Alaska State Legislature
Senate Rules Committee
Senator Bill Wielechowski, Chair

Senate Bill 122

Corporate Income Tax Modernization
Sponsor Statement

Senate Bill 122 modernizes Alaska's corporate income tax laws to address the realities of the digital economy by making two reforms to Alaska's tax apportionment system. This bill adopts market-based sourcing for calculating the portion of a taxpayer's sales that are subject to Alaska's corporate income tax and adopts a single sales factor for calculating the taxable income of highly digitized businesses. SB 122 does not make any changes to Alaska's corporate income tax rates or brackets.

Under the Commerce Clause of the U.S. Constitution, states may only tax activity that is reasonably attributable to that state. For taxpayers who operate in multiple states, it is necessary to determine what portion of a taxpayer's sales are subject to being taxed by Alaska. Traditionally, most states have used a three-factor formula for income tax apportionment where the percentage of the taxpayer's sales that take place in the state, the percentage of a taxpayer's property located in the state, and the percentage of a taxpayer's payroll in a state are used to determine how much of a taxpayer's income can be taxed by that state.

Market-Based Sourcing

SB 122 amends Alaska's codification of the Multistate Tax Compact (MTC) to clarify that sales of goods and services in Alaska or delivered to Alaskan customers are properly considered to be Alaskan sales. Alaska is a member of the MTC, which is an advisory compact that recommends model legislation to facilitate uniform tax apportionment and filings. The 6th Alaska State Legislature codified the MTC in Alaska Statutes in 1970, and they could not have anticipated how to properly apportion sales from online businesses.

Currently the source of sales is determined using a methodology known as "cost of performance" that allows out-of-state corporations to argue that online sales occur in the state where the business is based and are thus not subject to Alaska's corporate income tax. Under market-based sourcing, sales would be apportioned to Alaska if the market for the sale was in Alaska. Sales of any tangible property in Alaska will be considered to be an Alaska sale and sales of intangible property and services will be considered Alaska sales if they are used in the state or delivered to a location in the state.

Single Sales Factor for Online Businesses

The three-factor formula was designed for a brick-and-mortar world and does not properly reflect online sales made in Alaska. SB 122 would apportion income from highly digitized businesses based on the sales factor alone, to ensure that income earned in Alaska is subject to Alaska's corporate income tax.

Through the internet, companies can offer goods and services for sale in Alaska without maintaining any property or employees in the state. Online businesses can target advertising to Alaskans; make sales and deliver electronic products through Alaska's broadband infrastructure; and ship products through Alaska's roads, ports, and airports all without having any payroll or property in the state. In fact, the three-factor formula disincentives high-tech companies from opening facilities in Alaska because having payroll or property here would increase their taxes.

The single sales factor will apply to corporations that makes at least 50 percent of their Alaska sales through electronic means or sales of services related to computer or Internet technologies. The traditional three-factor formula will remain in place for brick-and-mortar businesses. Alaska has previously adopted alternative tax apportionment systems for industries, such as the oil and gas industry, where the three-factor formula has been found to not be appropriate.

These reforms will have little, if any, effect on consumer prices for Alaskans. Online businesses usually set their prices at the national level and both market-based sourcing and single sales factor apportionment are increasingly common across the country. At least 36 states have adopted some form of market-based sourcing and at least 37 states have adopted a single sales factor for at least some industries.

When the 6^{th} Alaska State Legislature adopted the current system for tax apportionment in 1970, they could not have imagined how the internet would allow businesses to operate in Alaska without any property or payroll in the state. SB 122 makes common sense amendments to bring Alaska's tax apportionment system into the 21^{st} century.