



STATE OF IDAHO

OFFICE OF THE ATTORNEY GENERAL

LAWRENCE G. WASDEN

June 10, 2015

The Honorable Lawrence Denney
Idaho Secretary of State
Statehouse
VIA HAND DELIVERY

RE: Certificate of Review
Proposed Initiative Amending the Idaho Sales Tax Statutes

Dear Secretary of State Denney:

An initiative petition was filed with your office on May 15, 2015. Pursuant to Idaho Code § 34-1809, this office has reviewed the petition and prepared the following advisory comments. Given the strict statutory timeframe within which this office must review the petition, our review can only isolate the areas of concern and cannot provide in-depth analysis of each issue that may present problems. Further, under the review statute, the Attorney General's recommendations are "advisory only." The petitioners are free to "accept them in whole or in part." The opinions expressed in this review are only those that may affect the legality of the initiative. This office offers no opinion with regard to the policy issues raised by the proposed initiative nor the potential revenue impact to the state budget.

BALLOT TITLE

Following the filing of the proposed initiative, this office will prepare short and long ballot titles. The ballot titles should impartially and succinctly state the purpose of the measure without being argumentative and without creating prejudice for or against the measure. While our office prepares titles for the initiative, petitioners may submit proposed titles for consideration. Any proposed titles should be consistent with the standard set forth above.

MATTERS OF SUBSTANTIVE IMPORT

The two principal purposes of the proposed initiative are (1) to lower the overall sales tax rate from six percent (6%) to five percent (5%); and (2) to broaden the sales tax base by including "services" within the sales tax scheme. In addition to taxing services, another significant way the initiative would broaden the sales tax base is to expand the definition of "sales" to include contracts for applying, installing, cleaning, altering, improving, decorating, treating, storing, or repairing real property. See proposed Idaho Code § 63-

3612(k). This provision has the effect of transforming many contracts for the improvement of real property into retail sales and subject to sales tax.

One overarching complication of this review is that the petitioners used prior versions of some of the statutes when constructing the proposal. Thus, it does not include many recent amendments made to the relevant statutes. Some of the recent amendments are minor; however, some of the statutory changes are significant. The petitioners will need to revise the proposal to include the most recent version of the relevant statutes (see Sections 6, 7, 10, 12 and 14).

The proposed amendment in Section 1 to Idaho Code § 63-602L will not affect Idaho sales tax because that code section relates to personal property tax. This code section exempts from property taxation certain intangible personal property. Personal property tax is a distinct tax that is applied separately from Idaho's sales tax. Likewise, Section 23 has implications beyond sales tax. The petitioners may want to omit these amendments in order to limit the effect of the initiative to Idaho sales tax only, if that is the intent of the initiative. Omission of the elements would resolve any claim that this initiative violates the single subject rule under Art. III Sec. 16.¹

Section 2 proposes a new section to Idaho Code pertaining to Computer Software and Digital Goods. This amendment pulls "computer software" out of the tangible personal property definition in Idaho Code § 63-3616 and creates a new taxable item outside tangible personal property. Section 2 defines "computer software" to include information stored in electronic media. The proposal also defines "digital goods" separately from computer software. Historically, digital goods have been interpreted to fall under the definition of computer software as "information stored in an electronic medium." Bifurcating these definitions could create internal inconsistencies. The petitioners may wish to review these definitions to make digital goods a subset of computer software if that is their intent. However, the proposal makes both items taxable which may make the issue immaterial. The drafters should also note that this area of taxation presents difficulty in defining these terms in this rapidly changing industry. This will also be a problem in the proposed sourcing sections as well. Finally, it should be noted that the imposition of tax on these types of transactions is a departure from the direction taken by the legislature the past few years as they have passed multiple bills exempting most sales of software and digital goods.

The proposed amendment in Section 4 will shift the tax obligation from the contractor to the purchaser since real property contracts would be taxable under the proposed changes to Idaho Code § 63-3612(2)(k). This will produce not only a tax shift, but the amount of tax paid on each contract will increase significantly. Moreover, it is possible the proposed initiative may tax the sale of new homes and not tax the sale of existing homes. If a builder builds a home that he intends to sell upon completion, he may be able to purchase the materials and the subcontract services for resale. Under the language of the proposed

¹ If these provisions remain, the title of the initiative may need to be broadened to inform voters that the initiative addresses more than sales tax, in order to permit a legal defense to be proffered under Art. III, Sec. 16.

initiative, the sale of the newly constructed home may be categorized as a retail sale. The sale of an existing home would not be a retail sale.

The proposed changes to Idaho Code § 63-3613, subsection (a)(6) includes contracts for applying, installing, cleaning, altering, improving, decorating, treating, storing, or repairing tangible personal property or real property. Recall that Idaho Code §§ 63-3622A and 63-3622O prohibit the imposition of taxes on retail sales to governmental entities. By including contracts described in subsection (a)(6) as retail sales, the initiative will completely exempt those contracts performed for governmental entities from taxation whereas under present law, materials used on government contracts are taxable. Contractors working at the Idaho National Laboratory (INL), Mountain Home Air Force Base, and contractors building or repairing highways or other roads are just a few examples of contracts that would completely escape taxation under the proposed initiative.

The petitioners should also revise the proposed changes to Idaho Code § 63-3613, subsection (f), which is incomplete.

Section 8 of the initiative, which creates a new Idaho Code § 63-3614A, broadly defines the term "services" to mean "all activities engaged in for other persons for a consideration, which activities involve predominantly the performance of a service as distinguished from selling or leasing property." This definition incorporates nearly every conceivable service. Moreover, this definition of "service" is, in part, circular, as the definition uses the same term it is defining (i.e., a "service" is an activity predominantly involving the performance of a "service"). The petitioners may want to provide more clarification in the definition of the term "service."

Of note, too, is that the new statute will not tax services performed for an "employer" by an "employee." The initiative does not contain a specific definition for either term, both of which are the subject matter of countless lawsuits. For instance, the classification of a worker as an employee or as an independent contractor is often problematic. The activities of an independent contractor may mirror that of an employee. Under a strict interpretation of the initiative, the activities of the independent contractor would be taxable while the activities of the employee would not be taxable, even though the services performed are identical. The petitioners may wish to clarify these terms and address their intent with regard to worker classification in order to avoid confusion.

Additionally, Section 8 does not include services provided by certain licensed medical professionals. It would appear that the drafters seek to exempt medical related services. However, by exempting the service providers rather than the service provided, the exemption could extend to any service provided by a licensed medical professional. For instance, a registered nurse could operate a day care out of her home. Those services provided by the nurse would be exempt under the proposed Idaho Code § 63-3614A. On the other hand, a day care operated by a non-licensed medical professional (such as a teacher or a full-time child care provider without a medical designation) would be fully taxable. Additionally, the list of service providers excludes some health care professionals and includes other health care professionals. Physical therapists are included, but occupational and speech therapists are not. This could be an impediment to passage by

those excluded from the exemption and should be more broadly worded to include all health care professionals "licensed" by certain state boards.

Finally, it should be noted that Section 8's definition of "services" is in contradiction to the information contained in the petitioners' Section 24. As stated above, this initiative generally seeks to impose a sales tax on the sale of services, and in Section 8, the term "services" is defined in the broadest way possible. However, in Section 24, the petitioners indicate many, many types of services would remain exempt, to include the comprehensive and wide-ranging fields of agricultural services, industrial services, transportation services, information services, health services, medical services, social services, and educational services. The two sections seem incongruent.

In Section 10, the petitioners seek to exclude "computer software" from the definition of "tangible personal property" in Idaho Code § 63-3616. As mentioned above, the code section used in Section 10 is not current with Idaho Code. Moreover, the Idaho Legislature has amended Idaho Code § 63-3616 in significant ways over the past three consecutive legislative sessions. Not only is the language used in Section 10 not current with Idaho Code, the changes proposed here would undo these very recent amendments (and would make more items taxable). It is unclear if that result is compatible with the petitioners' general intent.

The addition of the phrase "including sales of services" in Section 11 is redundant. The amendment to Idaho Code § 63-3612 includes the sales of services in the definition of "sales." The additions in this section may not be necessary.

The inclusion of the term "or service(s)" in Section 12 and Section 13 may not achieve the result intended by the drafters and may cause unnecessary confusion. By way of example, Idaho Code § 63-3621(f) relates to inventory held for resale. It is not clear how holding inventory for resale relates to services and the imposition of Idaho's use tax. Similarly, the addition of "or services" to Idaho Code § 63-3622(c) relates to tangible personal property sold for resale. The drafter's intent in adding "or services" is not apparent in relation to the resale of tangible personal property and could benefit from additional clarification.

The proposed Idaho Code § 63-3622D in Section 14 does not exempt any services except those services consumed in a production process. There are many statutes that provide exemptions of tangible personal property but would not be exempt from related services. For example, the occasional sale exemption exempts the transfer of tangible personal property between related entities. The proposed initiative would impose tax on service transaction between related entities. There are other exemptions that similarly exempt transactions involving tangible personal property, but related service transactions would be taxed under the initiative. Some obvious examples include the pollution control exemption, the research and development exemption, and the logging exemption. The drafters of the initiative have the prerogative to maintain any of the exemptions for sales of tangible personal property while taxing sales of related services, but the petitioners may wish to consider some consistency for service related transactions.

The drafters also included sourcing provisions in Sections 18, 19 and 20. These sourcing rules seem unduly complex. Moreover, the sourcing rules may or may not be consistent with other provisions of the Idaho sales tax laws. Sourcing is defined as the point where the retail sale occurs. Subsection (5) of proposed Idaho Code § 63-3642 states that services “performed and consumed” in Idaho will be sourced to that location in Idaho. Services “performed” in another state yet “consumed” in Idaho will be sourced to Idaho where the “consumption” occurred. Services “performed” in Idaho yet “consumed” in another state will be sourced to that other state. The terms “performed” and “consumed” appear to be terms of art which could benefit from an explicit definition. Additionally, this section affects services related to sales of computer software and digital goods. It’s worth noting that recent legislative changes also included provisions for remotely accessed software which will need to be addressed in the sourcing rules.

In Section 21, the petitioners provide language governing which contracts will be subject to the sales tax on services as well as which contracts are eligible for refunds. The operative dates in this section are based upon the dates of the written contract, as well as the nature of the services. This staggered implementation seems unduly complex and would present a huge administrative burden both for taxpayers as well as for tax administrators.

In Section 22, the petitioners seek to repeal approximately 26 sales tax exemptions. This section presents some substantive difficulties. First, the petitioners seek to repeal at least two of these exemptions in other portions of the initiative; repealing sections twice is redundant. Second, several of the exemptions pertain to matters involved in interstate commerce (i.e., railroad rolling stock, large motor vehicles, sales to out-of-state contractors). By repealing tax exemptions related to interstate commerce (or, said in the reverse, by allowing for a state tax on interstate commerce), the initiative may run afoul of the federal constitutional prohibition against excessively burdening interstate commerce.

Additionally, Sections 24 and 25 present a challenge from a drafting standpoint. These sections contain no actual statutory language to be adopted; there is neither new law to be implemented, nor existing law to be amended. Rather, these sections are merely statements of intent regarding sales tax exemptions. It is axiomatic that an initiative contains law. See Idaho Code § 34-1804 (which indicates that referenda refer to acts of the legislature, and initiatives pertain to proposed laws). The petitioners may want to revisit these sections and propose specific statutory language to be implemented.

Finally, the proposed statutes appear to raise revenue for the State of Idaho. This raises the question of whether an initiative that raises revenue will be struck because it did not originate in the House of Representatives. Article III of the Idaho Constitution provides that all bills which raise revenue must originate in the House. There is an argument that an initiative not originating in the House which raises revenue will be prohibited.

By using the term “bill,” the drafters of the Constitution implied that the provision only applies to legislative enactments. An initiative, as allowed for in art. III, sec. 1, is a process for the people through signatures and voting to enact legislation. The history of the federal Origination Clause is all about balance between the two legislative houses. Idaho seems to

Secretary of State Denney
June 10, 2015
Page 6 of 6

have just copied the federal practice. The Idaho Constitutional Convention in 1889 adopted this section without debate or amendment. At the federal level, the clause had two motives. First, it put the fiscal authority in the House of Representatives, which was seen as being the house closest to the people. Second, it acted as a counterbalance to the special powers granted only the Senate - the power to advise and consent to Presidential appointments and to ratify treaties.

Thus, the rationale for requiring revenue raising measures in the House seems inapplicable to initiatives. If, in fact, one of the motives is to give the power to the body closest to the people, then it seems logical that the initiative process could be used to raise revenue.

CERTIFICATION

I HEREBY CERTIFY that the enclosed measure has been reviewed for form, style, and matters of substantive import. The recommendations set forth above have been communicated to the Petitioner via a copy of this Certification of Review, deposited in the U.S. Mail to Betsy McBride, League of Women Voters of Idaho, 12923 N. Schicks Ridge Rd., Boise, Idaho 83714.

Sincerely,



LAWRENCE G. WAsDEN
Attorney General

Analysis by:

David B. Young
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