

SENATE FINANCE COMMITTEE
April 17, 2023
1:35 p.m.

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CALL TO ORDER

Co-Chair Olson called the Senate Finance Committee meeting to order at 1:35 p.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Donny Olson, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Jesse Kiehl
Senator Kelly Merrick

MEMBERS ABSENT

Senator David Wilson

ALSO PRESENT

Senator Bill Wielechowski, Sponsor; David Dunsmore, Staff, Senator Bill Wielechowski; Senator James Kaufman, Sponsor; Emma Torkelson, Staff, Senator Kaufman; Kris Curtis, Auditor, Legislative Audit; Ashlee Adoko, Executive Director, Office of Project Management and Permitting, Department of Natural Resources.

PRESENT VIA TELECONFERENCE

Brandon Spanos, Deputy Director, Tax Division, Department of Revenue, Anchorage; Tina Cunning, Alaska National Interest Lands Conservation Act (ANILCA), Anchorage; Stan Leaphart, Former Executive Director, Citizens Advisory Commission on Federal Areas (CACFA), Anchorage.

SUMMARY

SB 34 CITIZEN ADVISORY COMM ON FEDERAL AREAS

SB 34 was HEARD and HELD in committee for further consideration.

SB 122 APPORTION TAXABLE INCOME; DIGITAL BUSINESS

SB 122 was HEARD and HELD in committee for further consideration.

#sb122

SENATE BILL NO. 122

"An Act relating to the Multistate Tax Compact; relating to apportionment of income to the state; relating to highly digitized businesses subject to the Alaska Net Income Tax Act; and providing for an effective date."

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SENATOR BILL WIELECHOWSKI, SPONSOR, introduced the legislation. He referenced the Sponsor Statement (copy on file):

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

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

Market-Based Sourcing

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

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

Single Sales Factor for Online Businesses

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

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

The single sales factor will apply to corporations that makes at least 50 percent of their Alaska sales through electronic means or sales of services related to computer or Internet technologies.

The traditional three-factor formula will remain in place for brick-and-mortar businesses. Alaska has previously adopted alternative tax apportionment systems for industries, such as the oil and gas industry, where the three-factor formula has been found to not be appropriate.

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

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

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DAVID DUNSMORE, STAFF, SENATOR BILL WIELECHOWSKI, discussed, "SB 122 Corporate Income Tax Modernization" (copy on file). He addressed slide 4:

Under the Commerce Clause of the U.S. constitution, states may only tax activity that is reasonably attributable to that state.

For taxpayers who operate in multiple states, it is necessary to determine what portion of their income can be taxed by each state.

To avoid taxpayers having to do separate accounting in each state, states have adopted mathematical formulas to determine tax apportionment.

Mr. Dunsmore pointed to slide 5:

The U.S. Supreme Court has ruled that states must use "fair apportionment" to determine what is taxable by their state, requiring the system be internally and externally consistent.

Internal consistency:

If all states used the same system, there would be no double taxation.

External consistency:

That the value taxed is "fairly attributable" to the state.

Mr. Dunsmore addressed slide 6:

Traditionally states have used an equally weighted three-factor formula for tax apportionment

Sales Factor: The percentage of a taxpayer's sales that are made in the state

Property Factor: The percentage of a taxpayer's property that is located in the state

Payroll Factor: The percentage of a taxpayer's payroll that is made in the state

Mr. Dunsmore pointed to slide 7, "Alaska is a member of the Multistate Tax Compact":

This is an advisory compact with 14 other states and the District of Columbia that promotes uniformity in tax apportionment and filing procedures.

The Commissioner of Revenue represents Alaska on the commission that governs the compact.

The 6th Alaska State Legislature codified the compact in Alaska Statutes in 1970 as AS 43.19.010 which establishes Alaska's tax apportionment laws.

The Legislature has not made any amendments to this statutory language since then.

Mr. Dunsmore addressed slide 8, "The current apportionment formula was designed for a brick and mortar world":

In the modern digital economy a corporation can target advertising to Alaska, sell a product through Alaska's broadband infrastructure, and ship it through Alaska's roads, ports and airports without having any property or payroll in Alaska.

SB 122 makes common sense reforms to ensure these sales are properly apportioned to Alaska.

Mr. Dunsmore pointed to slide 11, "Currently Alaska uses a methodology called "cost of performance" to determine whether sales happened in Alaska":

- Under cost of performance, a sale is considered to happen in Alaska when "the income producing activity is performed in this state."
- This means that out of state corporations can argue that online sales to Alaskans do not take place in Alaska.

SB 122 replaces cost of performance with a "market based" methodology where sales will be considered to happen in Alaska when the market for the sales is in Alaska.

Mr. Dunsmore pointed to slide 12:

Under market-based sourcing a sale occurs in Alaska when

- For sales of real property when the property is located in the state
- For tangible personal property, when the property is located in the state
- For services when the service is delivered in the state
- For intangible property when it is used in the state

Mr. Dunsmore looked at slide 13:

At least 36 other states already use some form of market-based sourcing

Mr. Dunsmore addressed slide 15:

For highly digitized businesses only, the sales factor would be the only factor used for tax apportionment.

Mr. Dunsmore pointed to slide 16:

A business would be considered highly digitized if 50% or more of its Alaska sales are of:

- Intangible property delivered electronically
- Services delivered electronically
- Services related to computers, electronic transmission, or internet technology
- Tangible property purchased through the internet

Mr. Dunsmore looked at slide 17:

The three-factor formula will still be used for brick-and-mortar businesses

Mr. Dunsmore addressed slide 18:

Alaska has previously adopted a different apportionment formula for the oil and gas industry, because the Legislature found that the traditional formula did not fairly reflect their Alaska income.

Similarly, it is appropriate to use a different formula for highly digitized businesses, because the current formula does not fairly reflect Alaska sales.

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Mr. Dunsmore pointed to slide 19:

The current three-factor formula is a disincentive to high-tech businesses opening Alaska facilities

Having payroll and property in Alaska can significantly increase an online business' Alaska taxes.

Adopting a single sales factor for this industry will remove this disincentive and level the playing field between out-of-state and Alaska businesses.

Mr. Dunsmore looked at slide 20:

At least 37 other states already use a single sales factor for at least some industries

Mr. Dunsmore pointed to slide 21:

Jurisdictions Globally Are Facing Challenges
Determining How to Accurately Tax Digital Sales

"Through the use of remote technology, many digitalized businesses can effectively be heavily involved in the economic life of different jurisdictions without any, or any significant physical presence... One consequence of this development is that a growing number of businesses may have an economic presence in a jurisdiction without having a physical presence."

Mr. Dunsmore discussed slide 22:

Market-Based Sourcing and Single Sales Factor Allow States to Solve the Issues that Are Vexing Jurisdictions Around the World

"State corporate income tax systems – virtually alone among national or subnational corporate income tax systems in the world – facilitate the taxation of digital-only businesses..."

A large majority of states have enacted economic nexus and market sourcing rules that are designed for and adaptable to the emerging digital economy."

-Karl A. Frieden and Stephanie T. Do

Mr. Dunsmore pointed to slide 23:

These reforms would have little or no impact on Alaskan consumers

Online businesses generally set their prices at the national or global level.

Both market-based sourcing and single sales factor are common features of tax apportionment systems across the country.

This bill does not change the tax rates or brackets at all, merely the formula for determining what income is taxable in Alaska.

Co-Chair Olson wondered how the bill aligned with the other states that have enacted similar legislation.

Mr. Dunsmore shared that there were reports in the committee packet that showed the different formulas in the other states. He stated that it was an increasingly common practice.

Co-Chair Olson wondered whether the majority of states had a similar structure for electronic sales.

Mr. Dunsmore replied that a majority of states had some sort of market-based sourcing, and some form of single sales factor. He stressed that each state had its own unique tax structures.

Senator Kiehl remarked that an increasing number of large corporations were delivering goods through the internet. He wondered whether the bill had definitions that would cover those services as provided in Alaska.

Mr. Dunsmore replied that the language was suggested by the Department of Revenue (DOR) to address the concern of the specific question.

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BRANDON SPANOS, DEPUTY DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, ANCHORAGE (via teleconference), replied that the sale was treated the same as whether the good was tangible or intangible. He stated that the bill would consider that sale as marketed to Alaska, therefore it would be sourced to Alaska.

Senator Kiehl surmised that there would not be much change, because the service would not be digitized.

Mr. Spanos replied that it would depend on the definition of "highly digitized" or whether more than half the transactions were digital in form.

Mr. Dunsmore discussed the Sectional Analysis (copy on file):

Section 1 amends Alaska's codification of the Multistate Tax Compact. In accordance with the Manual of Legislative Drafting, the entire compact is displayed in the bill although most portions are not being amended.

- Articles I-III contain no amendments.
- Article IV contains amendments:
 - o Section 1 amends definitions:
 - Subsection (a) provides a definition of "apportionable income" which replaces the current definition of "business income."
 - Subsection (e) replaces the existing term "nonbusiness income" with "non-apportionable income."
 - Subsection (g) clarifies the definition of "sales."

- o Section 4 contains a conforming amendment replacing the word "nonbusiness" with "non-apportionable."

- o Section 9 contains a conforming amendment replacing the word "business" with "apportionable."

- o Section 17 is amended to adopted market based sourcing for calculating a taxpayer's sales.

- Subsection (a) states that sales are considered to be in the state if the taxpayer's market for sales is in the state.

- Paragraph 1 states that the market for transactions relating to real property is in the state if the property is in the state.

- Paragraph 2 states that the market for transactions relating to tangible

personal property is in the state if the property is in the state.

- Paragraph 3 states that the market for the sales of service is in the state if the service is delivered to a location in the state.

- Paragraph provides for how the market for sales is determined for intangible property.

- o Subparagraph (i) provides that the market for rented, leased, or licensed intangible property sales are in the state if it is purchased by a consumer in the state.

- o Subparagraph (ii) that when intangible property is sold, the market is considered to be in the state if the property is used in the state.

- Paragraph (b) provides that if the state of assignment for a sale cannot be determined, it shall be reasonably approximated.

- Paragraph (c) states that when a taxpayer is not taxable in a state to which sales would be assigned by this section, that they shall be excluded from the denominator of the sales factor.

- Paragraph (d) authorizes the tax administrator (the Department of Revenue for Alaska) to adopt regulations to implement this section.

- Articles V-XII contain no amendments.

Section 2 is a conforming section, replacing the word "business" with "apportionable."

Section 3 is a conforming section, replacing the word "business" with "apportionable."

Section 4 is a conforming section, replacing the word "business" with "apportionable."

Section 5 is a conforming section, replacing the word "business" with "apportionable."

Section 6 is a conforming section referencing the provisions concerning highly digitized businesses in Section 7.

Section 7 provides that a single sales factor shall be used for tax apportionment for highly digitized businesses.

- Subsection (a) states that tax apportionment for highly digitized businesses shall be done in accordance with Alaska's codification of the Multistate Tax Compact except as modified by this section to use a single sales factor.
- Subsection (b) states that only the sales factor shall be used for apportionment for highly digitized businesses.
- Subsection (c) defines "highly digitized business."
- Subsection (d) allows the Department of Revenue to require a taxpayer to apportion their income in accordance with this section if the Department determines that they are a highly digitized business.
- Subsection (e) provides definition of "delivered," "electronic transmission," "intangible property," and "Internet sales."

Section 8 is a transition section providing that the single sales factor for highly digitized businesses only applies for tax years beginning January 1, 2024 or later.

Section 9 provides an effective date of January 1, 2024.

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Mr. Spanos discussed the indeterminate fiscal note.

Co-Chair Olson asked for more specifics of the upper end or lower end.

Mr. Spanos replied that it was difficult to determine a specific number, but felt that it would be the lower end.

Co-Chair Olson OPENED and CLOSED public testimony.

SB 122 was HEARD and HELD in committee for further consideration.

#sb34

SENATE BILL NO. 34

"An Act reestablishing the Citizens' Advisory Commission on Federal Management Areas in Alaska; and providing for an effective date."

[2:02:48 PM](#)

SENATOR JAMES KAUFMAN, SPONSOR, explained the legislation. He addressed the Sponsor Statement (copy on file):

SB 34 reestablishes the Citizens' Advisory Commission on Federal Management Areas in Alaska (CACFA) which sunset in 2021 and sets a new sunset date of June 30, 2031. The Commission is made up of 10 public members, one Senator, and one Representative who represent "the diversity of users and uses of federal land in the state" and are appointed by the Governor and Legislature.

CACFA was first established in 1981, shortly after Congress passed the Alaska National Interest Lands Conservation Act (ANILCA)—comprehensive legislation governing all federal public lands in the state.

Under the balanced compromise Congress crafted in ANILCA, 104+ million acres (nearly a quarter of the state) were set-aside in permanent federal ownership as conservation system units (e.g., parks, preserves, wildlife refuges, wilderness areas) while at the same time creating unique provisions enabling Alaskan's to maintain their traditions, accommodate the social and economic needs of the state, provide a range of land-use and land access rights, safeguard opportunities for responsible resource development, and facilitate continued improvements in transportation and utility infrastructure.

Factoring in the provisions of the Alaska Statehood Act and the Alaska Native Claims Settlement Act, most Alaskans are regulated under a unique and extremely complex regulatory web.

CACFA was an independent and impartial source of information and center for advocacy on Statehood, ANCSA, and ANILCA issues that impact all Alaskans. When active, CACFA helps Alaskans navigate complex regulations and to works with federal agencies to ensure Congressional intent is implemented with respect to Alaska's interests. Among many things, the Commission holds hearings to collect public comment on decisions that affect them; disseminates information about historical and new regulation to the public, the Executive branch, and the Legislature; regularly submits written comment in response to federal requests; and helps Alaskans navigate federal permitting processes. While the State's ANILCA program and CACFA both monitor federal actions, CACFA does so on behalf of individual Alaskans, whereas the State can only focus on issues with state-level impact.

As time passes, institutional memory and ANILCA expertise is lost at both the federal and state level.

An active CACFA would ensure that this critical knowledge is preserved and remains accessible to Alaskans. Until CACFA is reestablished, individuals, organizations, and the Legislature have no independent source of ANILCA expertise. Furthermore, there is no organized center for which individuals can channel their concerns to higher levels of government making decisions that impact them. CACFA is an essential tool to ensure that Alaskans have a strong and powerful voice in what happens across our state

[2:06:09 PM](#)

EMMA TORKELSON, STAFF, SENATOR KAUFMAN, addressed the Sectional Analysis (copy on file):

Sec 1. - Amends AS 44.66.010(a) creating new subsection (15) reestablishing the Citizens Advisory Commission on Federal Management Areas in Alaska, setting a new sunset date of June 30, 2031.

Sec 2. - Technical Change: Amends AS 44.66.010(a) to remove subsection (10) where CACFA's previous sunset date (June 30, 2021) was listed.

Sec 3. - Incorporates transition language to the uncodified law of Alaska establishing the initial term lengths of new appointments to the commission. Thereafter, the term limits outlined in the Commission's statute will take effect.

Sec 4. - Sets an effective date of July 1, 2023.

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KRIS CURTIS, AUDITOR, LEGISLATIVE AUDIT, explained the audit (copy on file). She stated that the audit concluded that the commission was operating effectively.

[2:08:46 PM](#)

TINA CUNNING, ALASKA NATIONAL INTEREST LANDS CONSERVATION ACT (ANILCA), ANCHORAGE (via teleconference), spoke in support of the bill. She explained some history of ANILCA, and the impact on various parts of Alaska.

[2:13:19 PM](#)

STAN LEAPHART, FORMER EXECUTIVE DIRECTOR, CITIZENS ADVISORY COMMISSION ON FEDERAL AREAS (CACFA), ANCHORAGE (via teleconference), stated that he was available for questions, and felt that the commission was effective, because of the work with the public to resolve some conflicts.

Co-Chair Olson queried the reason for the sunset in 2021.

Mr. Leaphart did not respond.

[2:15:12 PM](#)

ASHLEE ADOKO, EXECUTIVE DIRECTOR, OFFICE OF PROJECT MANAGMEENT AND PERMITTING, DEPARTMENT OF NATURAL RESOURCES, explained the fiscal note.

Co-Chair Olson OPENED and CLOSED public testimony.

Senator Kaufman thanked the committee.

SB 34 was HEARD and HELD in committee for further consideration.

Co-Chair Olson discussed the upcoming committee meeting schedule.

#

ADJOURNMENT

2:16:31 PM

The meeting was adjourned at 2:17 p.m.