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FISCAL IMPACT STATEMENT

LS 7382
BILL NUMBER: HB 1365

NOTE PREPARED: Feb 23, 2004
BILL AMENDED: Feb 23, 2004

SUBJECT: Various State Tax Matters.

FIRST AUTHOR: Rep. Cochran
FIRST SPONSOR: Sen. Borst

BILL STATUS: 2nd Reading - 2nd House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) This bill freezes the assessed value of land classified in the farmland protection program. Upon withdrawal from the classification, the bill requires payment of the Property Taxes that would have been assessed to the land during the lesser of the period of classification or ten years, plus interest. It also requires deposit of the Property Taxes in the farmland protection program account, creates the farmland protection program to be administered by the Indiana Land Resources Council, and creates the Farmland Protection Program Account.

The bill makes the following changes to the Sales and Use Tax: (1) Grants a credit against Indiana use tax for sales tax paid in another state for a vehicle, a watercraft, or an aircraft; (2) Makes the furnishing of satellite television service, cable radio service, and satellite radio service a retail transaction; (3) Indicates that a deduction for sales tax paid on a purchase price that becomes uncollectible is assignable only if the retail merchant that paid the tax assigned the right to the deduction in writing; (4) Requires certain out-of-state entities to collect sales tax in Indiana; and (5) Provides that gross retail income does not include receipts attributable to delivery charges or installation charges if those charges are separately stated on the invoice.

The bill revises the manner in which net operating losses are computed.

The bill also makes the Research Expense Credit permanent (instead of expiring at the end of 2013).

The bill repeals the Sales Tax credit for sales of motor vehicles, trailers, watercraft, and aircraft that are sold in Indiana and titled or registered in another state.

The bill eliminates the $2 annual fee to renew a permanent registration of a semitrailer and repeals the registration fee for a converter dolly.

The bill repeals the Sales Tax on complimentary hotel rooms.

Effective Date: (Amended) January 1, 2005; Upon Passage; January 1, 2004 (retroactive); March 1, 2004 (retroactive); July 1, 2004.

Explanation of State Expenditures: The Department of State Revenue will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the changes. The Department's current resources should be sufficient to absorb additional costs associated with the implementation of the changes.

(Revised) *Farmland Protection Program:* This bill would create the Farmland Protection Program. The program would be administered by the Indiana Land Resources Council which is currently staffed and administered by the Commissioner of Agriculture. The Council currently consists of nine members plus the Commissioner. The Council's responsibilities and costs would increase under this proposal.

Owners of land in the program would be given priority for state grants or technical assistance given by the Commissioner or the Department of Commerce. In addition, land that has been classified under the program would be deemed "protected farmland . As such, if the land is condemned, the owner would receive as compensation, 200% of the fair market value of the land. This premium does not apply if condemnation is for a highway, road, street, or right-of-way.

Under the proposal, the Council, working with local agencies, would be required to establish criteria for "designated areas on a county by county basis. It must also establish criteria for evaluating applications for the program including requirements that the farmland:

1. Is in a designated area.
2. Has been in production or in a conservation program for at least five years.
3. Is composed of at least 35acres of working land with not more than one residence.

The criteria may give preference to land that is part of certain other agricultural programs. Larger tracts of land would also be given priority. Inclusion in the program would require a minimum score on a points system that would include standards on soil erosion, conservation plans, landowner participation, and management plans.

The bill would create the Farmland Protection Program Account in the state General Fund to provide matching funds for the purchase of conservation easements through the Federal Farm and Ranch Lands Protection Program (7 CFR 1941). The non-reverting account would include revenue from:

1. Recaptured taxes from farmland that is withdrawn from the program;
2. Gifts and bequests; and
3. Grants.

Expenses associated with administering the account would be paid from the account. The bill requires an appropriation by the General Assembly before money in the account may be spent.

Explanation of State Revenues: (Revised) *Research Expense Income Tax Credit:* This credit is currently set to expire on December 31, 2013. This bill would eliminate the expiration date and make this credit permanent. It is difficult to estimate the exact impact of continuing this tax credit indefinitely since it is dependent on both the amount of research expenses individual taxpayers make during the year and their total tax liability. This permanent extension would affect revenue collections beginning in FY 2014 and years after.

Background: P.L. 242-2002 (ss) increased this credit from 5% to 10% of qualified expenses for tax years beginning January 1, 2003, and eliminated the apportionment factor used to calculate the credit. P.L. 224-2003 extended this tax credit until December 31, 2013. The total estimated cost of this credit at the higher rate is expected to range from approximately $50 M to $75 M annually. Over the past six years when the credit was set at a 5% rate, the Research Expense Credit has ranged from a low of $9.2 M in FY 1996 to a high of $24.2 M in FY 1999. In FY 2000 $19.4 M were claimed, and in FY 2001 $21.9 M were claimed at the 5% rate. No data is available on the amount of credits which might be claimed under the changes made by P.L. 242-2002(ss).

With additional incentives created for research and development activity based in the state of Indiana, the revenue loss from this credit could increase by an indeterminable amount. The credit provides $100,000 for each $1 M in new research expenses. Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment.

The Research Expense Tax Credit affects revenue collections deposited in the General Fund and the Property Tax Replacement Fund.

Sales and Use Tax: The bill contains changes to the state's Sales and Use Tax law that would impact state Sales Tax revenue.

Sales and Use Tax Credits: This bill contains two provisions that impact the Sales and Use Tax exemptions and credits associated with the motor vehicle, trailer, watercraft, and aircraft sales. Under current law, sales of motor vehicles, trailers, watercraft, and aircraft that are immediately shipped out of state, delivered for title and used out of state, or those that are not registered for use in Indiana are exempt from the state Sales Tax. This bill removes this exemption and makes the sale of these vehicles subject to the state Sales Tax.

The bill also makes an accompanying change in current law to allow persons who purchase vehicles, watercraft, and aircraft in other states to receive a credit against Indiana's Use Tax for sales taxes paid in another state on the same item. For example, if an Indiana resident purchases a boat in Wisconsin for use in Indiana and the purchaser pays Wisconsin's 5% Sales Tax, this bill would allow the purchaser to receive a credit against Indiana's 6% Use Tax on the taxes paid in Wisconsin. In this example, the purchaser's Indiana Use Tax liability would be limited to the 1% difference between Indiana's and Wisconsin's tax rates.

The changes above are expected to have, on net, a positive impact on state Sales and Use Tax revenue. The full impact of these changes are currently unspecifiable. However, given the large volume of currently exempt vehicle sales in Indiana, the impact of this bill on state Sales Tax revenue is expected to be significant.

Sales Tax on Satellite Television Providers: This provision changes current law to specify that satellite broadcasts of radio or television signals that terminate in Indiana are subject to the state's Sales Tax. (Cable television service is subject to the state's Sales Tax.) Prior to a June 16, 2003, ruling by the state's Tax Court, sales of satellite television service were subject to the state's Sales Tax. The DOR estimates that, absent the language proposed in the bill, the state would lose approximately $12 M each year in Sales Tax revenue.

Assignability of Sales Tax Deductions: This provision specifies that Sales Tax deductions for bad debt are only assignable if the retail merchant that paid the tax liability assigns the right to the deduction in writing. The impact on this provision on state Sales Tax revenue is expected to be negligible.

Retail Merchants: This bill requires certain entities that are closely related to out-of-state business entities that engage in taxable activities in Indiana to register as retail merchant in Indiana and, when applicable, to collect Indiana's Sales and Use Tax. This provision is expected to have a unspecifiable positive impact on state Sales Tax revenue.

Sales Tax on Delivery and Installation Charges: Upon passage, delivery and installation charges which are separately stated on a retail merchant's invoice are not subject to the state's Sales Tax. The provision is expected to cause a slight reduction in state Sales Tax revenue. (Beginning January 1, 2004, certain delivery and installation charges became subject to the state's Sales Tax insofar as they are included in a retail merchant's gross income from the sale of a taxable good.)

(Revised) *Repeal of the Sales Tax on Complimentary Hotel Rooms:* Based on early data from the Department of State Revenue (DOR), it is estimated that repealing the Sales Tax on complimentary hotel rooms will reduce state Sales Tax revenue by approximately $2.1 M each year.

The Sales Tax on complimentary hotel rooms went into effect on July 1, 2003 and applies to complimentary rooms offered by all hotels, including those associated with casino riverboats. According to DOR filing data, only five of the eight casino riverboats that have adjacent hotels have reported Sales Tax remittances on complimentary rooms during the second quarter of FY 2004. Data is not yet available on the amount, if any, of Sales Taxes paid on complimentary rooms from hotels not associated with the casino riverboats.

Revenue from the state's 6% Sales Tax is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%). (Prior to making a retail transaction in Indiana, retailers are required to register with the Department of State Revenue. The fee associated with registration is $25. Fee revenue is deposited in the state General Fund.)

Net Operating Loss: The bill simplifies the calculation of Indiana net operating loss. Under the bill, Indiana net operating loss is equal to the taxpayer's federal net operating loss adjusted for a variety of modifications for the same taxable year that the net operating loss was incurred. These modifications include adding back state income taxes, property taxes, and charitable contributions and deducting interest on U.S. Government obligations and other modification. Then, the apportionment percentage is applied to determine the Indiana portion of the net operating loss. The number of years that a firm is allowed to take an Indiana net operating loss carryover and/or carryback is the same as the number of years allowed in the IRS Code: a carryforward for up to a 20 years following the loss year and a carryback for up to 2 years preceding the loss year.

The impetus behind this provision of the bill is a court ruling which found that the method used on the tax forms to calculate Indiana net operating loss is different from the method described in the current law. The method of calculating Indiana net operating loss that is prescribed on Indiana tax forms and used by the vast majority of businesses claiming the net operating loss deduction is very similar to the method that is presented in the bill. As a result, the bill should cause little disruption in the way that firms calculate net operating loss and any corresponding carryback or carryforward. The statutory change proposed in the bill should have little effect on Adjusted Gross Income Tax revenues.

Registration of Semitrailers: The total revenue loss from this provision is estimated to be approximately **$482,000** annually.

Semitrailer Renewal Fee and other BMV fees: The elimination of the $2 annual fee to renew a permanent registration of a semitrailer will cause a revenue loss of approximately $416,700 annually. This is based on 40,655 registrations in CY 2003. In addition to the elimination of the $2 statutory fee, BMV will not be able to assess $8.25 of other service charges and fees which are tied to the registration fee. The total revenue loss is equal to $10.25 per registration. The fees and funds affected are listed in the following table. Actual revenue loss over time will depend upon the number of such registrations.

Fee	Amount	Fund Affected
Semitrailer Renewal Registration	$2	Motor Vehicle Highway Fund License Branch Fund (BMVC)
Service Charges	$3.25	License Branch Fund (BMVC)
Administrative Service Charge- Insurance Enforcement	$0.50	License Branch Fund (BMVC)
Crossroads 2000 Fee	$3.00	Crossroad 2000 Fund
Public Service Fee	$.025	State Police Building Account
Service Charges	$1.25	Integrated Public Safety Communication Fund
Total	**$10.25**	

Farm Semitrailer Renewal Fee and other BMV Fees: Elimination of the $2 annual fee to renew a permanent registration for a semitrailer also will eliminate the $1 fee for the permanent farm semitrailer renewal due to the provision under IC 9-29-5-13 which states that this fee is 50% of the semitrailer fee. This will result in a revenue loss of $27,500 annually. This is based on 2,976 registrations of these vehicles in CY 2003. Along with the $1 statutory fee, BMV will not be able to collect $8.25 of other service charges and fees discussed above for a total revenue loss of $9.25 per registration.

IRP Registration Fee: The Department of State Revenue currently collects the $2 semitrailer registration fee on approximately 18,876 semitrailers filing under the International Registration Plan (IRP). The elimination of the $2 fee would result in a revenue loss of approximately $37,800 annually.

The funds affected for the various fees listed above are the Motor Vehicle Highway Fund, the License Branch Fund (BMVC), State Police Building Account, Crossroads 2000 Fund, and the Integrated Public Safety Communications Fund.

Additional Information: Currently, county wheel tax (in adopting counties) and the Commercial Vehicle Excise Tax (CVET) are collected at the time of registration and upon annual renewal of permanent semitrailer registrations. These annual taxes would remain in force even if the annual renewal of permanent semitrailer registrations is repealed by this bill. The method of collection could be similar to current practice in that the BMV could continue to send a statement for these taxes in lieu of the current renewal notice. The bill does not change the liability of semitrailer owners for these two taxes, but it may affect collection and compliance.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) *Farmland Protection Program*: Under the program, farmland may be entered for classification for assessment purposes. For as long as it is in the program, the assessed value of farmland that is classified under this program would equal the lesser of (1) the assessment under the normal rules in effect in a tax year or (2) the assessed value on the assessment date that follows the date on which the farmland was entered into the program. (The base assessed value for farmland is currently $1,050 per acre.)

This means that as the value of farmland in general is periodically increased, whether through annual adjustments or a general reassessment, the value of farmland in the program would remain unchanged (unless the new assessment would be lower). Annual assessment adjustments are scheduled to begin with taxes paid in 2006 and the next general reassessment will take effect with taxes paid in 2010.

Over time, the stagnant assessment on this land would shift part of the property tax burden from the classified farmland owners to all taxpayers in the form of an increased tax rate. The amount of the tax shift would depend on the amount and value of farmland placed in the program.

Farmland that is withdrawn from the program is subject to a penalty equal to any tax savings for the preceding ten years plus interest calculated at 10% per year.

State Agencies Affected: Department of State Revenue; Bureau of Motor Vehicles; Commissioner of Agriculture; Indiana Land Resources Council; Department of Commerce.

Local Agencies Affected:

Information Sources: Tom Conley and Mike Ralston, Department of State Revenue; Bob Lain, State Budget Agency; Multistate Tax Commission, "Corporate Tax Sheltering and the Impact on State Corporate Income Tax Revenue Collections, 15 July 2003; Mazerov, Michael. "Closing Three Common Corporate Income Tax Loopholes Could Raise Additional Revenue for Many States, Center on Budget and Policy Priortities, 23 May 2003; Chris Hall of the Ohio Department of Taxation. BMV Cash Audit, Draft Copy for CY 2003. Bob Lain, State Budget Agency, 317-232-3471.

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