

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS STANDING COMMITTEE

January 26, 2017

3:31 p.m.

MEMBERS PRESENT

Senator Mike Dunleavy, Chair
Senator David Wilson
Senator Cathy Giessel
Senator John Coghill
Senator Dennis Egan

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

PRESENTATION: The Effects of Various Taxes on Alaska's Economy

- HEARD

DISCUSSION: The Mechanics of Collecting Sales Tax

- HEARD

WITNESS REGISTER

JARED WALCZAK, Policy Analyst
Center for State Tax Policy
The Tax Foundation
Washington, D.C.

POSITION STATEMENT: Provided an overview on The Tax Foundation's activities.

BOB BARTHOLOMEW, Finance Director
Finance Department
City and Borough of Juneau
Juneau, Alaska

POSITION STATEMENT: Provided an overview of Juneau's tax collection.

CLINTON SINGLETARY, Sales Tax Administrator
Finance Department

City and Borough of Juneau
Juneau, Alaska

POSITION STATEMENT: Provided an overview of Juneau's sales tax collection.

ACTION NARRATIVE

[3:31:28 PM](#)

CHAIR MIKE DUNLEAVY called the Senate State Affairs Standing Committee meeting to order at 3:31 p.m. Present at the call to order were Senators Giessel, Egan, Wilson, and Chair Dunleavy.

PRESENTATION: The Effects of Various Taxes on Alaska's Economy

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CHAIR DUNLEAVY announced that the committee will hear a presentation from the Center for State Tax Policy. He asked that Mr. Walczak address broad-based taxes given that Alaska has had a generation of no broad-based taxes. He noted that some people hope that Alaska has another generation of no broad-based taxes, a discussion that the Legislature will have this year.

[3:32:36 PM](#)

SENATOR COGHILL joined the committee meeting.

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JARED WALCZAK, Policy Analyst, Center for State Tax Policy, The Tax Foundation, Washington, D.C., specified that he will address the following:

- Considerations that are associated with the various broad-based taxes other states levy.
- Pros and cons of each tax.
- Administrative questions.
- Ways Alaska will possibly structure the various broad-based taxes.

He divulged that The Tax Foundation is an 80-year old tax-policy research organization based out of Washington, D.C. and detailed as follows:

- Works at both the federal and state levels.
- Provides analysis and research on tax issues.

- Nonpartisan and strives to be a resource for members of both parties across the ideological spectrum by primarily focusing on a state's revenue targets and how to best structure taxes as simply and transparently as possible to achieve neutrality without picking winners or losers.

MR. WALCZAK summarized that The Tax Foundation addresses how a state can have a tax code within its revenue parameters that is as pro-growth as possible.

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He said Alaska has been a very unique place for many years. The ability to forgo not one, but multiple major taxes is very unique. He noted that most states with similar tax attributes have a significant natural-resource economy with some sort of a severance or extraction tax that can be a substantial portion of the budget: South Dakota, Texas or Wyoming.

He said one of the advantages to a resource economy is the exportation of a state's tax burden; for example, Alaska's oil and gas production tax is being paid by people outside of the state. The legal incidence of Alaska's oil and gas production tax is going to be the oil company, but the economic incidence is on everyone who is purchasing the final product outside of Alaska.

He noted that in some years, as much as 90 percent of Alaska's revenue has essentially come from the oil industry which is great for the average taxpayer who does not pay very much, but living and dying on one product creates an extremely volatile tax structure; e.g., no revenue in 2015.

He set forth that one reason why Alaska has an extreme reliance than other states is due to the structure of its severance tax. The severance tax in many states is based on volume or on price where revenue is generated even when there is no profitability; however, Alaska's system is on net revenue which is much closer to a high-rate corporate income tax on one industry where Alaska realizes all of the benefits during the good years, but no revenue like in 2015 when the companies lost money. Alaska's volatile tax structure suggests that there needs to be some mechanism.

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CHAIR DUNLEAVY addressed Mr. Walczak's statement that there was virtually nothing collected in Alaska and noted that there was a royalty collected.

MR. WALCZAK pointed out that he was referring to the production or severance tax. He admitted that Alaska collects other taxes: royalty and property. He specified that \$460 million on average is paid annually in property taxes on the pipeline; however, the bulk of the state's collection comes from the severance tax.

He set forth that volatility can be addressed in a number of ways. He said one way is to put things aside in good years and noted that Alaska has more than any other state in substantial reserves with over \$56 billion in the permanent fund and all of the different funds. He pointed out that Alaska's funds are both statutorily and constitutionally protected.

He said Alaska's ability to reserve some of its funding in the good years allows the state to get by in its volatile tax structure in ways other states could not. He referenced a study that shows most states over the last 15 years averages revenue swings of plus or minus 5 percent. Wyoming, a resource heavy state like Alaska, has revenue swings close to 12 percent. He revealed that no state gets close to Alaska's 34 percent plus-or-minus revenue swing. He summarized that in the good years, Alaska's tax revenue is really good, but in the bad years it's tough; being able to smooth that out with reserves is very valuable.

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He said the other thing that can be looked at is tax revenue diversification, something that is certainly on the table. Alaska benefits a lot by not having an individual-income tax or sales tax, but the reason for consideration includes additional revenue, revenue diversification and more stable tax structures. He pointed out that there are always tradeoffs. He said stability for the state government is important, but the state's economic health must be considered and every tax, to some degree, is going to disadvantage some activity; this is just the nature of taxation or any cost.

He said the broad-taxation choices are as follows:

- Capital tax:
 - Corporate income tax or other taxes on capital goods.
 - Effect:
 - Reduce investment which has a strong effect on economic growth.
 - Legal incidence is going to be on the owners of capital.

- Labor tax:
 - Individual income tax.
 - Effect:
 - Changes labor productivity: people on the whole are going to work less and fewer people are going to be in the labor force.
 - Competitive advantages for some people for being in other states: companies may have to pay a little more to be competitive, which may reduce employment due to higher salaries that applies pressure for some individuals to migrate to other states where there are better opportunities.
 - Falls almost entirely on labor.

MR. WALCZAK summarized that the previously mentioned tax scenarios are in the margin and there is no sense that levying any of the taxes will result in some mass exodus where everyone leaves, but people do respond to taxes.

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He set forth that the third broad tax is consumption:

- Consumption tax:
 - General sales tax or excise tax.
 - Less disadvantageous than a decrease in investment or in labor.
 - Consumption is more flexible where people can determine how much they spend.
 - Sales taxes can be regressive if solely based on a goods-only tax from the 1930s.
 - Sales tax is more neutral if personal services are taxed as well.
 - Effect:
 - Higher consumer prices.

He detailed that most states do have a somewhat regressive sales tax because they have an old sales tax that is based on the economy from the 1930s when sales taxes were first imposed. He noted that 50 years ago the nation's economy was two-thirds goods and one-third services, currently the economy is two-thirds services and one-third goods. He set forth that the U.S. is a service-oriented economy with sales taxes that are goods oriented, which makes for a somewhat more regressive tax. He explained that people of all income levels need to purchase the staples of life, but a lower-income person will spend a higher

percentage of their income on the "staples" than a higher-income individual who has more flexibility in their consumption. He set forth that services flips the equation because personal services are consumed much more by higher-income individuals. Sales taxes are made needlessly regressive when personal services are not included. He summarized that including personal services broadens the base, lowers the overall rate and the tax becomes much more neutral.

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MR. WALCZAK pointed out that Alaska's local-sales taxes contribute to regressivity primarily with the use of sales-tax caps. He noted that every locality has a sales-tax cap and some "caps" are high enough that they do not make an enormous difference. He detailed that Juneau's "cap" is \$12,000 where most purchases are being covered; however, some communities have "caps" as low as \$500 which makes the tax more regressive because wealthier individuals are getting a tax break on big-ticket items. He said a state considering a broad-base consumption tax needs to think about the distributional effects that can result in a lot of issues. He set forth that a state can make a neutral tax, but structure must be considered rather than just borrowing what some other state did because of a previous date going all the way back to the 1930s.

CHAIR DUNLEAVY asked to verify that the concept of broad-and-low means a broad tax that is across as many goods and services as possible, resulting in a percentage that is kept low. He added that excluding more means the percentage has to grow on fewer sectors, goods or services.

MR. WALCZAK answered correct. He revealed that more states are cutting individual and corporate taxes, but increasing sales taxes. He explained that the increases are not because states have decided to shift more towards consumption, but because the sales taxes are eroding. He detailed that erosion occurs when taxes for a limited base continues to be a smaller portion of a state's economy. He pointed out that excise taxes are constantly ratcheted up; for example, state cigarette taxes keep rising because less people smoke and taxes increase to maintain revenue. He said a narrow base without erosion controls requires continuous tax increase to keep up. He opined that coming back to vote on tax increases is not what anyone wants to do.

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SENATOR WILSON asked that Mr. Walczak address the services covered by a services tax.

MR. WALCZAK explained that ideally, all final sales or "terminus" of services would be included. Every state captures at least a couple of business inputs, some capture a lot. He noted that three states capture approximately 100 service-tax categories: Hawaii, New Mexico and South Dakota. He opined that personal services would not only include barbers or dry cleaners, but accounting and legal services as well. He cautioned that taxing "intermediate," "business to business" or "business inputs" causes multiple taxation, also called "pyramiding."

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CHAIR DUNLEAVY asked to confirm that theoretically a sales tax would be charged for a carpenter that does work on someone's house.

MR. WALCZAK answered yes.

CHAIR DUNLEAVY asked if a sales tax can be imposed on monthly rent.

MR. WALCZAK replied that rent theoretically could be, but rent would probably be excluded due to an equity issue in taxing home ownership as well. He noted that the materials used in constructing a home is taxable, but the labor often is not. He added that what to tax on a modular home is in question and typically a half-rate tax is imposed. He pointed out that a broad-based tax would include the service side of home construction.

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SENATOR EGAN asked what occurs for out-of-state modular-home construction.

MR. WALCZAK explained that sales taxes are typically "destination sourced," meaning that the sales tax is paid where the good or service is being received or utilized, not where it is purchased from. He pointed out that use-tax compliance comes into question and he noted that businesses comply at a high rate due to audits; however, individuals generally do not do a very good job of remitting their use-tax and most states do not deal with it. He noted that legally everyone has to pay their use-tax, but the odds of someone buying something from Amazon and filling out a form at the end of the year and noting an online purchase is low. He admitted that Alaska will have a higher percentage of sales that originate out of state, but noted that

Alaska will not have cross-border activity where people drive to a neighboring state to avoid paying higher taxes.

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SENATOR EGAN pointed out that a sales tax is imposed on goods from businesses with a presence in Alaska; however, an item purchased online from Amazon is not taxed.

MR. WALCZAK explained that "economic nexus" is required by the Supreme Court from the 1992 Quill decision. He revealed that two states have passed legislation to test the Quill decision.

SENATOR EGAN noted that some people have tried to include USPS, UPS and FedEx as instate warehouses for storing and delivering packages.

MR. WALCZAK explained that the courts are not going to allow the scenario that Senator Egan described. He admitted that challenges to the Quill decision regarding marketplace fairness could affect destination-based-remote transactions.

He advised that if Alaska would be looking at a sales tax that the state look at a group of other states that are involved in streamlining sales taxes in anticipation of new federal legislation. He projected that states will be required to have their sales taxes look a certain way, have unified collections and be simplified. He pointed out that the U.S. has over 10,000 sales-tax regimes and requiring every retailer to comply with 10,000 different sales-tax jurisdictions can be exceedingly complex. He suggested that if Alaska is creating a sales tax from scratch that the state look closely at the best practices for a streamlined sales tax so that remote sales taxes can be collected to avoid an overhaul.

CHAIR DUNLEAVY asked that Mr. Walczak hit the main points on a sales tax as it relates to Alaska and what the state's differences may be versus the Lower 48. He asked that Mr. Walczak address income tax and property tax as well.

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MR. WALCZAK concurred that Alaska is unique compared to a lot of states, which makes superimposing experiences from other states more difficult. He pointed out that the state does not have border competition where people drive to other states to buy something. He said a larger percentage of purchases in Alaska are going to be "use" rather than "sales" tax based simply because more things are being shipped in and purchased from

companies outside of the state. Alaska has higher costs of goods which creates price sensitivity issues depending on what the sales tax is when higher prices already exist.

MR. WALCZAK said the state has some unique opportunities because a patchwork of local sales taxes already exist with high compliance costs, individual remittances and requirements for everyone. He pointed out that consolidating local and state sales taxes is cost beneficial to remitting companies due to one source of collections and audits.

He opined that a sales tax often has advantages over an income tax in that consumption effects are less detrimental. Both the income and sales taxes do export to some degree; however, no tax will export the way that the severance tax shifts the economic burden on the rest of the country and not on Alaska. He said the majority of an income or sales tax is going to be borne by Alaskans, but not all of it. He detailed that an income tax will capture taxes from out-of-state workers and a sales tax captures tourism spending.

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SENATOR WILSON asked to clarify that it is better to have a sales tax than an income tax.

MR. WALCZAK replied that a sales tax is generally more economically advantageous. He admitted that distributional effects on which populations to burden should be considered, but a sales tax will have less of an effect on economic growth. He admitted that the average payer in Alaska will face a relatively low-tax environment from either a sales or income tax. He said a significant portion can be exported, but a sales tax is probably preferable of the two systems. He pointed out that purchases can be scaled up or down with a sales tax versus individual income, so the effects of an income tax to some degree are going to make it more costly to work in the state. He said either tax will have some effect on wages due to the higher cost of living and prices. He noted that there is an inverse correlation between income taxes and population shifts that is larger than in a sales tax, but both taxes would have some effect.

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SENATOR GIESSEL noted that the proposed income tax was based on federal-income tax. She referenced a news article that said using the federal-income tax is unusual.

MR. WALCZAK concurred with Senator Giessel's observation. He revealed that Alaska was one of six states that used the federal-income tax system when the state last had an income tax. Alaska would be the only state if it adopted the federal-income tax. He disclosed that every state is slightly different in how they structure their income taxes, most begin with a federal definition of income and then adjustments are made; e.g., incentives are provided or something is taxed more heavily, but the federal definition of income is the base.

He explained the advantages to using the federal definition of income as follows:

- The federal government's audit opportunities is captured.
- States adopt their own rates and brackets.

He noted that Alaska previously adopted wholesale the entire federal system and then just scaled it down to 15 percent. Most states adopt the federal definition of income and create single rate or progressive rate systems. He divulged that 18 states have single rate income taxes; e.g., 3 percent or 5-percent bracket rates.

He explained that the pro of adopting what Alaska used to have is the incredible simplicity for the taxpayer, multiply the Form 1040 results by 15 percent; also, the state would have advantageous auditing and administrative costs.

He set forth that the con in importing the entire federal system is that like it or not, there are incentives, deductions and exemptions in the federal code that may or may not be appropriate for Alaska that the Legislature may or may not wish to include. He added that any changes made by the federal government is immediately imported into Alaska without the state doing anything. He explained that whether or not the state wants to adopt a mortgage interest deduction, the same treatment of charities, child tax credit, earned income tax credit (EITC), treatment of capital gains income, dividend interest income, the state will be adopting the entire system for all of its pros and cons.

He summarized that states have chosen not to import the entire federal system. He noted that the federal government is looking at potential tax reform within the next two years which could radically change what the income tax looks like and the state may be a part of the change whether it wants to or not.

SENATOR EGAN explained that since statehood, municipalities have traditionally had the option of using a sales tax. He noted that sales taxes and property taxes vary throughout the state. He asserted that he has serious concerns about allowing a state-sales tax. He pointed out that non-resident workers in his district pay no more than the sales tax on a can of beer on their way back home. He admitted that companies that employ non-resident workers pay a property tax, but residents do not get direct benefit.

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MR. WALCZAK concurred and noted that Senator Egan's concern is very legitimate. He pointed out that there will be economic activity that is simply not subject to either a sales or income tax for out-of-state participants. He noted that an income tax does not capture tourism revenue and a sales tax does not capture the part-time Alaska employment. He disclosed that nationwide, Alaska's reliance on most taxes is fairly low. He detailed that Alaska has over 100 sales-tax jurisdictions, but property taxes are still much larger, primarily due to the pipeline or industrial property.

CHAIR DUNLEAVY noted that an upcoming presentation from ISER will show that a sales tax captures more outside income for Alaska than an income tax.

He set forth that the committee meeting's presentations should not be interpreted as a tax advocate discussion, but rather a way for the committee to get up to speed as to what the various taxes are like, how the taxes can be modeled in Alaska, and what are the things the state will have to look at.

He pointed out that Mr. Walczak mentioned that Alaska is unusual in its varied taxes. He opined that Alaskans are generally skeptical of taxes and are "taxaphobic." He said the Legislature is having tax discussions because more and more folks are advocating for alternative revenues and the committee wants to get as much information as possible.

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SENATOR WILSON asked for details on the costs associated with tax enforcement and collection.

MR. WALCZAK explained the costs associated with various taxes as follows:

- Sales tax:

- Relatively low costs for the state because retailers are the tax collector and remitter.
 - Retailers bear some of the burden of collection.
 - Administration costs are generally lower than an income tax.
 - Compliance tends to be fairly high because it is tougher for a business to cheat due to transaction counts.
- Individual income tax:
 - Few actually get reviewed, even at the federal level.
 - More expensive to have compliance and administrative cost on an income tax.
 - Less costly than corporate taxes, but more expensive than sales tax.
 - Corporate income tax:
 - Cost more due to complexity: apportionment of income, determining what is taxable within a company, and appeals.
 - Businesses appeal a lot because difficult questions are subject to rulings and court decisions.
 - Most expensive of the major taxes because corporate income taxes are fairly small share in most states' revenue.

MR. WALCZAK said neither of the taxes are going to be extraordinarily expensive for Alaska, but the costs are real, especially if taxes only raise a limited amount of revenue. He noted that estimates suggest that 50 to 70 full-time employees will be required for either of the taxes. He summarized that raising less money from any tax will mean a higher percentage will go towards audit collections, etc.

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CHAIR DUNLEAVY asked Mr. Walczak to address how property taxes in the Lower 48 differ from Alaska.

MR. WALCZAK answered that property taxes are the oldest taxes in the country and therefore have probably changed the most over the years. He said at one point every state had a tax on real property at the state level as well as taxes on tangible personal property.

He revealed that most states have exempted most personal property, at least for individuals. He noted that there was a time when an individual had to calculate out the cost of

everything they owned to remit an annual tax. He opined that the country may be a more materialistic culture and most people would not be able to easily determine how much they actually possess in personal property. He said most states either outright exempt all home-personal property or have a high enough threshold that only impacts the wealthiest people. He revealed that fewer and fewer states tax business personal property; however, outside of Alaska, every state in every locality has real property taxes at the local level.

MR. WALCZAK disclosed that 14 states have some sort of real-property tax at the state level where only certain classes, industries or personal properties are taxed. He noted that some states levy a property tax on rail cars or on airplanes, whereas local taxes are levied on all real property, including improvements. He added that some states have distinct classes of property with either different assessment ratios or rates. He said the most common practice is to have a single rate with different assessment ratios where residential property is assessed at a 50-percent assessment ratio and commercial or industrial at a 70-percent assessment ratio.

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He admitted that tax disadvantages occur when a lot of the tax burden is shifted to just a couple of property types, especially from an assessment limitation. He referred to California's "Prop 13" that set off a tax revolt decades ago where the ability for residential-property assessment values to rise was dramatically limited and the burden shifted to commercial property or new property placed in the system. He detailed that the end result caused an adverse effect where a massive lock-in incentivized people to not sell their property, a scenario that should be avoided. He explained that there are property tax limitations that can make sense to avoid pricing people out of their homes and noted "circuit breakers" where lower-income individuals can be protected from certain increases. He added that some states use levy limits or collections limits; however, a state should be careful in not creating some perverse incentives or a wholesale shift. He revealed that Iowa put limits on residential and agriculture properties that resulted in commercial and industrial rates becoming prohibitively expensive where Tax Increment Financing (TIF) are being used.

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He explained that a TIF means some revenue collection goes towards a dedicated project; for example, a district's property taxes for a commercial development goes towards building some

sort of infrastructure. He pointed out that Iowa uses kind of a ridiculous TIF system where taxpayers are paid back because they can't repeal their residential and agriculture property tax limits statute. He asserted that the Iowa example is not efficient, neutral or fair because not every business receives a TIF. He said tax neutrality means taxes should be predictable with horizontal equity where similarly situated and profiled businesses pay about the same. He set forth that there is always a cost with incentivized tax systems where certain economic activities, industries and taxpayers benefit at the cost of someone else who has fewer resources or who is less certain.

MR. WALCZAK continued that neutral is good because perfectly projecting what an economy is going to look like in 10 or 20 years is not possible. He pointed out that a lot of states have built tax codes entirely around an industry mix that either existed or one that ought to exist; when reality diverges from that, as inevitably it will at some point, the tax codes can be very uncompetitive. He said North Carolina was a good example of a state that had high taxes and "middle of the pack" collections due to huge "carve outs" for favorite industries like tobacco and textiles. Everything ran pretty smoothly when the favorite industries made up the majority of the economy, but tobacco and textiles no longer do and the state woke up and realized that they could not attract new businesses due to a tax code that was not competitive. He revealed that North Carolina reformed their tax code to one that is much more neutral with a broader base and lower overall rates where industries that previously would never have looked at the state now say North Carolina could, a valuable experience for a lot of states.

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At ease.

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CHAIR DUNLEAVY called the committee back to order. He noted that Alaska has a lot of exempt land, specifically native-corporate land. He asked if land purchased outside of a native corporation's exempt land might potentially be taxable.

MR. WALCZAK replied that to the best of his knowledge, tribal lands themselves in other states are sovereign and a state cannot impose a property tax on them, but lands purchased outside of tribal lands is subject to the same tax treatment that other states have.

CHAIR DUNLEAVY announced his intention to bring Mr. Walczak back. He asked that Mr. Walczak briefly address an overall property tax in Alaska in addition to income and sales taxes.

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MR. WALCZAK replied that he certainly wants to work with the committee. He said there are probably members who want to avoid imposing any new broad-based tax, but noted that there is an opportunity to get it right. He disclosed that most taxes in the rest of the country are gradual creations over time of miscellaneous provisions that sounded good at one point and may even be good in isolation, but there are hundreds of tax provisions that have become a bit of a hodge-podge of ideas that perhaps do not work together as a cohesive whole. He remarked that no one regardless of their political affiliation would start from scratch and design most of the systems that currently exist. He asserted that starting from scratch is actually an opportunity instead of importing some other state's tax code that is over a hundred years of miscellaneous accretions. He set forth that Alaska should ask what the tax principles are that stand behind the structural issues.

He addressed the different taxes as follows:

- Property tax:
 - Advantages:
 - Relatively little behavioral effects.
 - Real property is not going anywhere and does have value.
 - Comes closer to passing a benefits test.
 - Generally benefit property owners roughly in proportion to the value of the property.
 - Unusual for states to tax property partly because the benefits test is more tenuous versus local governments that provide direct benefits for: roads, street lighting, police services, and fire-and-ambulance.
- Sales tax:
 - Advantages:
 - More limited economic effect that reduces consumption rather than investment or labor.
 - Most economists would say that a minor negative effect on consumption is preferred than on other categories.
 - Captures income from tourists.
 - Compliance costs are cheaper.

- Disadvantages:
 - Not capturing much from seasonal workers that would have to be captured through an income tax.
 - Regressivity when compared to an income tax.
 - ◆ Legitimate concern that can be addressed through a neutral-tax framework with a broad base that captures services and eliminates caps.
- Income tax:
 - Advantages:
 - Progressivity can be built into the tax.
 - Captures out-of-state income.
 - Disadvantages:
 - Some degree of economic reduction.
 - Cost of working in the state will be driven up.

MR. WALCZAK said compliance costs for the various taxes will not be massively different. He opined that income and sales taxes will be fairly similar depending on their structures. He set forth that additional income tax considerations include:

- Should the federal tax base be used?
- Should the entire federal tax system be adopted wholesale?
- Should the tax be a percentage of the federal levy?
- Does the state want its own rates and brackets?
- Will the state be ready for federal tax reform if it happens?
- Will the base be broadened with a lower rate?

He summarized that most states prefer to have more fiscal control that is based on the needs of the state versus adopting the entire federal system. He pointed out that adopting the entire federal system puts control in the hands of what the federal government does.

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CHAIR DUNLEAVY thanked Mr. Walczak and noted that his presentation gives the committee an introduction on things to think about. He pointed out that the intent is to educate committee members as well as Alaskans as to what may be looked at. He asserted that some legislators still hope and believe that there are ways to potentially avoid a broad-based tax.

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At ease.

DISCUSSION: The Mechanics of Collecting Sales Tax

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CHAIR DUNLEAVY called the committee back to order. He announced that the committee's next topic addresses tax concepts, something foreign to Alaskans for the past 40 years on a statewide basis, but not foreign to many of the state's municipalities. He set forth that Bob Bartholomew and Clinton Singletary with the City and Borough of Juneau will talk about a municipality's sales tax, what are the mechanics, pros and cons, exemptions, and how the taxes are collected.

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BOB BARTHOLOMEW, Finance Director, Finance Department, City and Borough of Juneau (CBJ), Juneau, Alaska, detailed that Juneau is one of 105 local governments that have a sales-tax program. He opined that the state might be starting from scratch with a sales tax, but 105 communities with a variety of programs will have to be brought in as well.

He pointed out that CBJ's sales-tax code is 45 pages long with local citizens and businesses that interpret it completely differently. He concurred that a broad-based sales-tax program is a good tax policy goal and CBJ is known to have a very board sales-tax program.

He provided details about CBJ's sales and property taxes as follows:

- Collects sales taxes from services, goods, commercial rentals, but not from residential rentals.
- 4,000 registered merchants.
- 60 percent of sales-tax revenue goes into CBJ's general operating budget.
- 40 percent of sales-tax revenue goes into CBJ's capital projects and to keep deferred maintenance from growing.
- CBJ's revenue ratio from sales taxes and property taxes is 50:50.
- 60 percent of property taxes goes to education.
- 40 percent of property taxes goes into CBJ's general operating budget.

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MR. BARTHOLOMEW provided the history of CBJ's sales tax as follows:

- City charter adopted after CBJ unification in 1970 that said any sales tax requires voter approval.
- 1-percent sales tax adopted in 1970.
- 3-percent temporary-sales tax adopted in 1983 and continually renewed by voters every 5 years.
- 1-percent temporary-sales tax adopted in 1996 and continually renewed by voters every 5 years. The tax primarily goes towards capital projects.
- Inflation has caused the cost of goods and services to go up, but revenues have grown in line with inflation.

CHAIR DUNLEAVY asked if CBJ suffers under the dedication clause for its tax stream on a local level where revenue can be dedicated.

MR. BARTHOLOMEW replied that CBJ cannot dedicate. He explained that CBJ's voter pamphlets specifies the city-and-borough's desire to spend the sales tax on capital.

CHAIR DUNLEAVY clarified that CBJ "designates" sales tax spending.

MR. BARTHOLOMEW answered yes. He revealed that if the CBJ assembly chooses to spend the sales taxes differently, the intent is shared with the voters.

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CLINTON SINGLETARY, Sales Tax Administrator, Finance Department, City and Borough of Juneau, Juneau, Alaska, reiterated that CBJ has a 5-percent sales tax that is broad based. He noted that Lower 48 companies have commented that CBJ has one of the broadest taxes that they have encountered. He specified that CBJ taxes the retail sale of goods, services performed in Juneau, all rentals except for long-term residential, like apartment rentals.

CHAIR DUNLEAVY asked if CBJ taxes food.

MR. SINGLETARY answered yes.

CHAIR DUNLEAVY asked if CBJ taxes medicine.

MR. SINGLETARY answered no.

CHAIR DUNLEAVY asked if CBJ taxes clothes.

MR. SINGLETARY answered yes. He revealed that an additional 3-percent rate is added to alcoholic beverages and marijuana products. For FY16 there was \$45 million in revenues received only from the 5-percent sales tax, \$2.4 billion in actual gross sales reported for all retail goods, services and rentals.

CHAIR DUNLEAVY asked how much CBJ collects during the summer-tourist season.

MR. BARTHOLOMEW detailed that Juneau receives 1-million cruise ship passenger visitors and derives approximately \$8 million in sales taxes from spending activity, about 18 percent of the total sales taxes collected year round.

[4:41:52 PM](#)

CHAIR DUNLEAVY noted that some villages, hotels and restaurants are strictly open during the tourist season or offer discounts during the off-season.

MR. SINGLETARY provided details on CBJ's sales-tax exemptions as follows:

- 34 sales-tax exemptions.
- Most exemptions are fairly specific.
- Resale is the most common exemption for the state's jurisdictions that only applies to the end consumer that purchases from a retailer.
 - Example: a commercial fisherman that sells their catch to a processor, processor sells fish to a retailer and the retailer to the end consumer, the only tax occurs at the tail end to the end consumer.
- Government exemption for purchases by federal, state and local entities.
- Nonprofit organizations that are 501(c)(3) or 501(c)(4).
- \$12,000 tax cap on the first \$12,000:
 - Single item, not a total invoice.
 - Example: purchase of a vehicle where the first \$12,000 is taxed.
- FY16: exempt sales of \$1.5 billion, approximately 60 percent of CBJ's overall reported sales.

[4:43:57 PM](#)

He addressed program administration as follows:

- Merchant registration:

- CBJ does not have a business license, but merchants are required to register so that sales taxes collected can be reported.
- Merchant education:
 - Common misconception, a sales tax is not an income tax, but a remittance for tax collected from customers.
- Reporting and remitting collected sales tax:
 - Sales tax is considered a "trust tax" where merchants collect on behalf of CBJ and hold the collected tax in trust until remittance.
 - Sales taxes filed quarterly.
 - Monthly or annual filings upon approved request.
 - Process 15,000 returns annually.
 - Fairly steep late fees and penalties are charged to encourage on-time payments.
- Compliance and audit:
 - Compliance: more informal where returns and reports are reviewed to see trends or "red flags."
 - Audit: full review of reported sales to review a merchant's entire books.
 - Primary issue: exemptions that are improperly interpreted, rarely do merchants fail to report overall sales. Informal audits are conducted to focus on exemptions.
- Enforcement actions:
 - Failure to register:
 - Merchant is forced to register with a demand for returns.
 - Failure to file:
 - Most common issue.
 - Typically address 500 merchants on a quarterly basis.
 - Estimates can be prepared and billed to merchants that fail to file.
 - Failure to pay:
 - Work with collections in the department of law to take the best course of action to collect.
 - Less than two percent of total revenue a year take collection actions.

[4:45:54 PM](#)

CHAIR DUNLEAVY asked what the size and cost is for CBJ's administration that is dedicated to sales taxes.

MR. SINGLETARY answered that five people work in the sales-tax office, total cost is \$830,000 for collecting \$45 million in

sales tax, a little under 2-percent overhead. He added that CBJ's treasury department handles payments and the law department addresses collection cases.

CHAIR DUNLEAVY asked what percentage of CBJ's overall revenue is derived from sales taxes.

MR. BARTHOLOMEW answered approximately 35 to 40 percent.

[4:48:42 PM](#)

CHAIR DUNLEAVY asked if a sole proprietor that offers piano tutoring services has to register and pay a tax for their service.

MR. SINGLETARY answered yes.

SENATOR WILSON asked how a building contractor is taxed regarding their labor and materials.

MR. SINGLETARY explained that contractors have a specific exemption. He detailed that a contractor exemption is tied to a city building permit for a job where services or any materials going into a job are exempt. He noted that a handyman-level service to paint or fix a window would be taxable because typically the activity does not have a building permit.

[4:51:52 PM](#)

MR. BARTHOLOMEW addressed public policy challenges that apply to local and statewide sales tax programs:

1. Sales tax sensitivity to economic changes:
 - a) Occur faster than income taxes.
 - b) People stop spending when they get nervous or there is uncertainty.
 - c) Alaskans and tourists stopped spending during the 2008-2009 financial crisis. CBJ lost \$2.5 million of revenue in 2009.
2. Sales tax rate is sensitive to buying elsewhere:
 - a) People buy online if the sales tax gets too burdensome.
 - b) Younger demographics buy online.
3. Potential state sales tax uncertainties:
 - a) CBJ considered a sales tax exemption on food with a sales tax increase to 6 percent in order to cover a 15-percent loss in revenue from the exemption. The increase was tabled due to a concern that the addition

of a state-sales tax could make the overall sales tax too high.

- b) Concern about the 1-percent tax renewal vote in October 2017 if there is the potential for an added state-sales tax.

[4:55:36 PM](#)

MR. BARTHOLOMEW addressed a previous comment that collecting a sales tax is administratively less expensive than an income tax. He pointed out that the cost of a business's time and costs is not taken into consideration. He noted that CBJ does not reimburse businesses, but a \$25 credit is provided.

He opined that an income tax on the state level will provide diversification by capturing lost economic activity. He asserted that a sales tax should be left at the local level for local control rather than state control. He pointed out that a hundred separate programs will have to be unified because businesses would not be able to administer two separate tax programs. He remarked that a sales tax is a more regressive approach versus income tax, but communities have gone the sales-tax route because it's a way for everyone to pay, including tourism.

He set forth that the biggest challenge is controlling the rate that does not affect purchasing behavior. He said CBJ supports the fact that the state needs to raise revenue or adjust expenses. He asserted that Alaska's forefathers got it right by saying sales tax should be the privy of local government and the income tax should be the privy of state government.

[4:59:44 PM](#)

SENATOR EGAN asked for an explanation on the sales-tax exemption on products exported from Juneau, like fish and beer.

MR. SINGLETARY specified that the exemption applies to products that are ordered and consumed outside of Juneau.

SENATOR WILSON asked if CBJ knows what the sales tax percentages are for goods versus services.

MR. SINGLETARY answered no.

MR. BARTHOLOMEW stated that CBJ will get back to the committee and provide the tax percentage information.

SENATOR GIESSEL asked for an explanation of the cruise ship fee that Juneau receives.

MR. BARTHOLOMEW specified that Juneau receives two fees totaling \$8 per passenger: port development fee and the local-marine passenger fee. He added that as a cruise ship port-of-call, Juneau also receives a statutory portion of the state's passenger-fee program. He pointed out that what the passenger-fee revenue can be used for is very restricted by federal law.

[5:01:40 PM](#)

SENATOR WILSON asked what CBJ's bed tax percent is.

MR. SINGLETARY answered that the bed tax is 7 percent on top of the 5 percent sales tax, totally 12 percent for a hotel room.

CHAIR DUNLEAVY thanked Messrs. Bartholomew and Singletary for assisting the committee in understanding the sales tax "on the ground" in Juneau. He reiterated that the discussions in the meeting were intended to be informational as the committee tries to get an understanding of taxation. He opined that there are a number of individuals that hope the state does not have to go down the taxation road. He noted that Mr. Bartholomew expressed his hope that a state-sales tax is not instituted, but he added that there are people who also hope that state income and property taxes are not instituted as well. He remarked that there will be no easy solution to the solving of the problem. He admitted that oil has been very good to Alaska, but billions of dollars have evaporated with the recent price crash, coupled with a prolonged situation with the oil price and Alaskan production. He set forth that everyone is determined to get a fiscal fix this year for Alaska looking out several years into the future.

[5:03:53 PM](#)

There being no further business to come before the committee, Chair Dunleavy adjourned the Senate State Affairs Committee at 5:03 p.m.