

**ALASKA STATE LEGISLATURE**  
**SENATE COMMUNITY AND REGIONAL AFFAIRS STANDING COMMITTEE**

April 6, 2005

1:34 p.m.

**MEMBERS PRESENT**

Senator Gary Stevens, Chair  
Senator Bert Stedman  
Senator Thomas Wagoner  
Senator Johnny Ellis  
Senator Albert Kookesh

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

SENATE BILL NO. 158

"An Act prohibiting the imposition of municipal sales and use taxes on state construction contracts and certain subcontracts; and providing for an effective date."

MOVED SB 158 OUT OF COMMITTEE

SENATE BILL NO. 114

"An Act relating to consolidating or abolishing certain service areas in second class boroughs."

MOVED CSSB 114(CRA) OUT OF COMMITTEE

**PREVIOUS COMMITTEE ACTION**

BILL: SB 158

SHORT TITLE: MUNI TAX ON STATE CONSTRUCTION CONTRACTS

SPONSOR(S): SENATOR(S) HUGGINS

04/01/05	(S)	READ THE FIRST TIME - REFERRALS
04/01/05	(S)	CRA, FIN
04/06/05	(S)	CRA AT 1:30 PM BELTZ 211

BILL: SB 114

SHORT TITLE: SERVICE AREAS IN SECOND CLASS BOROUGHES

SPONSOR(S): COMMUNITY & REGIONAL AFFAIRS

02/23/05	(S)	READ THE FIRST TIME - REFERRALS
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02/23/05 (S) CRA  
03/09/05 (S) CRA AT 1:30 PM BELTZ 211  
03/09/05 (S) Heard & Held  
03/09/05 (S) MINUTE(CRA)  
04/04/05 (S) CRA AT 1:30 PM BELTZ 211  
04/04/05 (S) Heard & Held  
04/04/05 (S) MINUTE(CRA)

**WITNESS REGISTER**

Senator Charlie Huggins  
Capitol Building  
Juneau, AK 99801

**POSITION STATEMENT:** Sponsor SB 158

Deborah Grundmann  
Capitol Building  
Juneau, AK 99801

**POSITION STATEMENT:**

Steve Boyd  
Alaska Chapter  
National Electrical Contractors Association  
Anchorage, AK 99507

**POSITION STATEMENT:** Supported SB 158

Dave Lance, General Manager  
Diamond Electric Co.  
Anchorage, AK 99507

**POSITION STATEMENT:** Supported SB 158

Denise Michels, Mayor  
City of Nome  
P.O. Box 281  
Nome, AK

**POSITION STATEMENT:** Opposed SB 158

Kevin Ritchie, Executive Director  
Alaska Municipal League  
217 Second Street, Suite 200  
Juneau, Alaska 99801

**POSITION STATEMENT:** Testified on SB 158 and stated support to give municipalities broad purview for sales taxes

Jim Dokoozian, General Contractor  
Anchorage, AK

**POSITION STATEMENT:** Supported SB 158

John Wheatley, Surety Manager  
Anchorage, AK

**POSITION STATEMENT:** Supported SB 158

Rynniewa Moss  
Staff to Representative Coghill  
Alaska State Capitol  
Juneau, AK 99801-1182

**POSITION STATEMENT:** Explained aspects of SB 114

#### **ACTION NARRATIVE**

**CHAIR GARY STEVENS** called the Senate Community and Regional Affairs Standing Committee meeting to order at [1:34:24 PM](#). Present were Senators Stedman, Wagoner, Ellis and Chair Gary Stevens. Senator Kookesh arrived momentarily.

#### **SB 158-MUNI TAX ON STATE CONSTRUCTION CONTRACTS**

[1:34:46 PM](#)

CHAIR GARY STEVENS announced SB 158 to be up for consideration.

[1:35:00 PM](#)

SENATOR CHARLIE HUGGINS, Sponsor, said the issue is that some construction subcontractors have had local sales taxes imposed on Alaska Department of Transportation and Public Facilities projects. The primary contractor doesn't pay sales tax on these projects, but that immunity doesn't carry over to the subcontracts.

In the instance of the Nome Airport Project, a subcontractor was assessed sales tax in excess of \$20,000. The tax was not anticipated or therefore it not considered in the bid.

If this practice continues, subcontractors will pass the costs along to the state in the form of higher bids. While all municipalities don't assess this sales tax, the policy needs statewide consistent.

[1:38:59 PM](#)

DEBORAH GRUNDMANN, Staff to Senator Huggins, reiterated some subcontractors in certain areas of the state had local sales tax

levied on DOT funded projects. The tax was levied on the value of the subcontract and not on food, lodging and incidentals.

[1:40:26 PM](#)

CHAIR GARY STEVENS said he wanted a clear understanding of what is taxable and what is not. He heard that a subcontractor would pay tax on food, lodging, and car rentals, but he questioned whether tax would be due on local purchases of electrical supplies and lumber.

MS. GRUNDMANN said each municipality has its own ordinance so the tax could be different in every municipality. According to the contractors, they pay tax on the purchase of incidental materials. This bill isn't designed to change that. SB 158 addresses local sales tax levied on the value of subcontracts for state projects.

[1:42:24 PM](#)

SENATOR THOMAS WAGONER said subcontractors in the Kenai Peninsula Borough that are licensed through the state and as a tax-exempt business through the borough, have the ability to purchase job related items locally without paying sales tax. At the end of the job a tax is due, but the cap is \$25 or 2 percent. In the Nome instance, there was no cap.

[1:43:14 PM](#)

SENATOR HUGGINS said that until recently, the practice has been that state contracts are not taxed. Now that some municipalities have started to impose a tax on subcontractors, the Legislature has to pass this bill or the state will pay the tax in the form of higher contract bids.

[1:44:02 PM](#)

CHAIR GARY STEVENS opened public testimony.

[1:44:29 PM](#)

STEVE BOYD, Alaska Chapter, National Electrical Contractors Association, stated that the association feels that the scope of state projects logically links subcontractors to the general contractor so the local tax exemption that applies to the general contract should also apply to subcontract values.

Contract bids are typically solicited from general contractors for a total product, which includes subcontractor work. Subcontractors do work for the state through a state established conduit. They are bound to the general contractor in much the same way and with the same language that the general contractor is bound to the state and should therefore receive the same tax exemption.

The association learned that subcontractors were assessed local sales tax on work done on state airport projects in Nome and Sandpoint, which sets up an inequity between subcontractors and the general contractor. It is the association's goal to create a consistent and equitable practice statewide. Clarification of the statute would be in the best interest of the state and the industry.

[1:47:30 PM](#)

CHAIR GARY STEVENS asked how much sales tax was collected on the Nome airport project.

MR. BOYD said he didn't have that information.

SENATOR JOHNNY ELLIS said that although he liked the direction of the bill, he questioned why some subcontractors bill through the general contractor and some don't.

MR. BOYD reiterated the general contractor typically provides a price for the entire project and solicits bids from subcontractors. In some instances a project might only include electrical work or mechanical work and then the subcontractor would work directly for the state, municipality or federal government.

SENATOR WAGONER suggested the defining point of the discussion is who does the certified payroll.

MR. BOYD said that would be an obligation on the contract.

SENATOR ALBERT KOOKESH made the point that if a contractor did a non-state job, then sales tax would be paid.

MR. BOYD agreed that the issue relates just to state contracts.

SENATOR KOOKESH said he wanted that on record to make it clear that contractors or subcontractors that aren't doing state jobs pay municipal taxes if there are any.

MR. BOYD agreed this relates to state contracts.

SENATOR GARY STEVENS remarked this could be a problem for a number of reasons. If a subcontractor bids a project and isn't aware that tax is due it's unfair. Neither is it fair if some subcontractors include the tax in the bid and others don't.

MR. BOYD agreed this creates uncertainty and an imbalance in the playing field.

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DAVE LANCE, Diamond Electric General Manager, said his company worked on the Nome project. The project was bid in 2001 and it happened in the summer of 2002. As part of the process, the Department of Transportation and Public Facilities (DOT/PF) approved Diamond Electric and the other subcontractors to provide bona fide subcontract work.

Part way through the project the City of Nome issued a sales tax bill to Diamond Electric on the full amount of its \$400,000 subcontract. The company purchased about \$75,000 in goods and services from the city and paid sales tax on those local purchases as anticipated. What they didn't anticipate was the tax bill on the amount of the contract.

Because this was a change in conditions, they submitted a bill to the state for reimbursement, but that went nowhere. It became a legal issue and finally, to cut their losses, they settled out of court and paid the city \$20,000 and \$11,000 more in attorney fees.

He pointed out that they were actually double taxed because they paid tax on incidental goods and services and then paid tax on the total project.

CHAIR GARY STEVENS summarized that they paid tax when they purchased incidental amounts of cement, lumber, room and board, and then they paid an additional 5 percent tax on the entire project.

SENATOR KOOKESH noted the effective date is immediate so it wouldn't resolve any past problems.

MR. LANCE agreed.

SENATOR KOOKESH said he wanted that to be part of the record because he didn't want subcontractors looking back and seeking reimbursement.

MR. LANCE replied he realizes he wouldn't be reimbursed.

[1:58:01 PM](#)

DENISE MICHELS, Mayor, City of Nome, stated that the city opposes the bill. From the city perspective this is a local government option for getting revenue. Since 1990, revenue sharing has been reduced from \$600,000 to nothing. In fact the city is looking at operating at a deficit this year.

She explained that the city receives revenue from property tax and sales tax and charging sales tax to subcontractors is one way for the city to stay afloat financially. Removing this option would impose one more cut on the city. She asked the committee to view this as a local option and not pass the bill.

[2:00:22 PM](#)

CHAIR GARY STEVENS remarked it's a bit of a double-edged sword because if subcontractors were to include tax in their bids then the community would ultimately receive less work on a project.

MAYOR MICHELS agreed that the situation is difficult. She explained that DOT takes a 5 percent cut before project funds go out and although the city believes in partnering, it needs to maintain local options and the citizens of Nome choose to tax subcontractors.

[2:01:52 PM](#)

SENATOR BERT STEDMAN said Sitka has a \$1,000 cap on sales tax and he was curious whether Nome has a cap.

MAYOR MICHELS replied the tax is 5 percent of purchases and for building projects it's a percentage based on the amount of the project.

SENATOR STEDMAN questioned how much the sales tax would decline if the bill passes.

MAYOR MICHELS estimated between \$100,000 and \$200,000 and added that Nome is lucky to get one or two state projects every three to five years.

SENATOR WAGONER stated he didn't know about the fairness of taxing the state when it put \$8 million into benefiting Nome. He suggested this is a protection for small contractors as much as a protection for the state.

MAYOR MICHELS responded it is part of due diligence for the contractor to call the city and make sure you know what to expect when bidding a project. She reiterated this should be considered a local option.

CHAIR GARY STEVENS said he heard Mr. Lance say that he wasn't taxed on previous projects in Nome but that part way through this project he was taxed. He asked whether the city shouldn't assume the responsibility of letting contractors know that they would be taxed.

MAYOR MICHELS replied the option has been on the books.

CHAIR GARY STEVENS asked if the city simply hadn't collected the tax in the past

MAYOR MICHELS replied she wasn't sure; she was elected just three years ago.

[2:06:18 PM](#)

SENATOR KOOKESH thanked Mayor Michels for the job she was doing and made the point that being mayor is a difficult and unpaid job in a small community. A lot of communities are closing because they can't afford to operate so he doesn't blame the city for looking for additional revenues.

He asked that the record reflect the clarification that very little general fund money goes into airports in the state. It's mostly federal dollars that build airports.

SENATOR WAGONER said he doesn't care whether it's federal or state dollars because they are all taxpayer dollars. There's a big difference in the amount of work that gets done in a community if tax is figured into the bid. He reiterated the City of Kenai has a \$25 tax cap.

[2:08:16 PM](#)

SENATOR STEDMAN opined it's not equitable or good public policy to structure the sales tax with no cap and to target

subcontractors on state projects. Certainly the lack of revenue sharing and dropping revenues are cause for concern and legislators need to work on that as a policy issue.

2:10:37 PM

CHAIR GARY STEVENS thanked Mayor Michels for serving as mayor.

2:10:58 PM

KEVIN RITCHIE, Executive Director of the Alaska Municipal League (AML), commented everyone recognizes that there are issues on both sides and the point Senator Stedman brought up about helping communities is the work of this committee. Since last year, ten cities have stopped city government operations. Although it isn't clear why the cities no longer exist, it is clear that the work that the city governments did isn't being done now unless a tribe or other organization took over. Based on current information, another 25 cities will stop government operations by next year.

With the loss of revenue sharing and the loss of capital matching grants coupled with fuel and insurance increases many communities can no longer afford to operate. Looking from larger to smaller cities you can see different aspects of sales tax. In some larger cities, getting sales tax isn't key for operating revenue, but for smaller communities that have fewer options you'll see fewer caps.

AML would like municipalities to have the broadest purview for creating a local tax structure that works. As Mayor Michels said, the community made the decision to tax subcontractors. He suggested that might be the best forum to resolve an issue such as this.

Although it's unfortunate that the contractor didn't know about the tax, that isn't the real issue. The real and important issue is the relationship between communities and the state.

He pointed out that the State of Alaska represents the largest local tax exemption in the state and if it operated like a business, it would pay about \$60 million in property tax on the various state facilities and services in communities around the state. But with no revenue sharing there is no general fund offset for the costs that communities have for fire, police and roads. Although that might not be relevant to the bill, it is relevant to the work the Legislature is doing.

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CHAIR GARY STEVENS noted that if no changes are made then nearly every community could impose a local tax. He questioned whether it wouldn't amount to a reduction in projects throughout the state if all communities levied sales tax on subcontractors.

MR. RITCHIE agreed and added the City of Nome charged subcontractors 5 percent, which is equal to the administrative charge DOT/PF took on the contract. DOT/PF charges the administrative fee to help cover department expenses and Nome has a sales tax to help to pay the cost of running Nome. It's a choice that communities make.

He suggested this wouldn't be an issue in all communities, particularly the larger ones. Most large communities have a cap so even if they taxed the entire contract it wouldn't amount to much. That's a local choice that Nome, Sand Point and Unalaska have made. There might be a better way, but it's tied in the financial relationship between the state and its communities.

[2:18:23 PM](#)

CHAIR GARY STEVENS said if no change is made then all subcontractors would have to be made aware of the tax in different communities.

MR. RITCHIE agreed.

JIM DOKOOZIAN, General Manager of Dokoozian and Associates, stated support for the bill. The company bid on a federally funded FAA contract in Nome and included sales tax in the bid. The FAA neglected to do the same and had to go back to the federal government to get more money to pay the tax.

Dokoozian paid sales tax on the total price of the project including subcontractor amounts. Nome not only raised the tax more than once during the job, it also levied a tax on the subcontractors, sub-subcontractors and the suppliers, which amounted to a double tax. He suggested that the bill should make it clear that sub-subcontractors and suppliers would be included as well.

SB 158 would clarify the issue, add certainty and level the playing field among contractors.

[2:22:36 PM](#)

CHAIR GARY STEVENS asked about the change in tax during the contract.

MR. DOKOOZIAN explained that the FAA reimbursed the company only after they were educated to the fact that this was an unknown, unanticipated condition that fit the definition of a change order.

[2:23:31 PM](#)

JOHN WHEATLY, Senior Vice-President of Marsh USA and Surety Manager, spoke on behalf of Associated General Contractors in support of SB 158. They would like to see uniformity across the state in the application of taxes on state projects. It doesn't matter whether it's federal or state money, tax dollars are being spent to improve the community and to tax those tax dollars flies in the face of good public policy.

[2:25:30 PM](#)

CHAIR GARY STEVENS asked Senator Huggins if he had further comments.

[2:25:47 PM](#)

SENATOR HUGGINS said this isn't just the practice in Nome it's part of a strategy that is based on legal advice. His concern is threefold. The rules aren't clear, there will be an escalating affect, and it's just not fair.

[2:28:25 PM](#)

SENATOR KOOKESH asked if he thought there was a loophole that should be closed.

SENATOR HUGGINS replied he introduced the bill after it came to his attention as the Chair of the Transportation Committee. He reiterated his three concerns.

SENATOR KOOKESH asked if he believes he is closing a loophole regarding taxation of subcontract work on state projects

SENATOR HUGGINS said yes.

SENATOR KOOKESH said he wanted that point to be clear because Nome is taxing subcontractors according to their interpretation of the law. It's incorrect to insinuate that anyone did anything wrong; this is a loophole.

SENATOR HUGGINS replied it's part of a legal strategy based on legal advice. He acknowledged that Nome didn't do anything wrong.

SENATOR KOOKESH said his point is that Nome has every legal right to tax subcontractors now because the law is unclear. The intent is to clarify the law.

SENATOR HUGGINS replied that's the "fogginess factor" and most people don't agree with you. His point is that if there is any theme that will create an uncertainty for a business or the community then the Legislature needs to clear that up. His fix is to make both contracts and subcontracts exempt. "It's a foggy area."

SENATOR KOOKESH replied that is the point exactly; Nome isn't doing anything wrong. It's a foggy area and the sponsor is trying to close it.

SENATOR HUGGINS agreed that Nome is doing nothing wrong.

SENATOR KOOKESH said he'd like to review the 5 percent administrative charge the state takes because \$350 million on a DOT/PF contract amounts to a huge amount of money. Legislators should find out how DOT/PF is benefiting from that 5 percent charge because they might be able to operate on just 3 percent and the other 2 percent could be used for a community dividend program.

SENATOR HUGGINS said he could look at that, but philosophically he opposes taxing a visitor.

[2:33:33 PM](#)

SENATOR STEDMAN remarked there is a low correlation between the 5 percent DOT/PF administrative fee and a sales tax structure to generate money to run a community. Taking an administrative fee is a standard way of operating government so costs are allocated to the appropriate divisions.

CHAIR GARY STEVENS called a brief recess from [2:34:57 PM](#) to [2:36:48 PM](#)

CHAIR GARY STEVENS reconvened the meeting and asked for a motion.

SENATOR STEDMAN motioned to report SB 158 and attached zero fiscal note from committee with individual recommendations.

[2:37:08 PM](#)

SENATOR KOOKESH objected to make a comment.

I think there is a loophole here and we're fixing it and I think everything that people like Nome did was certainly within the law, but now that the basic premise is that when the state has a contract, that all subcontractors should be exempt just like the general contractor. It was our fault for having that loophole in there. I think we're fixing that loophole and people like Nome are going to understand that that door is closed and they're going to have to look farther away to raise revenues. ... I'm going to vote for this to move on to the next committee because I believe that we have a job to do as Senators and that is to close that little loophole because I think state contracts have to have a certain degree of standard.

SENATOR KOOKESH removed his objection.

[2:38:09 PM](#)

CHAIR GARY STEVENS thanked the Senator for the explanation and said everyone understands that Nome did nothing at all wrong.

SB 158 and attached fiscal note moved from committee.

**SB 114-SERVICE AREAS IN SECOND CLASS BOROUGHS**

[2:38:27 PM](#)

CHAIR GARY STEVENS announced SB 114 to be up for consideration and that the \G version committee substitute (CS) was before the committee.

He explained that he held the bill over because the letter from the attorney general was confusing. Tam Cook subsequently sent a letter explaining her position. He asked Ms. Moss to explain Ms. Cook's response to the attorney general's letter.

[2:40:11 PM](#)

RYNNIEVA MOSS, Legislative Aide for Representative Coghill, stated agreement with Tam Cook's opinion that the language in SB 114 would stand up under a constitutional challenge.

It would be a violation of the constitution if the legislation took away home rule borough powers, but the language is giving second-class boroughs the authority to dissolve service areas that are dysfunctional and create a liability. This is not giving or taking away any powers from a home rule borough.

Referencing a chart that Ms. Lesh distributed, she pointed out that home rule borough can determine what it takes to dissolve a service area. The bill doesn't deprive home rule boroughs of the ability to do something about dissolving service areas.

The second point is that it would be unconstitutional to limit the ability to dissolve a dysfunctional service area to one area of the state. That isn't the case. The bill gives the authority to all second-class boroughs statewide.

According to Tam Cook, the language in SB 114 would stand up to a constitutional challenge.

[2:41:56 PM](#)

CHAIR GARY STEVENS noted there were no questions or comments and he asked for a motion.

SENATOR STEDMAN motioned to report CSSB 114(CRA), \G version, and attached fiscal note from committee with individual recommendations. There being no objection, it was so ordered.

There being no further business to come before the committee, Chair Gary Stevens adjourned the meeting at [2:42:50 PM](#).