

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

May 1, 2003

7:08 a.m.

MEMBERS PRESENT

Representative Mike Hawker, Co-Chair
Representative Jim Whitaker, Co-Chair
Representative Cheryll Heinze
Representative Vic Kohring
Representative Bruce Weyhrauch
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Norman Rokeberg

OTHER LEGISLATORS PRESENT

Representative Ralph Samuels
Representative Paul Seaton
Representative Dan Ogg
Representative Harry Crawford
Representative Kelly Wolf

COMMITTEE CALENDAR

HOUSE BILL NO. 293

"An Act levying and collecting a state sales and use tax;
and providing for an effective date."

- HEARD AND HELD

PREVIOUS ACTION

BILL: HB 293

SHORT TITLE: STATE SALES AND USE TAX

SPONSOR(S): WAYS & MEANS

Jrn-Date	Jrn-Page	Action
04/30/03	1202	(H) READ THE FIRST TIME - REFERRALS
04/30/03	1202	(H) W&M, FIN
04/30/03	1202	(H) REFERRED TO WAYS & MEANS

05/01/03

(H) W&M AT 7:00 AM HOUSE FINANCE
519

WITNESS REGISTER

LARRY PERSILY, Deputy Commissioner
Office of the Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Testified on HB 293 and answered questions.

DAN DICKINSON, Director
Tax Division
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: Testified on HB 293 and answered questions.

ACTION NARRATIVE

TAPE 03-20, SIDE A

Number 0001

CO-CHAIR JIM WHITAKER called the House Special Committee on Ways and Means meeting to order at 7:08 a.m. Representatives Hawker, Whitaker, Heinze, Kohring, Weyhrauch, Wilson, and Moses were present at the call to order. Representative Gruenberg arrived as the meeting was in progress. Representatives Samuels, Ogg, Seaton, Crawford, and Wolf were also present.

HB 293-STATE SALES AND USE TAX

CO-CHAIR WHITAKER announced that the only order of business would be HOUSE BILL NO. 293, "An Act levying and collecting a state sales and use tax; and providing for an effective date."

Number 0055

CO-CHAIR HAWKER moved to adopt HB 293, Version 23-LS1064\D, as the working document. There being no objection, Version D was before the committee.

Number 0122

LARRY PERSILY, Deputy Commissioner, Office of the Commissioner, Department of Revenue, testified on HB 293 and answered questions. He told the committee that this [bill] is a starting point for a sales and use tax, but it does not include any of the exemptions that were discussed in previous legislative sessions. For example, he said, some of the exemptions that were discussed were for medical care, prescription drugs, food. Furthermore, [some of the exemptions had] caps such that the tax would only apply to a certain amount of the purchase. He emphasized that this [legislation] is a starting point from which members can make policy decisions that will determine how the legislature wants it implemented, what will be taxed, and if exemptions will be offered. The sales and use tax [bill] would [delineate] the administration, enforcement, and collection of taxes. He said [the administration] believes that if a sales tax is to work in the state of Alaska, and work for businesses that are going to be collecting the tax on the state's behalf, there needs to be one set of laws and exemptions; one central point of enforcement and collection; and audits so [businesses and municipalities] are dealing with just one taxing entity rather than 98 different taxing entities between the communities, boroughs, and the state.

MR. PERSILY emphasized that the fiscal note is only an estimate, not a science. He said that the Department of Revenue (department) believes that if there is a sales and use tax without significant exemptions, caps, or other measures that would detract from the gain of revenue, there would be roughly \$110 million dollars for every 1 percent of a statewide year-round sales tax. HB 293 proposes a 3 percent sales and use tax, so there would be about \$330 million per year in revenue to the state. The first fiscal year would take effect on January 1, 2004, and tax returns would be due the next month so the state would get 5 months worth of tax returns in FY 04 [which would amount to approximately] \$135 million in revenue and \$330 [million in the next year]. As the economy continues to grow, that number would grow with it. Mr. Persily pointed out that fiscal notes do not take into account growth or inflation. He directed attention to page 2 of the fiscal note where some of the exempted items are listed. These are exemptions that the [administration] believes are essential to making [the legislation] work and giving it the clarity that is needed. For example, there are exemptions for items such as sale for resale, which means the sales tax is

[only] collected at the final end purchaser at the retail point not at every step of the way. Some other common sense exemptions are ingredients or components used in manufacturing and mining, sales to or by government agencies, and purchases with food stamps, WIC (Special Supplemental Nutrition Program for Women, Infants and Children) coupons, wages, dividends, and interest.

Number 0521

MR. PERSILY told the members that the department strongly recommends that if Alaska adopts a sales and use tax that it conform to the Streamlined Sales Tax Project [Streamlined Sales Tax Agreement Project]. He explained that this is a nationwide effort to adopt a simplified approach for customers and businesses. As nationwide trade in Internet sales, phone, and mail orders continue to grow, states have realized that there are significant amounts of money lost to those sales tax revenues. Part of the goal is to come up with nationwide standards so that it would be easier to work with the business community, thereby allowing the state to start collecting those sales tax revenues.

Number 0647

DAN DICKINSON, Director, Division of Taxes, Department of Revenue, testified on HB 293 and answered questions. He provided the following testimony:

We administer 19 different tax types, and I'd like to take a couple of minutes to talk about one important aspect of a tax that Alaska doesn't have - and that is the Streamlined Sales Tax Project. What is the Streamlined Sales Tax Project and what could it mean for Alaska? It will increase the likelihood that we can get out-of-state businesses to collect sales taxes for us on their sales into Alaska. It gives us a precise framework for simplicity, fairness, uniformity, and certainty - all worthy goals of any tax programs. And it will make Alaska a friendlier place to do business than if we instituted a complex maze for a sales tax.

Consider for a moment a business selling its goods nationwide. First of all, it is confronted

with 7,500 different taxing jurisdictions - states, cities, and counties, and special jurisdictions such as transit districts, school districts, or my favorite, the Brewers Stadium District in Wisconsin. Many of these jurisdictions overlap. Each might have a different sales tax, rules, and different rates. Suppose the state taxes clothing, but the county exempts clothing but not athletic gear, but the transit district taxes clothing but considers a softball mitt to be clothing. The business would have to figure out which transit district and which county the address was in, and then decide whether the purchase was taxable for each one and, if so, what was the tax rate.

If our example were in Mississippi, there could be seven different tax rates depending on what was sold, ranging from an 8 percent tax on drink for human consumption through vending machines to a 1 percent tax on services performed by an electrical power association. After withholding the tax, that same business might be subject to three different audits, including the one that said, "Oh, our rates changed two weeks ago. What do you mean you didn't know?"

And suppose the consumer bought an item and sent the check to a business' corporate headquarters in Missouri, which then notified its distributor in Oregon, who found that the closest warehouse with the product was in North Carolina, who called up a shipping firm in South Carolina to deliver it back to the purchaser in Virginia. In what state did the sale occur? Each state may have its own sourcing rules and each state could say, "That sale occurred in our state."

Now consider the phone call itself that was used to place the order. I will not flesh out the full example, but if you think about it, it should come as no surprise that AT&T is one of the biggest backers of the Streamlined Sales Tax Project. AT&T nationwide files about 70,000 different sales tax returns a year.

Back in 1967, the U.S. Supreme Court looked at all this and issued its famous (or for some of us infamous) Bellas Hess ruling. Illinois had a sales and use tax and asked that Bellas Hess, a firm in Missouri that sold goods by mail to purchasers in Illinois, be required to collect sales tax and remit it to Missouri. The Supreme Court said it would be an intolerable burden on interstate commerce to require an out-of-state business to do all the work necessary to accurately collect the tax. As such, no state could ask that of businesses outside its legal jurisdiction.

Number 1026

Before we roll our eyes too much, let's look at what a retailer looking at Alaska sees. For example, the Kenai Peninsula Borough has a 2 percent tax and, within the borough, the City of Homer has a 3 percent tax, but the City of Kachemak has none. Another example, the City of Ketchikan and Ketchikan Gateway Borough have separate sales taxes. Newspapers and publications are taxable in the city, but not under the borough tax. Residential rentals are taxable by the borough taxes, but not the city.

Many attempts to remedy this mess fell short over the 35 years since the court case, while the amount of interstate commerce has grown and grown. Finally, as Internet sales hit, the Streamlined Sales Tax Project looks like it might have created a good answer. What is the answer? It is a short statute that each participating state must adopt - the Uniform Sales and Use Tax Administration. The legislative body for that act says: "This state should enter into an agreement with one or more states to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance for all sellers and for all types of commerce."

The agreement between the states sets forth the framework that a state tax must conform to:

Uniform Definitions - Any state that, for example, that ... exempts groceries, but taxes restaurant food will have to treat a ham and cheese croissant from the Safeway deli the same way as a croissant sandwich in a restaurant.

Rate simplification - Each state may have just one tax rate covering all categories, except a specialty allowance for food and drugs which may have a lower rate. Each city can have its own rate, or other jurisdiction added to the state tax rate.

It requires state administration. The state is responsible to track local changes and provide a central point of administration. There are also uniform sourcing rules, audit rules, and administration of exempt transactions.

Thirty-eight states have brought the project together. It is their hope to ask Congress for a law allowing that if a state is a participating member of this project, then every business would be required to collect tax on items sold into that state. Under the Streamlined Sales Tax Project, such collection would not be unreasonable because it would no longer be an unreasonable burden on interstate commerce.

Number 1257

Before closing, let me mention a couple of things the Streamlined Sales Tax Project does not do. It does not set the tax rate in any state or city; that is up to you and the municipal assemblies. It does not set out what you can decide to exempt or not exempt; it just requires that if you exempt something for which the Streamlined Sales Tax Project has a definition, that you use the definition. The project creates a framework in which legislatures can make the critical policy decisions.

As you think about a sales tax, please think about the Streamlined Sales Tax Project. We would be the first state to adopt a sales tax

since it came into being, and we have the chance to learn from other states' mistakes.

Thank you, and I'll try to answer any questions you may have, though I usually do better answering questions on taxes we have in place rather than taxes we don't.

Number 1405

MR. PERSILY pointed out that the members have the executive summary of the Streamlined Sales Tax Project in their packets.

CO-CHAIR HAWKER asked Mr. Dickinson to reiterate what the Streamlined Sales Tax Project does and what it does not do.

Number 1540

MR. DICKINSON explained that it is not a prototype sales tax act, and merely passing the model legislation would not be the final step. This project addresses many of the troubling areas of sales taxes, especially the areas that are troublesome because each state has different rules instead of a uniform set of rules. In areas where uniformity is not required, it allows the local jurisdiction, states, or localities to make the critical decisions that are important to them. He told the members that, for example, it's not that AT&T wants to avoid taxes, it is simply more expensive in some cases for them to do the billing for a phone call, than to route the phone call. When the company has to figure out each jurisdiction, has to keep up to date on all 7,500 possible changes including ones that they were not aware of before, it becomes extremely difficult. Mr. Dickinson said that it almost seems trivial, but if the difference between a transit and school district does not line up with a zip code, it is hard for the company to send out a bill because they are unsure if the addressee is in the right set of jurisdictions. The natural reaction is that business will say that if they do not have a presence in the state, they will not establish one. There are many businesses that sell in Alaska that do not have a presence here, he commented. Under the current rules, these companies do not have to collect sales taxes.

MR. DICKINSON explained that this project would create a structure that enables businesses to collect taxes and remit it to [the State of Alaska] without an intolerable burden.

Number 1830

REPRESENTATIVE WEYHRAUCH posed the hypothetical question that if the legislature were to adopt the Streamlined Sales Tax Project, would it require Alaska to enter into an interstate compact with one or more states before or concurrent with the law [being enacted]. How does that work, he asked.

MR. DICKINSON responded that if this project became law, then Alaska would become a participating state with certain rights and obligations. No state has ever passed the act without having a sales tax in place, so there may be some curious aspects with respect to that. The main obligation would be that when passing the sales tax act itself, it must meet the requirements of the uniform standards. Mr. Dickinson offered the example of our current income tax under Title 43.19 and Title 43.20 for corporate income taxes. Title 43.19 covers the multi-state act which sets out broad principles while Title 43.20 covers the specific implementation of those principles for Alaska.

Number 2039

REPRESENTATIVE WEYHRAUCH pointed out that some communities already have sales taxes. If Alaska were to adopt a sales tax or enter into this uniform sales and use tax administration act with other states, what would happen to a local communities' ability to implement a sales tax and garner the benefit of its own local sales tax, he asked.

MR. PERSILY replied that HB 293 rewrites that section of Title 29 which deals with municipal powers. It simply says that the legislature or state determines the exemptions, enforcement, collection, and administration of the sales tax. He explained that the municipality would simply say to the state that it wants a 2 percent, 3 percent, or 4 percent sales tax and that would be collected from businesses in its jurisdiction. The state would collect the taxes and send them back to the municipality.

Number 2227

REPRESENTATIVE WEYHRAUCH surmised that [the state assumes authority in collecting the tax] then delegates it back to the municipalities through a check.

MR. PERSILY responded that the municipalities would get the money, and could in essence, shutdown the local sales tax offices. In Juneau's case there are 38 sales tax exemptions, those would go away and the state sales tax exemptions would be in effect, he explained.

REPRESENTATIVE WEYHRAUCH posed a situation which this law is in place. He asked if the local sales tax would go away and the city would simply [tell the state] it wants a 5 percent sales tax on sales from the community or would the state say this is what has been calculated for the [local] sales tax and the state would send the city a check.

Number 2359

MR. PERSILY clarified that if this law went effect the municipalities would tell the state what [percent sales tax] rate, which is set by municipal ordinance, it wants collected. The state would collect the sales tax and send the municipality a check.

REPRESENTATIVE WEYHRAUCH referred to the "Comparison of State and Local Retail Sales Tax" chart that was distributed to the members, where there is a maximum of 7 percent that can be levied by communities under Title 29. He asked if that assumption is correct.

MR. PERSILY replied that the highest sales tax in the state is 7 percent right now. He told the members that he is not aware of a limit on sales taxes under Title 29; however, cities who currently have a 5 percent, 6 percent, and 7 percent [sales tax], will be worried that if the state adds on another 3 percent sales tax, it will hurt the local economy. The legislature could setup something in statute that may include a grandfather clause specifying that a combined state/local rate may not exceed 8 percent, for example.

REPRESENTATIVE WEYHRAUCH said that he believes that under this scheme, the local tax would be supplanted by the statewide policy and the city would have the incentive to

say it wants the 7 percent sales tax, even if the community does not have a sales tax in place now.

Number 2530

MR. DICKINSON highlighted that in Anchorage there is no sales tax and if the city did not introduce one, everyone there would be paying a 3 percent sales tax on goods and services. If Anchorage were to add the 7 percent, then everyone would be paying 10 percent. The aforementioned decision remains with the local government. Before a community could get 7 percent refunded, it would have to add the 7 percent [sales tax] on all goods and services sold in the community.

MR. PERSILY stated that there is nothing in statute or this legislation that sets a maximum rate for the combined state/municipal tax rate.

Number 2634

REPRESENTATIVE WEYHRAUCH asked if Mr. Persily believes this bill could become a sales tax exemption bill rather than a sales tax bill.

MR. PERSILY responded that it will be incumbent on public officials to hold the line against lobbyists who will want to turn it into an exemption bill. This could become something like Juneau's sales tax with 38 exemptions, which requires a much higher rate to obtain the same amount of revenue, he said.

CO-CHAIR HAWKER commented that whatever is accomplished [with this bill] must accommodate local tax structures. He pointed out that communities with property taxes are relevant. It is important to note the aggregate self-assessed, self-reliance that communities are taking on. A fair benchmark of looking at that is the per capita revenue generated from whatever sources are within the communities. As Representative Weyhrauch pointed out, the sales tax project offers an extreme benefit across the state. If there is uniformity and consistency, it will make it possible for statewide businesses to work among jurisdictions. Co-Chair Hawker commented that it will be important to work with communities and the Alaska Municipal League. He said he believes this is a vital dialogue. As divergent as interests are in these communities the per

capita burden, on Fairbanks and Anchorage is less than \$2 per capita difference. The local tax burden in the City of Wrangell which is often cited as a community with a high tax burden is less than \$60 per capita higher than Anchorage and Fairbanks. The Streamlined Sales Tax system offers efficiency, consistency, and facilitates business in the state. He said he agrees with Representative Weyhrauch that the great fear is that this bill does not become one that panders to special interests.

CO-CHAIR WHITAKER noted for the record that Representatives Gruenberg, Wolf, and Crawford have joined the meeting.

Number 3055

REPRESENTATIVE SAMUELS asked if all the exemptions would be accepted statewide, or do the exemptions just have to meet the statewide definitions.

MR. PERSILY replied that state statute would set the exemptions and the municipal exemptions would go away because the [municipalities] would lose that authority.

Number 3157

CO-CHAIR HAWKER told the members that the Streamlined Sales Tax Project has detailed position papers on many subjects. The issue that Representative Samuels' just raised is discussed under a series of position papers on subject. He told the members that copies of those papers would be distributed to the members.

Number 3241

REPRESENTATIVE OGG asked how the state's cost of administration would differ from the [current] local cost of administration.

MR. PERSILY responded that the bill and fiscal note before the committee assumes that the state will fund the total cost of enforcing, administering, and collecting the sales tax. The local municipalities, cities, and boroughs could shutdown their sales tax collection efforts. He noted that it will become a policy call for the legislature as to whether the state pays the total cost and sends the check to the communities, or the state charges municipalities for the services that are provided. He reiterated that in the

current fiscal note there is the assumption that the state pays the total cost in Alaska and just sends the checks to the cities.

Number 3400

REPRESENTATIVE OGG summarized that if Kodiak had a 6 percent sales tax, there would be no administrative costs; the city would just receive a check for the sales tax.

MR. PERSILY responded that as the bill is currently written, that is a correct assumption. The communities would see the revenue, and save the administrative costs.

Number 3422

MR. DICKINSON advised the members that at one Streamlined Sales Tax Project meeting that he attended that issue was hotly debated. He explained that what might be an option, for example, is that the City of Kodiak may want to employ a part-time person to review the state's records on distribution. It is a policy question, he said. The legislature may say the state will do everything necessary and then the municipality may chose to have some degree of interaction to ensure that the municipalities are comfortable and that it makes sense. There is an "analogy" [currently in place] with statewide property taxes that are assessed, and the localities are very interested in what happens in that process.

REPRESENTATIVE OGG pointed out that existing sales taxes in some communities are high, some are low, and some have a cap. He asked if there has been any analysis on the kind of impact a statewide sales tax would have on communities that have used local sales taxes as a way of offsetting property taxes.

Number 3702

MR. PERSILY responded that one of the policy calls the legislature will have to make in dealing with this legislation is whether to set a cap and whether it applies to only certain goods. The analysis of this policy was discussed at great length in fiscal policy meetings over the last couple of years. He explained that the discussion centered on the fact that there is a threshold of pain, at which point the tax rate is so high that it does begin to

affect consumers' purchases. In other words, he said, at what point will [consumers] say they will not pay the sales tax, and buy an item somewhere else. Mr. Persily stated that he is not aware of any scientific study or conclusion [on this issue] other than the recognition that there probably is a point at which consumer habits will be impacted.

MR. DICKINSON told the members that with the Streamlined Sales Tax Act there would be a phase out of caps and thresholds by December 31, 2005. However, it is important to note that certain sales would be exempted. Those exemptions are motor vehicles, aircraft, watercraft, modular homes, manufactured homes, and mobile homes. Homes are exempted because they are real property, and motor vehicles are not covered because there is a specific exemption under the uniform sales tax.

MR. DICKINSON, in response to Representative Ogg, clarified that under the Streamlined Sales Tax Act there could only be caps on motor vehicles, aircraft, watercraft, modular homes, manufactured homes, and mobile homes. For example, Tennessee has a cap on an aircraft over \$100,000. He explained that the state could continue to make exceptions and pass caps on how much an Alaskan would have to pay when purchasing a car or a boat, although the state would not be exempting it from the sales tax.

Number 4007

REPRESENTATIVE WILSON inquired as to how the state would take over the collection of sales tax. Would the state contract with someone locally or send [a state employee] into each community, she asked.

MR. PERSILY explained that the state would set up a central sales tax office so that there would be one place to send the checks. He added that there would possibly be satellite offices in larger communities. However, he mentioned that some communities may want to keep someone on staff to monitor state collections and enforcement.

Number 4125

REPRESENTATIVE WILSON commented that the person doing that work in local communities would lose his/her job.

MR. PERSILY acknowledged that the cities have the option of eliminating that position or reassigning it to other duties. However, communities may want to keep staff on to monitor the collection of sales taxes.

MR. DICKINSON pointed out that this bill does not affect special excise taxes. For example, the local raw fish taxes and bed taxes will still be a local option and may still require administrators. This bill only refers to a broad-based sales tax, he said.

REPRESENTATIVE GRUENBERG asked how the bill addresses Internet sales.

Number 4344

MR. DICKINSON replied that [Internet sales] are the focus of the Streamlined Sales Tax Act and the same rules apply. For example, if Amazon.com does not have a substantial presence in the state, and it sends books or records to Alaska, it has no obligation to collect a sales tax for the localities or a statewide sales tax. Once this Streamlined Sales Tax [Act] is in place, the notion is that either through a federal court decision or federal legislation, [Internet companies] would be required to start collecting taxes. He added that Amazon.com is fine with the processes of collecting taxes; they just do not want to be in a position of not knowing what is necessary.

CO-CHAIR HAWKER asked Mr. Dickinson to explain Section 5 of the Uniform Sales and Use Tax Administration Act, which authorizes the state to enter into a streamlined sales and use tax with other states.

MR. DICKINSON read the following quote from Section 5 of the [Uniform Sales and Use Tax Administration Act]:

No provision of the agreement authorized by this act, in whole or in part, invalidates or amends any provision of the law of this state. Adoption of the agreement by the state does not amend or modify any law of this state, implementation of any condition of the agreement in this state, whether adopted before or after the membership of this agreement must be an action of this state.

MR. DICKINSON said that all this act does is set out the broad framework that says the state is going to enter into agreement with one or any number of other states. He added that the notion right now is that agreement would be with 38 other states. He told the members the agreement is set out so that the goal would be to bring the state in line with the principles enunciated here. Mr. Dickinson summarized that the uniform act sets the goal. He asked the members to look at another sentence in Section 7 of the uniform act, which says:

This agreement authorized by this act is an accord among individual cooperating sovereigns in furtherance of their governmental functions.

MR. DICKINSON summarized that this is not some agency coming in and telling [Alaska] what to do; it is basically saying that if Alaska does this the same way other states are doing it, there will be a mutual benefit.

Number 4646

REPRESENTATIVE HEINZE said that she is confused regarding what items are taxable.

TAPE 03-20, SIDE B

MR. PERSILY specified that real property is not taxable.

Number 4631

MR. DICKINSON said property is either real or personal property. For example, the valuation of the Trans-Alaska Pipeline System is considered personal property. Mr. Dickinson said it is important to recognize that this is not just a sales tax, but also a sales and use tax. To ensure that the state is not swamped with importation from states with a lower sales tax, the use tax becomes very important. He used the example of someone buying a sofa in Seattle and shipping it to Alaska. That person may not fill out paperwork, but just go ahead and pay the sales tax in Washington. The individual could use the tax paid in Washington as a credit toward the sales tax in Alaska, and then he/she would not have to pay anything. Mr. Dickinson explained that it will be up to the legislature to determine how the state will deal with industrial purchases. In some states, the purchase of any business-

related materials are exempt. Other states only exempt items that are purchased for resale. He posed an example of a business building chairs. On one extreme the wood and varnish are tax exempt while the tools are not. In the other extreme, where there is a blanket exemption for business, the tools would be exempt. Mr. Dickinson identified that as one of the decisions the members will have to make. In HB 293 there is a fairly narrow restriction on exemptions. That issue varies greatly between states, he said.

Number 4336

REPRESENTATIVE HEINZE said that she noticed the bill analysis specifies that certain exemptions include ingredients and components of manufacturing. If a module built in Kenai is on its way to Prudhoe Bay, would the components be tax exempt while the completed module would be taxed.

MR. DICKINSON explained that if a firm in Kenai were to purchase all the pieces, use them to create a module, and then sell it to a producer on the North Slope, the company that purchased the pieces would not be taxed. However, when the module is sold, it [the sale of the module] would be taxed. If the entire process were owned by the producer, in other words, a Kenai firm was fabricating it, then as those [imported pieces] were brought in they would be taxed.

CO-CHAIR WHITAKER clarified that the item would be taxed only once.

MR. DICKINSON agreed and pointed out that is why there is a use tax credit for tax already paid in other states.

Number 4127

REPRESENTATIVE WILSON asked how this tax would work for a restaurant. For example, when lettuce is purchased for a salad, no tax is paid; however, when the salad is sold a tax is charged.

MR. DICKINSON commented that if the legislature chooses to exempt all business inputs, then when the restaurateur buys lettuce he/she would not pay tax, although there would be a tax on the meal. He explained that a system is set up so

that when the restaurateur goes to the store, the restaurateur simply presents the tax exempt certificate. The problem with this is that in a recent court case, for example, where a funeral parlor purchased a 50-gallon tank of weed killer the court ruled that was not a reasonable use and that the business honoring the exemption certificate should have asked more questions. Mr. Dickinson said one of the reasons this bill is so long is that it gets into the businesses' obligations to each other when resale or exemption certificates are presented. He emphasized that the goal is to only tax items once. He explained that there is also a direct pay certificate. For example, in a restaurant only the things that were resold [were taxable] not the items that contributed to that resale. With a direct pay certificate, a restaurant would figure out on a monthly basis what was taxable and what was not and pay the state monthly. This method may be easier for the business than determining what is taxable and what is not each time there is a purchase.

Number 3804

CO-CHAIR WHITAKER asked Mr. Persily to go over page 4 and 5 of the fiscal note where the department recommends adding provisions to the legislation.

MR. PERSILY told the members that the first two items the department recommends adding to the legislation has to do with the streamlined sales tax. He said that he believes there should be something in the legislation that directs the department to write regulations that are consistent with a streamlined sales tax, particularly a section detailing sourcing of services. The third item deals with bartering. The department is not proposing exempting or taxing bartering; however, the legislature should address the issue. He pointed out that the taxing of bartering would be very difficult to enforce. The fourth item would allow the department to issue direct pay permits.

MR. PERSILY said the next several items deal with consolidating liability. He explained the Department of Revenue hired an individual several years ago on a short-term contract to research a draft sales tax bill. It was done because the department believed at some time in the future a sales tax would be considered. As a result of that research the 25 suggestions brought issues to light. Mr. Persily told the committee that some of these items are

housekeeping, and some are significant. He pointed out that the draft bill presented to the House Special Committee on Ways and Means is a work in progress and still needs technical changes to it. For example, item six needs the first sentence deleted and the word "however" added to the second sentence. Item seven would clarify that this is a sales and use tax. This change would ensure that each reference refers to both. Mr. Persily explained that item nine deals with the connection needed to have taxing jurisdiction over an entity. Under existing law [there is a requirement for] a physical presence in the state, which is why Amazon.com, for example, sales into Alaska cannot be required to collect sales tax because there is no nexus. Mr. Persily said that the department wants this legislation to say that the state can collect sales taxes to the full extent that is allowed by the U.S. Constitution.

MR. DICKINSON added that this is something the department hopes will be changed in the near term. The notion is to make it a very broad [statement].

Number 3331

MR. PERSILY explained that item 11 deals with certificates. For example, in Juneau when a building permit is obtained, all purchases are exempt from sales tax. Each building permit holder is issued a card so when there are purchases made for the project, the items are logged in as tax exempt. This section allows for two kinds of certificates, one of which is a blanket certificate or specific transaction certificate.

MR. PERSILY told the members that item 13 deals with Section 43.40.090 which exempts government purchases from sales taxes. [That exemption includes] city, municipal, state, school districts, and Indian tribes. This change would amend the section to read "a federally recognized" Indian tribe.

MR. PERSILY summarized his comments by saying that the remaining items deal with adopting the streamlined sales tax definitions. He said he is not aware of any other changes that are significant, and asked Mr. Dickinson if he would like to add anything to what he has said.

MR. DICKINSON agreed that the rest of the changes are not significant policy calls for the committee.

Number 3100

CO-CHAIR HAWKER asked Mr. Persily if the department believes the legislature should consider a separate [higher] rate structure on sales of contraband and the performance of illegal services.

MR. PERSILY replied that he is not sure there is a good way to answer that question.

MR. DICKINSON observed that if the state does adopt the streamlined sales tax, only one general rate is allowed, although the states do allow a different rate for drugs.

CO-CHAIR HAWKER commented that addressing that issue may have to be handled by a separate excise tax.

MR. DICKINSON agreed that is possible. He added that if the state wanted to put on a separate excise tax for marijuana that would be permissible.

Number 2929

REPRESENTATIVE WILSON asked Mr. Dickinson about a question of fairness. Because of Alaska's great vastness, products must travel great distances to reach consumers. For example, the cost of a gallon of milk in Wrangell costs \$3.99 so if there were a 3 percent sales tax the residents would be paying 12 cents; however, the cost in Nome is \$5.69 so the residents there would be pay 17 cents, in Kotzebue the cost is \$8 a gallon so they would be paying 24 cents for the same gallon of milk, and in Anchorage that same gallon of milk is only \$3.49 so they would only pay 10 cents on that gallon of milk. She asked how fairness would be addressed in this case.

MR. DICKINSON replied that a fair way of handling this kind of purchase would be to handle purchases by unit and not by the price. He explained that fairness [can be achieved] by treating everyone the same based on how much they spend, or by going to a per unit basis. However, with a broad tax it is hard to go to a per unit basis. Mr. Dickinson explained that some states that tax food go to a credit that allows a payment back to low-income families who pay a disproportionately large portion of their income on taxes because they spend a disproportionately large portion on

food. There are a number ways of dealing with this issue. Mr. Dickinson told the members the most common way is to keep these purchases outside the sales tax system, but make it a remission to the targeted group so they receive back some of what they have paid in.

Number 2614

REPRESENTATIVE WILSON commented that it will be very difficult because of the cost of transportation [that is added to the purchase price.

MR. PERSILY addressed Representative Wilson's concern by saying that if the legislature wants to adopt a sales tax as a part of an overall fiscal plan, it is not easy to overcome the fact that there is a certain amount of unfairness. If a person pays more for a certain product, that person will pay more tax, he said.

REPRESENTATIVE WILSON suggested providing a payback to those areas might be a good idea.

Number 2452

REPRESENTATIVE HEINZE noted that the bill does not allow for the sale of natural gas to be exempt. She asked if Mr. Persily believes this will produce a large impact on rural Alaska.

MR. PERSILY replied that utilities are not tax exempt. He said he believes that the component in the manufacturing process would be tax exempt.

Number 2309

CO-CHAIR HAWKER told the members that he concurs with Mr. Dickinson's response on fairness and equalization across the state. If the measure is truly to be the same dollar collected across the state no matter where residents reside, it is important to look at a system of unitizing assessment structure. He said he believes this will be the more daunting challenge in this process.

MR. PERSILY clarified his response by saying that the gas purchased to turn into fertilizer would not be taxed. In response to Representative Heinze's question about sales tax on natural gas for Chugach Electric, he explained that

the gas the company purchases would not be taxed, but when electricity is sold to a customer, the customer would pay [tax] on the electricity that is generated from that gas.

Number 2138

REPRESENTATIVE OGG commented on Representative Wilson's idea and suggested that while it may be impossible to credit individuals, perhaps it would be possible to compensate communities on a CPI [Consumer Price Index] or something similar to that.

Number 2038

MR. PERSILY pointed out that the department also provided a document titled "Comparison of State and Local Retail Sales Taxes", which is a summary of other statewide sales taxes. He explained that this handout was provided to provide the members an idea of what other states charge; what other cities and boroughs of Alaska charge; how much the department believes would be raised; and who would pay a tax. For example, the department estimates that approximately 10 percent of the year-round sales tax would be paid by out-of-state visitors and temporary workers. Another item which is titled "Building Blocks" raises some of the policy and technical issues that need to be considered as the committee crafts a sales tax bill.

Number 1921

CO-CHAIR WHITAKER asked the members to give this necessary component to a fiscal plan a great deal of thought.

REPRESENTATIVE KOHRING told the committee he has a concern about the sponsor statement. He asked that the statement reflect that this bill was produced at the suggestion of the co-chairs and not the whole committee.

CO-CHAIR WHITAKER responded that the committee will be happy to comply with his request.

Number 1637

REPRESENTATIVE WILSON commented that even if there is a mechanism to payback communities [that pay an inequitable amount of sales tax] the individual citizens in that community will not be reimbursed. For example, Wrangell,

which has the highest sales tax in the state, will be paying 10 percent if the state implements a 3 percent sales tax. Representative Wilson cautioned that the committee must work to make this fair because if it cannot be worked out, she said she would not be able to support the legislation.

[HB 293 was held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 8:28 a.m.