The "modern era" of Idaho tax policy began in 1965 with adoption of the sales tax. The new tax quickly became the third leg of the "three-legged stool" upon which Idaho public finance rests. Adoption of the sales tax was accompanied by reduction in personal and corporation income tax rates, phase-out of inventory taxes, and the beginning of a long decline in primary reliance on the relative importance of property taxes as the principal source of government revenue. Work by the Division of Financial Management chronicles the changes showing that property taxes, which in 1965 accounted for nearly 70% of all government revenue from these sources, currently accounts for a little more than a third. The sales tax has taken up the lion's share of the slack. Currently, it accounts for something like one-third of the revenues generated by these sources.

There is evidence that the tax structure which came into being in the middle 1960s provided ample revenues for the state's needs for several years. During the 1970s state revenues usually met or exceeded the legislature's spending goals. By the early 1980s, a variety of changes in world and national economies eroded Idaho's traditional economic base causing a change from a production to a service economy.

We do believe that a combination of factors, including legislative inclination to respond to requests for exemptions from the various taxes, has produced inequities, particularly in the sales tax, which should be remedied.

BACKGROUND

We have reached conclusions and make specific recommendations. The recommendations which we have made vary in their intensity. Some of these are matters that, in our opinion, should, in fairness, be remedied immediately and, in the different tax areas, these appear first, at the top of the list. We believe that other matters have considerable merit but, lacking the time for intense study, we recommend that legislative and executive attention and study be directed toward the indicated areas.

Each of the recommendations made by this Committee and contained in this report have economic impact as they deal with taxation. The implementation of some are a cost; the implementation of others would increase revenue. In the aggregate, a significant increase in revenue would result if these changes were implemented. At its initial meeting, this Committee determined that it would go forward with its recommendation only if the result was to reduce tax rates. We have not set out to increase or enhance revenue and would not support the implementation of these proposals if they were utilized for that purpose and not for rate reduction.

THE SALES TAX

In theory, a Sales Tax is a tax that is relatively easy to administer. Taxpayer liability is easy to understand and predict. A broad based sales tax possesses elements of equity, a larger portion of the tax is paid by those more able to pay. A tax so structured is also responsive to changes in the overall economy and grows with income.

Idaho's Sales Tax is not the broad-based consumption tax that is so appealing in theory.

Against this background with your mandate of fairness in mind, we turn to specific recommendations:

1. **ELIMINATION OF EXEMPTIONS.** The Committee has found that the number and scope of sales tax exemptions has grown alarmingly over the nearly quarter century since initial implementation of Idaho's sales and use tax. The attached table presents an updated set of revenue impact estimates associated with the various sales tax exemptions, and displays both the variety and the magnitude of the current exemptions.

Some of the sales tax exemptions serve a proper purpose and are defensible on grounds of keeping Idaho businesses competitive or honoring restrictions imposed on the state by federal statutes or the Constitution. However, many of the exemptions seem to simply provide special favors to various special interest groups.

If one applies reasonable and systematic tests of fairness and consistency to the range of exemptions now contained in the Idaho Code, it leads to the conclusion that there should be a substantial reduction in the number of exemptions. If pursued in earnest, this course of action would:

a) provide the "level playing field" that is often cited as a fundamental goal of tax policy,

b) improve the simplicity and ease of administration of the sales tax,

c) reduce the opportunity for abuse of the sales tax through improper use of exemptions, and

d) allow for overall sales tax rate reduction, thereby reducing the potential impact of the sales tax on consumption and location decisions.

Since it is the belief of this committee that taxes should be broad based with the lowest rates possible, we recommend that immediate steps be taken to reduce the number of exemptions granted in the Idaho sales and use tax. As a guiding principal, we suggest that exemptions be retained only in instances where:

a) they are required by federal restriction,

b) their removal would clearly and directly impede the competitiveness of Idaho business, or

c) their retention is warranted on grounds of compelling social equity.

It is our belief that such an effort could, when combined with our other recommendation on the sales tax regarding services, lead to a return to the original rate of 3 percent or less. At that level the sales tax becomes less regressive, and is far less likely to distort business or consumer buying decisions.

2. **SERVICES INTIMATELY CONNECTED WITH SALES.** The Committee recommends taxation of services intimately connected with taxable sales, such as delivery, installation and repair services.

3. **EXTENSION OF TAX TO OTHER SERVICES.** The committee finds that the traditional distinction made between transactions involving goods and transactions involving services is not defensible on economic or administrative grounds. Services have grown from 38% of GNP in 1960 to 51% in 1987 and will continue to increase. Idaho (and many other states) now tax selected services such as hotel lodging and outfitters and guides. Idaho should immediately begin the process of expanding the sales tax base to include most service transactions. This will serve to improve the Idaho tax structure in a number of ways: fairness will be enhanced; the predictability of the tax system will be improved; and the stability of the tax structure will be enhanced and the rates could be reduced.

   Because of the significant impact such a change could have on individual businesses and taxpayers, careful consideration must be given to proper implementation strategies. We recommend that further study directed toward actual implementation of this specific proposal begin as soon as possible, with a goal of comprehensive legislative action by 1991. Certain elements of the sales tax on services, notably installation and repair services performed on tangible personal property, are relatively uncomplicated and should be implemented immediately. Special attention must be given to devising a structure that does not put Idaho businesses at a competitive disadvantage, and that minimizes the incentive for businesses or individuals to alter their actual or financial operations for the purpose of tax avoidance. It is our hope that the sales tax base-broadening attained through a combination of exemption elimination and extension to services will be accompanied by significant rate reduction, thereby further minimizing the impact of the sales tax on transactional and locational decisions.

4. **CHANGES IN THE ACCRUAL METHOD FOR REPORTING.** Noting the occasional inequity resulting from use of the accrual method in reporting sales, the tax has to be paid even though goods are sold on credit or contract, a recommendation for change to a cash basis was proposed and considered. The committee concluded that this was a dramatic change (apparently unique in this country) but that it was an equitable issue that was worthy of study and decided to recommend that the state study the possibility of such a change.

THE PROPERTY TAX

The property tax has been a part of our system since time immemorial. It is a local tax, presumably controlled by those who most benefit from its incidence.

With the increase of revenue from other sources, the property tax contribution has declined from 68.5% of state and local revenue in 1965, to 36.2% of this revenue in 1986 (as demonstrated by the graph attached hereto).

The relative ease by which new taxing districts can be created and the inconvenience and lack of interest generated by a multitude of local elections lead to confusion on the part of the public.

Property tax exemptions work to the detriment of those to whom the cost of government is assigned based on the value of their property.

National studies using the "Representative tax system" indicate that Idaho has additional ad valorem tax capacity if all property is assessed at actual fair market value. With other state tax categories already near capacity and the deficit driven lack of federal funds, it is obvious to the committee that property taxes will continue to play an important role in financing local government for years to come.

To foster greater public awareness and hopefully some appreciation for the necessity of the property tax, the committee makes recommendations which, in its opinion, will provide taxpayers with a greater understanding of the processes that determine the need for taxes, give the taxpayer confidence that taxpayers have access to that process and allow the taxpayer to appreciate and, if he sees fit, comment upon the potential size of his tax bill or, at least, be content with the knowledge that the tax dollars assessed are necessary for local government needs.

Against this background, we make these recommendations:

1. **TRANSACTION DISCLOSURE.** Real property sales data must be reported to the County Assessor and the State Tax Commission on a mandatory, confidential basis to assist in the valuation process and assure the validity of the assessment process.

2. **TRUTH IN TAXATION.** Current ad valorem limitations have become increasingly confusing for taxpayers and public officials and should be scrapped in favor of a mandatory, standardized ad valorem budget publication format separate from any other budget format or requirements and current statutory levy limitations should be retained.

    a. Currently, no two ad valorem budget publications are alike. Few provide the public with easily understandable information that can be used to determine the meaning of proposed budgets and the amount of individual tax increase an individual will be required to shoulder if the proposed budget is adopted.

b. A publication should be required that would demonstrate the current ad valorem budget, the effect of any tax increase on an individual taxpayer and the reason for the tax increase.

c. There must be a clear procedure for public hearing on a proposed ad valorem budget, one in which the public has the opportunity for input and in which the budget as proposed or as amended is adopted prior to adjournment of the public hearing.

3. **CONSOLIDATION OF ELECTIONS.** Few things contribute more to the confusion and irritation of the taxpayer than the number of local elections held each year for purposes ranging from increasing local M&O budgets to creating more local taxing districts. With modern technology in place in most County offices there is no longer any excuse for the number and frequency of local, taxing district elections. The committee recommends that Idaho either require that all elections be held in conjunction with regular elections or that specific dates be provided by statute for the conduct of local taxing district elections state wide. The attention that creation of new taxing districts would attract at an election in which a majority of electors participate might contribute a great deal to slowing the proliferation of new taxing districts.

4. **SUNSET PROVISION.** Creation of a taxing district in general serves a useful purpose. However, many districts once created outlive their utility to the taxpayers whose action created them. A sunset provision that would insure additional consideration of the utility of the district after a fixed period of time should be a part of the creation of any new taxing district.

5. **INVENTORY OF EXEMPT PROPERTY.** Currently, there is no information available from which interested persons can determine the extent to which property tax exemptions impact upon non-exempt taxpayers. A county by county inventory of exempt property should be prepared and published by each county annually. Funds for the initial inventory should be provided by the state and conducted pursuant to rules promulgated by the State Tax Commission. Enacting legislation should define specific types of exempt property to be included in the inventory and provide enforcement authority.

6. **ELIMINATION OF EXEMPTIONS.** Currently, billions of dollars of otherwise assessable property values are exempted by statute and local decision. Seldom, if ever, are the decisions granting property exemptions revisited. The committee recommends that all property exemptions except the authority given county commissioners to exempt taxes due for reasons of hardship be carefully examined and studied by the Legislature to determine if the exemption is still justified.

STUDY RECOMMENDATION

7. INSTALLMENT PAYMENTS. The committee considered a suggestion that property tax be paid in four (4) installments with an appropriate interest charge. The committee concluded that this was a recommendation worthy of study.

INCOME TAX

Measured by any standard, our income tax meets the criteria espoused in our introduction. It is the fifth most progressive tax in the nation. Since it follows the federal, administration is relatively easy and taxpayer understanding is, in general, present at least insofar as understanding of our complex federal system can ever be stated to be present. The rates from bottom to top are not confiscatory, do not impact to a degree which would affect business decisions and have, to a very substantial degree, been predictable.

Against this background, the Committee recommends:

1. **ESTIMATED TAXES FOR INDIVIDUALS.** After noting that corporations and wage earners paid their taxes in advance, the committee recommends that the requirement for payment of estimated taxes be extended to individuals.

2. **IMPOSING A TAX ON STATE AND LOCAL INTEREST INCOME EARNED BY CORPORATIONS.** After noting the problems created by the current state of the law exempting federal interest income from taxation as a result of the discrimination generated by exempting certain state and local interest income, it was recommended that the tax on corporations should be amended to delete the current exemption of interest income from local, state and municipal bonds.

3. **MOVING TO THE FEDERAL EXEMPTION.** Noting the problems in administration and tax return preparation caused by deviation from the federal exemptions, the Committee recommended moving immediately to the federal personal exemption and dependency deductions (currently $1,950 as opposed to $1,900 in our law).

   fn) In view of the political identity that the Investment Tax Credit (ITC) has assumed, the Committee has not analyzed it in depth but, based on the information avalilable, does recommend that:

   1) The ITC be studied by the legislature to determine;

   a) the number of business entities utilizing the ITC;

b) Benefits, jobs and revenue realized from the ITC;

c) Investment decisions affected by the ITC

2) Action then be taken based on these facts.

3) The effect of such action be revenue neutral.

CONCLUSION

Our tax system has been praised, advisedly, by those whose business is to look at state tax systems with a critical eye. They have found effective balance in the distribution of revenues from the three major sources, income, sales and property tax, and we believe that this approximate balance is desireable and should continue. The balance that we have in our system leads to effective predictability which, in our opinion, will be enhanced if the recommended changes, including areas in which we counsel study, are adopted. Idaho has been the subject of some criticism in the area of fairness because of the exclusions from operation of our sales tax. We believe that any criticism will be ameliorated if the recommendations that we have placed before you are adopted and the base of that tax broadened.

Measured by the standards which we enunciated in the beginning of this report, our tax system may be found wanting in areas of equality, largely due to the narrow base on which the sales tax is imposed. We do believe that we have economic efficiency, that, with certain exceptions, our rate structures in all three systems are not so burdensome that they lead rather than follow business decisions; and that some of the recommendations which we have made can make our tax system easier to understand and administer and one upon which taxpayers may rely for certainty now and into the next century.

TAXATION OF SERVICES[1]

ESTIMATED REVENUE IMPACT BY CATEGORY
5% Rate, FY90 $'s, Gross Collections

,ERVICE CATEGORY	REVENUE IMPACT	
Industrial Services[2]	$ 497,000	
Transportation Services[3]	$ 9,785,000	
Communications[3]	$ 15,684,000	
Construction	$ 22,757,000	
Landscape & Horticultural Services	$ 980,000	
Repairs[2,4]	$ 11,787,000	
Professional Services	$ 32,050,000	
Legal		$ 9,179,000
Accounting		$ 5,104,000
Finance, Insurance, Real Estate		$ 10,865,000
Engineering & Architectural		$ 6,902,000
Business Services	$ 12,249,000	
Personal Services	$ 6,269,000	
Health & Medical Services	$ 67,712,000	
Social Services	$ 3,462,000	
Educational Services[5]	$ 318,000	
Miscellaneous Services[6]	$ 2,774,000	
Total, All Services[1]	$ 186,324,000	

[1] This list covers only those services that are not presently covered by the sales tax. It does not include services (such as hotel lodging, theater admissions, hunting guides, etc.) that are already subject to Idaho's sales tax.

[2] Calculated on the basis that services performed on production exempt goods or equipment are also exempt if the service performed is essential to or a part of the production process.

[3] Sales tax is applied only to intrastate transactions.

[4] Adds the labor component; repair materials are already taxed.

[5] Excludes public and private elementary, secondary, and higher education.

[6] This category consists mostly of sewer and trash services provided by local units of government.

Estimates prepared jointly by the Idaho Division of Financial Management and the Idaho Department of Revenue and Taxation. Printed December 19, 1988.

SALES TAX EXEMPTIONS

ESTIMATED REVENUE IMPACTS BY CATEGORY
5% Rate, FY90 $'s, Gross Collections

EXEMPTION	CODE SECTION	REVENUE IMPACT
Specific Entities		
Certain Nonprofit Organizations	63-3622O.	$ 6,621,000
State & Local Government[1]	N/A	$ 8,057,000
Boy Scout Encampments[2]	63-3622Y.	$ 0
INEL	63-3622BB.	$ 1,000,000
4H/FFA	63-3622K(b)(5).	$ 23,000
Indian Tribes[3]	63-3622Z.	not estimated
Exported Goods		
Out-of-state Contracts	63-3622B.	$ 79,000
Motor Vehicles for use outside Idaho[4]	63-3622R(a).	$ 6,257,000
Out-of-state Shipments	63-3622P,Q.	not estimated
Business Purchases		
Production	63-3622D,R(b),W.	$ 322,490,000
Materials & Supplies[5]		$ 299,525,000
Equipment		$ 22,964,000
Railroad Remanufacturing		
Rolling Stock	63-3622CC.	$ 647,000
Equipment, Parts and Supplies	63-3622DD.	$ 914,000
Publication Equipment	63-3622T.	$ 192,000
Broadcast Equipment	63-3622S.	$ 562,000
Aircraft	63-3622GG.	$ 148,000
Containers		
Nonreturnable Containers[6]	63-3622E(a).	not estimated
Containers for Exempt Products[6]	63-3622E(b).	not estimated
Returnable Containers	63-3622E(c).	$ 12,000
Liquor for Resale[6]	63-3622M.	not estimated
Specific Products		
Motor Fuels	63-3622C.	$ 27,300,000
Utility Sales & Heating Materials	63-3622F,G.	$ 27,003,000
Pollution Control Equipment	63-3622X.	$ 1,253,000
Prescriptions	63-3622N.	$ 6,734,000
Official Documents	63-3622AA.	$ 35,000
Funeral Services	63-3622U.	$ 365,000
Used Manufactured Homes[7]	63-3622R(c).	not estimated
Religious Literature	63-3622I.	$ 28,000
Church Meals	63-3622J.	$ 5,000
Bullion	63-3622V.	$ 500,000
Federal Restrictions		
Constitutionally Prohibited[8]	63-3622A.	not estimated
Statutorily Prohibited[9]	N/A	not estimated
School Lunches and Senior Meals	63-3622J.	$ 696,000
WIC/Food Stamps	63-3622EE,FF.	$ 2,501,000
Miscellaneous Transactions		
Trade-in Value	63-3613(b)(2).	$ 13,300,000
Motor Vehicles Between Relatives	63-3622K(c).	$ 714,000
Sale of Business	63-3622K(b)(1-3).	$ 587,000
Occasional Sales	63-3622K(b)(4).	not estimated
Yard Sales	63-3622H.	$ 932,000
Vending Machine Sales[10]	63-3613(e).	$ 900,000
Transactions Under 12¢	63-3622L.	not estimated

Estimates prepared jointly by the Idaho Division of Financial Management and the Idaho Department of Revenue and Taxation. Printed on December 1[illegible]. [illegible]. Footnotes on next page.

[1] Purchases by state & local government are not specifically identified as exempt in the Code, but have traditionally been treated as such based on an Executive directive at the time of original implementation.

[2] The zero revenue impact is due to an absence of planned Boy Scout encampments at Farragut State Park in FY90. Encampments in subsequent years could lead to a non-zero impact.

[3] This impact figure is only based on estimates of sales by Indian tribes to non-Indians. If this exemption were removed, sales to Indian tribal members would remain exempt.

[4] This exemption applies only in the case of vehicle sales to non-residents who take delivery in Idaho then immediately remove the vehicle from this state. If this exemption were removed it is believed that much of the revenue impact would likely remain because Idaho dealers would arrange to make delivery in cases of sales to non-residents to points outside of Idaho, thereby qualifying for exemption as an out-of-state shipment.

[5] The materials and supplies componant of the production exemption includes both raw materials and componant parts as well as supplies used in the production process. If the production exemption is eliminated raw materials and componant parts would still be exempt under the resale exemption (63-3609). Only supplies and equipment would become taxable. No breakout is available regarding materials vs. supplies.

[6] This exemption is entirely redundant. If removed, the resale exemption (63-3609) would still apply.

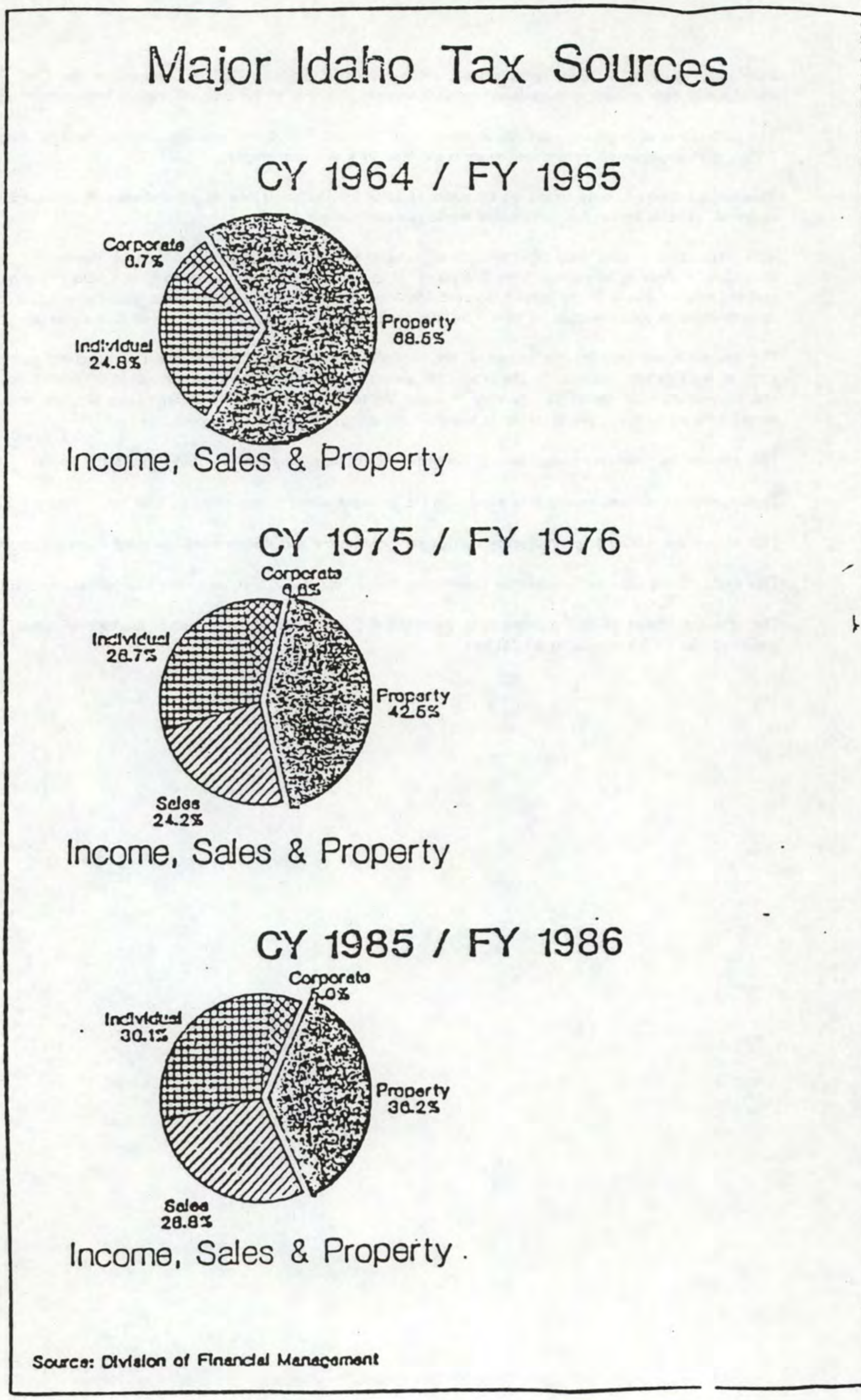
[7] This exemption is conceptually consistent with the practice of not taxing sales of used real property.

[8] This exemption relates to purchases by the federal government and transactions involving interstate commerce.

[9] This exemption relates to purchase by federal land banks, the Red Cross, and state and federal credit unions.

[10] The revenue impact of this exemption is based on the difference between actual markups of vending machine goods vs. the 17% assumed in 63-3613(e).

Figure 1


Major Idaho Tax Sources
CY 1964 / FY 1965
Corporate
6.7%
Property
68.5%
Individual
24.8%
Income, Sales & Property
CY 1975 / FY 1976
Corporate
6.6%
Individual
26.7%
Property
42.5%
Sales
24.2%
Income, Sales & Property
CY 1985 / FY 1986
Corporate
5.0%
Individual
30.1%
Property
36.2%
Sales
28.8%
Income, Sales & Property
Source: Division of Financial Management

TAXATION MATTERS

Summary of Report

Senate Concurrent Resolution No. 144 directed "a study of the State's tax structure" be conducted. We are pleased to submit this report in fulfillment of that directive.

The Committee on Taxation Matters met only twice, on May 19 and again on October 21, 1988. Following the May 19th meeting, the Co-chairman applied for, and the Legislative Council granted, a request to form subcommittees. Four of these subcommittees were formed, and met for a total of eight times during the interim. The bulk of this report is condensed from the various subcommittees' reports and recommendations to the Committee on Taxation Matters.

Sales Tax Matters

The Committee on Taxation Matters recommends an in-depth study on the issue of taxing catalog sales.

The Committee on Taxation Matters recommends repeal of the sales tax exemption for Boy Scout encampments.

The Committee on Taxation Matters recommends that the definition of nonprofit corporations be redefined in order to eliminate confusion about which groups or businesses are exempt from paying sales tax.

The Committee on Taxation Matters reached a consensus that a method for identification of persons entitled to the production exemption from sales tax should be pursued.

Taxing Districts and Dedicated Tax Matters

The Committee on Taxation Matters recommends that the Senate Commerce and Labor Committee pursue further the concerns expressed about requirements of workers compensation insurance for the trucking and logging industries.

Income Tax Matters

The Committee on Taxation Matters recommends that a credit adjustment be allowed when a federal audit has shown a difference in either a tax liability or a tax refund.

The Committee on Taxation Matters recommends that more tax legislation (not revenue-raising measures) be introduced in the Senate.

The Committee on Taxation Matters recommends that the issue of an alternative minimum tax be recommended to the germane committee of the Legislature for review.

The Committee on Taxation Matters recommends that state's personal exemption amount conform to the federal personal exemption amount.

Ad Valorem Tax Matters

The Committee on Taxation Matters recommends the introduction of a prepared draft (RS 21907) from the County Assessors Association to eliminate obsolete references in current statutes and to clarify the process for perfecting an appeal of appraisals.

The Committee on Taxation Matters recommends the introduction of a prepared draft (RS 21923C1) from the County Treasurers Association to delete duplicative material from existing statutes, to provide a shorter time period during which the treasurer's books are closed for audit, and to allow a process for treasurer's to accept moneys from taxpayers when offered, irrespective of due date.

The Committee on Taxation Matters recommends consideration of a prepared draft (RS 21900) which would start the process of developing an inventory of exempt properties.

The Committee on Taxation Matters recommends that a germane committee of the Legislature consider legislation to repeal the five percent budget cap, and replace it with a "truth in taxation" concept.

The Committee wishes to express its thanks and appreciation to the many people who assisted in the study.

1993 Governor's Tax Policy Package
Outline

1. Tax Relief - $64.6 Million

A. Grocery Credit - Double Present Amount, Extend To Lowest Income Idahoans - $17 Million

B. Homeowners' Exemption - Increase From 50/50 To 55/55 - $10 Million

C. Circuit Breaker - Extend To Homeowners Below 65 Years Of Age - $4.4 Million

D. School M&O Levies - Reduce Maximum Levy From .4 Percent To .28 Percent - $29.9 Million

E. Indigent Funds - Provide Appropriation To Counties To Offset Property Tax Levies - $3.3 Million

2. Spending Needs - $65.1 Million

A. State Unavoidable & Critical Needs - Pay For Growth And Mandate Driven Public Services - $55.7 Million

B. Cities & Counties - Revenue Sharing From Sales Tax Base Broadening, For Services And/Or Tax Relief - $9.4 Million

3. Tax Revenues From Base Broadening - $126.3 Million

A. Insurance Premium Tax - Extend To For-Profit Hospital & Professional Service Corporations And Idaho State Insurance Fund - $5.4 Million

B. Sales Tax On Services - Extend To Communications, Delivery, Installation, Repairs - $54.5 Million

C. Sales Tax Exemptions - Repeal Exemptions For Equipment Used In Production; Sales Of Electricity, Natural Gas, Water (Except For Irrigation), And Heating Materials - $66.4 Million

4. Individual Quarterly Estimated Payments - $50 Million ONE-TIME

A. Budget Reserve Fund - Replace Money Borrowed To Pay Bills In FY 1992 And FY 1993 - $14.5 Million

B. Permanent Building Fund - Meet Building Project Needs In FY 1994 and FY 1995 - $35.5 Million

1993 Governor's Tax Policy Package
w/o indigent fund
Overview

Tax relief, funding essential public services, and leveling the tax playing field are the cornerstones of the 1993 Governor's Tax Policy Package. A total of $126.3 million in new revenue is obtained primarily through sales tax base broadening, with $61.3 million going directly to property tax relief, and doubling the grocery tax credit. $55.7 million is used to fund essential state services — mostly education. $9.4 million is provided to Idaho cities and counties through the revenue sharing program.

An additional $50 million in FY 1994 one-time revenue is obtained from implementing quarterly payments for individuals. This cash-flow acceleration is used to replace monies previously removed from the budget reserve fund, to balance revenue and spending needs in FY 1993 and to provide funding for permanent building fund construction projects in FY 1994 and 1995.

Tax Relief

Property taxpayers will receive $47.6 million in tax reductions. Over two-thirds ($33.2 million) is spread over all property taxpayers through a 30% reduction in the public school levy limit and $3.09 per person ($3.3 million) to be used for indigent fund relief.

Just under one-third ($14.4 million) is targeted at homeowners in general through a 10% increase in the homeowners' exemption, and low-income homeowners in particular through extending the circuit breaker program to homeowners under 65 years old.

The grocery credit is doubled and extended to the very lowest income Idahoans at a cost of $17.0 million. The new amount of $30 ($60 for seniors) is the first change in the amount of grocery credit since 1978.

Spending Needs

Only $2 million is available from base revenue growth after unavoidable expenditure needs are met. An additional $55.7 million is needed to meet critical state spending requirements. Eighty five percent of this additional revenue is spent directly on education programs.

One-half of the base revenue growth is spent on $34.5 million in unavoidable enhancement expenditures. School enrollment increases, inmate population increases, and Medicaid and AFDC caseload growth account for almost 90% of the total FY 1994 unavoidable enhancements. These expenses "crowd out" the critical, but not unavoidable, expenditure needs such as counselors in elementary schools, reform programs, and a modest teacher salary increase.

Revenue Sources

Additional revenues are obtained exclusively through base broadening. The sales tax base is broadened through a combination of exemption repeal and extension to services. Exemptions slated for elimination are the equipment component of the production exemption and utility sales. These repealed exemptions fund property tax and grocery tax relief.

Services that are slated to be taxed are primarily those that can generally be described as closely related to tangible property — installation, delivery, and repair. These services are presently exempt to varying degrees. The proposed changes eliminate a number of arbitrary distinctions, and make the full price of transactions associated with or performed on tangible property taxable. Communications services are also brought under the sales tax.

The insurance premium tax is extended to a) the State Insurance Fund, and b) Hospital and Professional Service Corporations that are for-profit. These changes provide $5.4 million in revenue and a more level playing field in the areas of workers' compensation insurance and health insurance.

1993 Governor's Tax Policy Package
Policy Goals

Equity improvements and property tax reduction are primary policy goals of the 1993 Governor's Tax Policy Package. A three point property tax relief program, doubling of the grocery tax credit, and quarterly estimated income tax payments are central features of the package and offer significant equity enhancements to Idaho's tax structure.

Low income Idahoans under 65 years of age will for the first time become eligible for the grocery tax credit and the circuit breaker program. The circuit breaker was just doubled to a maximum of $800 this year, and the current proposal includes a doubling of the grocery credit, its' first adjustment in 14 years. Together, these two programs will make a tremendous difference for the neediest of our citizens.

Middle income Idahoans are not left out of this tax reform package. The doubling of the grocery credit will apply to all Idahoans regardless of their income or age. This means that those under 65 years old will go from either $0 or $15 to $30, while seniors over 65 years old will go from $30 to $60. The homeowners' exemption will be increased by an across the board 10% without any shift to other taxpayers, giving the typical Idaho homeowner a 7% reduction in property taxes. And the property tax levy limit for public school operations will be cut by 30%, thereby reducing the <u>overall</u> property tax load by a further 7 percent.

Non-residential property taxpayers are not ignored by this package, with several major features directed specifically at them. First and foremost is the 30% reduction in the public school levy limit. Just as for homeowners, this will result in <u>overall</u> property tax burden reductions of 6% on average in urban areas and 8% on average in rural areas of Idaho. Secondly, and just as important, the proposed increase in the homeowner's exemption will not be shifted to any other property taxpayer, but will instead be paid from General Fund revenue sources, i.e., sales tax base broadening.

Sales tax base broadening will reverse several decades of sales tax base erosion. While over the past 30 years we have shifted from a predominantly goods consuming to a predominantly service consuming economy, the *Idaho Code* has been stuffed with exemption upon exemption upon exemption — to the point where the list is well on its second trip through the alphabet.

Under the changes proposed for the sales tax, producers will lose the equipment portion of their sales tax exemption, but much of that equipment will still qualify for the investment tax credit. Utility and heating material sales will no longer be exempt, thereby promoting conservation of energy and water. Communications services will become taxable, bringing Idaho into the company of 43 other states that currently apply the sales tax to all or some communications services. Services closely connected with tangible property (delivery, installation, and repairs) will become taxable, thereby making many transactions that are presently partially taxable (material) and partially exempt (labor) fully taxable. All of these changes may cause an expression of shock from those who think they will be affected. But a careful look at the probable impacts and effects of these proposals should reveal that many of these proposed newly taxable goods and services are already taxable in a great many other states. They will not make

Idaho uncompetitive, they will not shut down any industry, and they will not bring about the end of civilization as we know it.

The insurance premium tax is the fourth largest individual revenue source for the General Fund, producing about 2.9% of annual General Fund revenues. Just ten years ago it produced 3.8% of General Fund revenues. Two entities (the "Blues" and the State Insurance Fund) have captured increasing shares of their respective markets for health insurance and workers' compensation insurance. These two entities also share another common feature - they are exempt from the insurance premium tax. Besides being behind a major erosion of the fourth largest Idaho General Fund revenue source, these exemptions put the state of Idaho in the position of tilting the marketplace in favor of these entities over others trying to compete for the same business. Market concentration and monopoly power are not often in the public interest, and if warranted must be carefully regulated. The proposed changes will move toward a level playing field where competitive forces, not selective government largesse, determine who will provide these insurance services. Competition, after all, is the most effective means of holding down costs.

Quarterly estimated payments will put individuals who receive substantial investment or business income on payment terms more similar to wage-earners, i.e. they will pay taxes as their income is earned rather than several months after the close of the tax year. This will be a substantial equity improvement. Quarterly payments involves absolutely no increase in anyone's tax liability, and, because of state income tax deductibility for purposes of the federal income tax, the federal treasury will actually absorb about one-half of the $50 million payment acceleration.

1993 Governor's Tax Policy Package
Individual Taxpayer Impacts

The impacts of this tax policy package on individual taxpayers will vary depending on individual circumstances, but several general examples can be illustrative. For homeowners, the increase in sales tax will usually be more than offset by the combined grocery tax credit and property tax reductions. Low income homeowners under 65 years old will probably receive the greatest net property tax benefit. Seniors, larger families, and very low income families will get the most net benefit from the grocery credit.

The "typical" Idaho family of four, with the median Idaho household income of $29,600, living in a house worth $55,000 (on land worth $20,000) with a property tax rate of the state residential average of 1.8% would save $35 per year in overall taxes under this package.

A family of six with income of $30,000 living in a house worth $55,000 (on land worth $20,000) with a property tax levy of 1.8% would save $55 per year.

A family of three with income of $12,000 living in a house worth $30,000 (on land worth $10,000) with a property tax levy of 1.8% would save $374 per year.

A senior couple with income of $25,000 living in a house worth $80,000 (on land worth $25,000) with a property tax levy of 1.5% would save $66 per year.

All of these examples assume that utilities, home and auto repairs, and freight expenditures of these households are at the average level found in the U.S. Department of Labor *Consumer Expenditure Survey*.

1993 Governor's Tax Policy Package
Circuit Breaker

This proposal extends the property tax circuit breaker program to low income Idahoans who are currently ineligible due to their age. Presently, only homeowners over age 65 or who are blind, widowed, or who are disabled may qualify for the circuit breaker program. No change is made to the maximum assistance amount ($800) or to the household income limits that presently apply to the circuit breaker program.

This change will cost $4.4 million and provide an average estimated benefit of $340 to 13,000 low income Idahoans. It is funded by elimination of sales tax exemptions.

With this change, Idaho will join at least 12 other states that provide circuit breaker type programs to <u>all</u> homeowners without regard to age, disability status, or other non-income related criteria.

1993 Governor's Tax Policy Package
Homeowners' Exemption

This proposal increases the homeowners' exemption from a maximum of 50 percent or $50,000 (50/50) to 55 percent or $55,000 (55/55). This yields a 10% increase in the value of the homeowners' exemption for every current and future recipient. (An estimated 250,000 households are eligible for Idaho's homeowners' exemption.) None of the increase in the homeowners' exemption is shifted to other property taxpayers. The full cost of the increase is paid from General Fund revenues through a reimbursement program similar to the circuit breaker program. The cost of this program to the General Fund is $10 million. It is raised by elimination of sales tax exemptions.

The homeowners' exemption was originally enacted in 1980 and has not been changed since 1983. The value of the homeowners' exemption adjusts itself for inflation under the 50 percent component but, once the $50,000 limit is reached, the exemption is effectively "frozen." As a result, "inflation" increasingly diminishes the value of the homeowners' exemption as assessments reach and exceed the $50,000 limit. The proposed increase to $55,000 will "recover" a small amount of the inflation that has occurred since 1983 for homeowners who have reached the $50,000 limit. To be equivalent to the $50,000 limit enacted in 1983, today's limit would need to be $72,590.

Idaho's homeowners' exemption has an effect similar to other states' assessment ratios. Because of the exclusion of the homesite's land value, the $50,000 limit, and the inapplicability of the homeowner's exemption to rental property, Idaho's homeowners' exemption is equivalent to a residential assessment ratio well above 50%. Even with 55/55 the equivalent assessment ratio will be well above 50%. Five other states provide residential assessment ratios at or below 50% of the assessment applied to commercial and industrial property. Many others have a wide variety of exemptions similar to Idaho's homeowners' exemption.

1993 Governor's Tax Policy Package

School M & O Levy Limitation

This proposal reduces the property tax levy limit for public school maintenance and operations by 30% from .4 percent to .28 percent. It also replaces the amount of property tax revenue school districts actually lose in FY 1993-94 by distributing to each school district an amount equal to its actual levy reduction (based on 1992 property tax levies, up to a maximum of .12 percent) multiplied by the district's 1993 taxable value. The replacement revenue ($29.9 million) is obtained from sales tax exemption elimination.

For school districts that receive replacement revenue based on less than .12 percent in FY 1993-94 (i.e., their 1992 levies were below .4 percent), the difference between their 1992 levy and .4 percent is added in one-fifth increments for five years. After five years, all districts will receive replacement revenue equal to .12 percent times the current year's taxable market value.

In the case of charter districts that have no statutory levy limits, participation is voluntary. However, to qualify for this program a charter district must agree to reduce its M & O levy (from the 1992 rate) by the amount it exceeds .28 percent, or .12 percent, whichever is less. Failure to comply will result in no state funds being distributed to that district under this program. State equalization funds are not impacted by this program.

This program will save property taxpayers a total of $29.9 million in 1993 property taxes, a reduction of approximately 5.5 percent in overall property taxes. Individual taxpayer percentage savings will vary depending on whether their district initially replaces .12 percent or some lesser amount, and how much they pay to other property tax districts (cities, counties, highway districts, etc.)

After five years all school districts will receive the full .12 percent state property tax relief. Expressed in 1993 dollars, that amount is $39.7 million, for an average savings of 7 percent. Individual taxpayer savings will vary depending on how much they pay to other property tax districts. Average rural savings will be 8%, and average urban savings will be 6%.

1993 Governor's Tax Policy Package
County Indigent Fund

This proposal allocates \$3.256 million from the General Fund to be used for indigent fund levy reductions. The money is allocated to counties on a per capita basis (\$3.09 per county resident) and must be used to reduce the budgeted amount for the county's indigent fund before the indigent levy is calculated. The funds will actually be distributed to the counties by December 20, 1993.

1993 Governor's Tax Policy Package
Grocery Tax Credit

This proposal would double the amount of grocery credit available to Idahoans from $15 to $30 for those under 65, and from $30 to $60 for those over 65. It also makes the grocery credit available to all Idahoans, regardless of their age. The cost is $17 million in General Fund revenue. It is raised by elimination of sales tax exemptions.

Idaho has provided an income tax credit for the sales tax paid by residents on food since the sales tax was enacted in 1965. The basic credit was set at $15 and has not been changed since. Idahoans over 65 years of age presently receive $30, which is the amount that seniors have received since 1978. Prior to 1978, seniors received a grocery credit of $20.

This change in the amount of the grocery credit will not even make up for the inflation that has occurred since 1965. For example, the original $15 credit is worth $3.27 today after inflation from 1965 to 1993 is taken into consideration. Today's credit would need to be $68.86 to be equivalent to the value of $15 in 1965. The picture is a little brighter for Seniors. The $20 credit of 1965 is equivalent to $4.36 today. Today's senior credit would need to be $91.81 to be equivelant to the value of $20 in 1965.

Another feature of the present grocery credit is that Idahoans with income below the income tax filing requirement ($3,300 for single filers; $5,000 for couples) are not allowed to claim the grocery credit unless they are over 62 years old, blind, or disabled. This means that the poorest Idahoans are excluded from the grocery tax credit. No Idahoans are excluded under this bill.

1993 Governor's Tax Policy Package
State Insurance Fund

This proposal extends the insurance premium tax to workers' compensation insurance premiums written by the State Insurance Fund effective 1/1/93. It raises $1.6 million in revenue for the General Fund in FY 1994.

Presently, the State Insurance Fund <u>does</u> pay the 2% Industrial Commission tax on workers' compensation premiums. It is left out of the insurance premium tax laws by omission. This change will put this governmental agency on a similar tax basis (from a state perspective) as other private workers' compensation insurers, thereby removing a source of unfair competitive advantage.

1993 Governor's Tax Policy Package
Hospital and Professional Service Corporations

This proposal modifies the insurance premium tax laws in the area of Hospital and Professional Service Corporations (HPSCs), the so-called "Blues." Specifically, insurers who fail to qualify for federal tax-exempt status (but otherwise meet the criteria of HPSCs) will pay the regular premium tax instead of the subscriber tax effective 1/1/94 and will have less restrictive investment constraints immediately upon enactment of this bill. For two years it will be "assumed" that any for-profit HPSCs meet the investment criteria needed to qualify for the premium tax rate based on Idaho investments. Beginning 1/1/96 the rate of the premium tax paid by the for-profit HPSC will depend on the actual investment mix of the HPSC.

The estimated revenue impact of this change is an additional $3.8 million for the General Fund in FY 1994. The impact on HPSC insurance premiums is less clear. The upper limit is a 1.6 percentage increase. Since the impacted entities pay federal income tax, up to 1/3 of this impact can be offset by a corresponding reduction in federal tax liability. Also, the proposed change in investment restrictions will occur immediately upon passage of this bill and should allow for more profitable investments than are currently allowable. This will also provide an offset against the added premium tax. A third major factor that will determine the extent of premium tax flow-through is the degree to which competitive forces may absorb a portion of the premium tax increase. Both HPSC administrative overhead and provider payments are areas where greater efficiencies may mitigate a portion of the premium tax increase.

If health insurance premiums charged by affected HPSCs do go up as a result of this proposal they must be put into a proper context of a) their magnitude and b) their policy implications. As to the magnitude of a tax induced premium increase, we know it is bounded in the short term by 0 and 1.6 percentage points. Given recent federal tax liabilities and the prospect for enhanced investment earnings, a one percent increase is a reasonable increase to examine.

Over the past decade for-profit HPSC health insurance premiums have gone up 215% (12.15% per year) in Idaho. This proposal, if it causes a 1 percent increase in the premium charged, will increase the rate of premium growth by 1 percent, but only in the first year. After the first year premiums would be 1 percent than otherwise, but the <u>growth</u> in premiums due to the tax change will be over. Any further growth will be <u>strictly</u> due to other factors such as provider rates, subscriber utilization, etc. In other words, this potential change in health insurance premiums is less than 1/200th of the change that has occurred over the past decade.

But why have <u>any</u> increase in health insurance premiums if it can be avoided? This question gets directly at the central policy issue. Over the past decade the "Blues," Blue Cross and Blue Shield, have grown from a 57% share of Idaho's health insurance market to about 70% of Idaho's health insurance market. This market domination reflects a loss in competition and options within the Idaho health insurance marketplace. A 1.6% to 3% premium tax rate advantage enjoyed by the "Blues" may be a key factor in this large concentration in market power. Regardless, it makes no sense for Idaho <u>government</u>, through selective tax breaks, to promote one company's competitiveness over another's. By leveling the playing field, a small (and possibly trivial) premium cost increase can lead to greater diversity and choice for Idaho consumers, and quite possibly lower long-term costs as competition among health insurance companies leads to greater efficiency in health care delivery.

1993 Governor's Tax Policy Package
Services Performed On Goods

This proposal extends the sales tax to the delivery, installation, and repair of taxable tangible property effective July 1, 1993. This represents a major broadening of the sales tax base, and corresponds to one of the major recommendations that came out of the 1988 Governor's Tax Study Committee. It makes many transactions that now have both taxable and non-taxable elements fully taxable. It generates an estimated $35.8 million in additional revenue, of which $33.0 million is used for unavoidable and critical state spending needs. $2.8 million is allocated to cities and counties for revenue sharing.

Delivery

Delivery and transportation charges are sometimes taxable and other times non-taxable in today's sales tax system. Transportation that occurs before a sale is taxable, but transportation that occurs after a sale is not (generally) taxable. Transportation of mobile homes after the sale is taxable, but transportation of building materials after the sale is not taxable. Transportation of both freight and passengers by charter aircraft is taxable. The change proposed will simply make all transportation charges associated with otherwise taxable property (but not passenger transportation) taxable. Thus, items purchased for resale or supplies that are exempt under the production exemption would also be exempt from transportation charges. However, separately billed freight charges or transportation that occurs after the sale of a taxable item would, under this proposal, become taxable. This generates an estimated $2.2 million in FY 1994.

Installation

Unlike manufactured goods, construction activities are currently taxable only on the materials component. This change will make "constructed" goods taxable on the full "installed" price. This change will result in construction activities being taxed on an identical basis as manufacturing activities. Idaho doesn't presently tax the materials that go into a manufactured good, Idaho taxes the final price charged for the good. In the case of custom fabrication, Idaho specifically includes labor charges in the taxable transaction. After this change, materials that are used in construction will be exempt (because they are for resale) and the final price will be the basis for the sales tax. This generates an estimated $21.2 million in FY 1994.

Repairs

Repairs that are presently separated into a taxable parts component and a non-taxable labor component will become fully taxable. In the case of repairs, adjustments, cleaning, etc. that are **performed on goods** (but where no parts are involved in the transaction) the price of the transaction will become taxable. The critical element that determines taxability is that a service was performed on otherwise taxable property. This generates an estimated $12.4 million in FY 1994.

1993 Governor's Tax Policy Package
Communication Services

This proposal extends the sales tax to communication services effective July 1, 1993. It raises \$18.7 million in revenue, of which \$17.3 million (92.25 percent) is used for unavoidable and critical state spending needs. \$1.4 million (7.75 percent) is allocated to cities and counties for revenue sharing.

The principal services that will be covered under this proposal are local and long-distance telephone service (both intrastate and interstate), and cable television. A total of 43 states tax some or all telecommunication services. Forty-two tax intrastate telephone service, while eighteen tax interstate telephone service. Twenty-two states tax cable TV services.

1993 Governor's Tax Policy Package
Electricity, Gas, Heating Materials, and Water

This proposal extends the sales tax to all sales of electricity, natural gas, heating materials, and water (other than for irrigation). The change is effective July 1, 1993 and no general exemptions (such as the production exemption) are allowed. It provides an additional \$40.6 million in revenue, of which \$37.5 million (92.25 percent) is used for tax relief and \$3.1 million (7.75 percent) is allocated to cities and counties for revenue sharing.

This change will increase the price of these goods to consuming industries and individuals by 5%, thereby promoting greater conservation. However, this increase is not going to materially impact the low cost position enjoyed by Idaho utilities and consumers in the area of electricity rates or natural gas rates. Idaho presently has the second lowest average electricity prices in the nation, and with prices 5% higher Idaho will still have the third lowest electricity prices in the nation. Idaho natural gas prices are the ninth lowest in the nation, and would remain ninth lowest with prices 5% higher.

Most other states presently apply their sales taxes to these products. Thirty-eight states tax industrial use of electricity, natural gas, and other heating materials. Twenty-five states tax residential use of electricity, and 24 states tax residential use of natural gas and other heating materials. Sales of water to industrial customers are taxed by 22 states, and sales of water to residential customers are taxed by 12 states.

1993 Governor's Tax Policy Package
Production Exemption

This proposal limits the production exemption to those items that are actually consumed in the production process, regardless of whether the item actually becomes a part of the final product. The change is effective July 1, 1993.

Tools, equipment, and machinery would no longer qualify for the production exemption. Most tools, equipment, and machinery that would no longer qualify for the production exemption would continue to receive Idaho's 3% investment tax credit, unless the tools, equipment, or machinery are expensed — an even more favorable tax option. Besides production equipment, this change also makes equipment used for logging, irrigating, railroad remanufacturing, and pollution control taxable.

This change would add approximately $25.8 million in additional sales tax revenue in FY 1994. $23.8 million (92.25 percent) of this added revenue is used to provide property tax relief. The remaining $2.0 million (7.75 percent) is allocated to cities and counties for revenue sharing.

Eight states give no exemption to farm equipment. Thirteen states give farm equipment exemptions that are more limited than Idaho's. Eleven states give no exemption to manufacturing equipment. Nine states give exemptions that are more limited than Idaho's. Only eleven states grant an exemption for logging equipment. Nineteen states give no exemption to pollution control equipment, and two states give a partial exemption.

1993 Governor's Tax Policy Package
Inventory Replacement Distribution

This proposal reduces the percentage allocation in the sales tax distribution formula that allocates funds to non-public school taxing districts as replacement of revenues lost when the property tax on inventories was repealed. The change is designed to hold the share of the sales tax distributed in this manner constant after allowing for the increase in sales tax base contained elsewhere in this package. The new percents are 4.85 percent on July 1, 1993, then 4.7% on July 1, 1994 and beyond. The reason for the two step change is related to annualization of the first year (only 11 months of collections will be received) and lags in the sales tax change related to construction services.

1993 Governor's Tax Policy Package
Quarterly Estimated Payments

A major element of the FY 1993 — FY 1995 executive budget proposals is the addition of a quarterly payment requirement for Idaho individual income taxpayers. This is a logical extension of the change enacted in 1987 that placed a quarterly payment requirement on Idaho corporate income taxpayers. It does not represent any additional tax liability for Idaho taxpayers, and in fact is actually funded in substantial part by the U.S. treasury. Idaho is one of only three states that have an individual income tax but don't require quarterly payments. Making this change will put approximately 60,000 taxpayers receiving substantial business and/or investment income on a more equitable payment plan relative to wage earners (the other 340,000) who pay their "estimated" taxes as they receive their income (through withholding).

Commencement of Idaho's individual taxpayer quarterly payment will be in September, 1993. For calendar year taxpayers that corresponds to the third (of four) 1993 federal quarterly payments. Idaho individual income taxpayers will only be required to make quarterly payments to Idaho if they meet the federal requirements.

The attached tables show the cash-flow associated with quarterly payments for two representative self-employed individual income taxpayers. An important aspect of implementation of Idaho quarterly payments is the fact that five of the initial six Idaho quarterly payments are accompanied by reductions in the federal quarterly payment that is due at the same time. The reduction in the federal payment is a direct result of the deductibility of state income tax from federal taxable income. For a self-employed taxpayer with over $86,500 taxable income, the federal treasury actually "pays" over half of the out of pocket cost associated with the tax payment acceleration. For self-employed taxpayers with taxable incomes between $0 and $86,500, the federal treasury actually "pays" at least 43% of the cash flow acceleration.

Idaho Individual Income Tax Quarterly Estimated Payments

Cash-Flow Impact Analysis

Taxpayer Profile: Approximately $130,000 Federal Taxable Income; 34% Effective Marginal Federal Tax Rate

Cash Flow Schedule By Calendar Year:

	PRESENT LAW - No Individual Estimated Payments				PROPOSED LAW - Individual Estimated Payments			
	Idaho Tax Return Payment	Idaho Quarterly Payment	Federal Tax Return Payment	Federal Quarterly Payment	Idaho Tax Return Payment	Idaho Quarterly Payment	Federal Tax Return Payment	Federal Quarterly Payment
Jan 15, 1993				$10,000				$10,000
Apr 15, 1993	$11,000		$4,000	$10,000	$11,000		$4,000	$10,000
Jun 15, 1993				$10,000				$10,000
Sep 15, 1993				$10,000		$2,500		$9,575
Jan 15, 1994				$10,000		$2,500		$9,575
Apr 15, 1994	$11,000		$4,000	$10,000	$6,000	$2,500	$4,000	$9,575
Jun 15, 1994				$10,000		$2,500		$9,575
Sep 15, 1994				$10,000		$2,500		$9,575
Jan 15, 1995				$10,000		$2,500		$9,575
Apr 15, 1995	$11,000		$4,000	$10,000	$1,000	$2,500	$4,000	$10,000
Jun 15, 1995				$10,000		$2,500		$10,000
Sep 15, 1995				$10,000		$2,500		$10,000
Jan 15, 1996				$10,000		$2,500		$10,000
Apr 15, 1996	$11,000		$4,000	$10,000	$1,000	$2,500	$4,000	$10,000
Jun 15, 1996				$10,000		$2,500		$10,000
Sep 15, 1996				$10,000		$2,500		$10,000

Idaho Fiscal Year Basis (Jul 1 - Jun 30) Cash Flow Impact:

	State of Idaho			Federal Government			Taxpayer		
	PRESENT LAW	PROPOSED LAW	CHANGE	PRESENT LAW	PROPOSED LAW	CHANGE	PRESENT LAW	PROPOSED LAW	CHANGE
Idaho FY 1994	$11,000	$16,000	$5,000	$44,000	$42,300	($1,700)	$55,000	$58,300	($3,300)
Idaho FY 1995	$11,000	$11,000	$0	$44,000	$43,150	($850)	$55,000	$54,150	$850
Idaho FY 1996	$11,000	$11,000	$0	$44,000	$44,000	$0	$55,000	$55,000	$0
Cumm. Impact			$5,000			($2,550)			($2,450)

Idaho Individual Income Tax Quarterly Estimated Payments

Cash-Flow Impact Analysis

Taxpayer Profile: Approximately $22,000 Federal Taxable Income; 29.1% Effective Marginal Federal Tax Rate (income tax and federal self-employment tax)

Cash Flow Schedule By Calendar Year:

	PRESENT LAW - No Individual Estimated Payments				PROPOSED LAW - Individual Estimated Payments			
	Idaho Tax Return Payment	Idaho Quarterly Payment	Federal Tax Return Payment	Federal Quarterly Payment	Idaho Tax Return Payment	Idaho Quarterly Payment	Federal Tax Return Payment	Federal Quarterly Payment
Jan 15, 1993				$1,500				$1,500
Apr 15, 1993	$1,100		$600	$1,500	$1,100		$600	$1,500
Jun 15, 1993				$1,500				$1,500
Sep 15, 1993				$1,500		$250		$1,464
Jan 15, 1994				$1,500		$250		$1,464
Apr 15, 1994	$1,100		$600	$1,500	$600	$250	$600	$1,464
Jun 15, 1994				$1,500		$250		$1,464
Sep 15, 1994				$1,500		$250		$1,464
Jan 15, 1995				$1,500		$250		$1,464
Apr 15, 1995	$1,100		$600	$1,500	$100	$250	$600	$1,500
Jun 15, 1995				$1,500		$250		$1,500
Sep 15, 1995				$1,500		$250		$1,500
Jan 15, 1996				$1,500		$250		$1,500
Apr 15, 1996	$1,100		$600	$1,500	$100	$250	$600	$1,500
Jun 15, 1996				$1,500		$250		$1,500
Sep 15, 1996				$1,500		$250		$1,500

Idaho Fiscal Year Basis (Jul 1 - Jun 30) Cash Flow Impact:

	State of Idaho			Federal Government			Taxpayer		
	PRESENT LAW	PROPOSED LAW	CHANGE	PRESENT LAW	PROPOSED LAW	CHANGE	PRESENT LAW	PROPOSED LAW	CHANGE
Idaho FY 1994	$1,100	$1,600	$500	$6,600	$6,456	($144)	$7,700	$8,056	($356)
Idaho FY 1995	$1,100	$1,100	$0	$6,600	$6,528	($72)	$7,700	$7,628	$72
Idaho FY 1996	$1,100	$1,100	$0	$6,600	$6,600	$0	$7,700	$7,700	$0
Cumm. Impact			$500			($216)			($284)

HIGHLIGHTS HB-856

SECTION 1

The language regarding bond elections in IC 33-409 is changed to reflect only supplemental school m & o levies. This was done because the state will be responsible for funding school m & o.

For the purposes of this act, this section is in full force retroactively from January 1, 1994. For all other purposes, such sections continue in full force as they existed on December 31, 1993 for the terms and limits under which any action was taken.

SECTION 2

Several changes to IC 33-802 are made in this section. Most importantly, the language regarding authorized school m & o levies has been stricken. This was done because part of the school m & o will no longer be funded by property tax, but will be funded with state money instead. The language regarding supplemental school m & o for non-charted school districts remains largely intact, but a limit is imposed on what can be raised. The amount of supplemental school m & o would be the lesser of 10% of the school districts budget for m & o for the current year or 110% of the actual supplemental levy certified by the school district in 1993. This section also specifies that for all participating school districts the local district contribution is the amount utilized for calculating local district participation in the educational support program and this amount (see SECTION 3) is calculated annually using the method specified in IC 33-1002. Finally, this section specifies that all voter approved levies authorized prior to June 30, 1994 remain in effect.

For the purposes of this act, this section is in full force retroactively from January 1, 1994. For all other purposes, such sections continue in full force as they existed on December 31, 1993 for the terms and limits under which any action was taken.

SECTION 3

This section updates the language of the educational support program to reflect the new infusion of state funds.

For the purposes of this act, this section is in full force retroactively from January 1, 1994. For all other purposes, such sections continue in full force as they existed on December 31, 1993 for the terms and limits under which any action was taken.

SECTION 4

This section deals with property tax replacement. It details the amount that will be replaced and when state payments will be made to school districts. From July 1, 1994 to June 30, 1995, each noncharter school district will receive an amount equal to its current levy times its 1993 property value. Participation is voluntary for charter school districts. Charter school districts with a M&O levy above 0.004 will reimbursed at 0.004 times its 1993 property value. The estimated cost of this shift is $127 million in FY95. After this period, those districts at the 0.004 levy will receive 0.004 times the previous year's December 31 property value. For those districts not at 0.004 levy rate, they will be allowed to raise their levy by 5% annually to a maximum of 0.004. These rates will also be applied to the previous year's December 31 property value. Payments of state funds would be made in five equal payments.

For the purposes of this act, this section is in full force retroactively from January 1, 1994. For all other purposes, such sections continue in full force as they existed on December 31, 1993 for the terms and limits under which any action was taken.

SECTION 5

This section deletes language pertaining to special cases where a school district's adjusted market value suffers a catastrophic decline. With the school m & o now funded with state money, the impacts of such a decline are mitigated.

For the purposes of this act, this section is in full force retroactively from January 1, 1994. For all other purposes, such sections continue in full force as they existed on December 31, 1993 for the terms and limits under which any action was taken.

SECTION 6

Requires taxpayers to make Idaho income tax quarterly payments if they are required to do make estimated payments at the federal level and have $200 in Idaho income tax liability.

This section is effective on approval and passage.

SECTIONS 7 & 8

These sections make all transportable personal property exempt from personal property tax. Items such as tractors, trailers, bailers, etc. would be exempt. Saws, paper-making machines, and furnaces would not. This exemption does not apply to operating property, railroads, public utilities, or car companies.

These sections are in full force retroactively from January 1, 1994.

SECTION 9.

The changes in SECTIONS 7 & 8 shift the part of the personal property tax burden onto the other property classes. As a result, the same amount of property tax dollars will have to be raised from a smaller property tax base. To do this, some taxing districts will have to raise their rates above their statutory levy limits. To accommodate this, all statutory levy limits are removed in tax year 1994. After that year, the Tax Commission will make recommendations to the Legislature as to what the new levy limits should be.

This section is in full force retroactively from January 1, 1994.

SECTION 10

This sets the annual ad valorem budget limitations for each year beginning with 1995. Taxing districts can generally take the greater of 103% of any of the previous years' ad valorem budget or the current year's tax rate times its market value. Special considerations are also made for districts that are new, had no levy in 1994, or non-school districts for which no increase was taken in the previous year.

This section is in full force from January 1, 1995.

SECTION 11

Repeals the "One Percent Initiative" from the Idaho Code.

This section is in full force retroactively from January 1, 1994.

SECTION 12

Repeals the "Truth in Taxation" sections of the Idaho Code.

This section is in full force from January 1, 1995.

SECTION 13

The homeowner's exemption is raised from the lesser of $50,000 or 50% of improvements to the lesser of $60,000 or 60% of improvements.

This section is in full force retroactively from January 1, 1994.

SECTION 14

This section changes the sales tax distribution formula so that the amount of money needed to fund the school M&O replacement will be appropriated from the sales tax. Also reduces the percent of the sales tax channeled to counties and revenue sharing. This occurs in two steps, in order to keep both counties' and revenue sharing dollars from the sales tax the same as they would have been before the sales tax base was broadened.

This section is in full force from July 1, 1994.

SECTION 15

This section repeals the sales tax exemption for the following items:

Broadcast Equipment
Publication Equipment
Precious Metal Bullion
INEL Research & Development

This section is in full force from June 1, 1994.

SECTIONS 16-27

Extends the sales tax to the following services and items:

Construction Labor
Agricultural & Industrial Services
Transportation
Communications & Cable TV
Repair Labor
Business Services
Personal Services
Educational Services
Miscellaneous Services
Sewer Services
Trash Services
Lottery Tickets
Pari-Mutuel Betting
Used Manufactured Homes

These sections are in full force from June 1, 1994.

SECTIONS 28-29

These sections deal with contracts. SECTION 28 specifies that services that are part of a contract entered into before the effective date of the sales tax on services are exempt from the sales tax. This extension would be in effect from June 1, 1994 to June 30, 1995. SECTION 29 specifies that tangible personal property that are incorporated into real property improvements as part of contracts entered into before the effective date of the sales tax on services are exempt from the sales tax. This extension would be in effect from June 1, 1994 to June 30, 1996.

These sections are in full force from June 1, 1994.

SECTION 30

Repeals sales tax exemption on lottery tickets.

This section is in full force from June 1, 1994.

SECTIONS 31, 34, & 35

These sections exclude the production exemption and logging exemption for transportable equipment.

These sections are in full force from June 1, 1994.

SECTION 32

This section restricts the grocery tax credit to those with less than $20,000 in Idaho taxable income. All additional grocery credits for the elderly would still be available, but only to those under the $20,000 income threshold.

This section is in full force retroactively from January 1, 1994.

SECTION 33

Specifies that prepaid tax credits shall not be limited by either the statutory levy limits or the 3% budget cap described in SECTION 10 of this bill.

This section is in full force from June 1, 1994.

SECTION 36

Specifies the interest that will be due on for the underpayment of estimated taxes.

This section is effective on approval and passage.

SECTIONS 37-39

These sections set a budget cap for taxing districts in tax year 1994 and adapt the Truth in Taxation provisions of the Idaho Code to handle this limitation. The budget cap for tax year 1994 would be 110% of a taxing district's 1993 ad valorem budget. Any district's 1994 budget that exceed its 1993 ad valorem budget by 5% or more would be subject to the Truth in Taxation requirements.

These sections are in full force retroactively from January 1, 1994.

SECTION 40

Enactment dates.