

# MEMO

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## Recommendations for Alaska municipalities to advance a coordinated, cost-effective approach to taxing online sales

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The goal of this effort is to devise an efficient, cost-effective and legally survivable structure for Alaska municipalities to collect their full share of local sales taxes from online commerce. The intent is twofold: To remove the disadvantage that local merchants encounter when their potential customers shop tax-free online; and to stem the expanding loss of municipal sales tax revenues to online commerce.

“There is little logic in asking consumers who prefer to shop at local businesses to pay more toward funding public services than consumers who shop via their laptops or smartphones,” the independent Washington, D.C.-based Institute on Taxation and Economic Policy wrote in a March 2018 report. “Additionally, local economies are harmed by this arrangement because it incentivizes price-conscious shoppers to buy from out-of-state Internet retailers instead of businesses that hire local residents, pay local property taxes, and otherwise contribute to the local economy.”

This memo for Alaska Municipal League members provides background of the online sales tax issue, an analysis of the major decisions facing Alaska municipalities, and then a brief listing of just some of the taxation definitions that I believe must be common to all Alaska cities and boroughs that choose to participate in the effort.

### U.S. Supreme Court decision

The opportunities for sales tax collections dramatically changed when the U.S. Supreme Court on June 21, 2018, upheld the state of South Dakota’s right to require online sellers to collect and remit sales tax on orders delivered into the state (*South Dakota v. Wayfair*) — even if the seller has no physical, employee or legal presence in the state (referred to as “nexus”). The 5-4 decision effectively overturned a Supreme Court decision from 1992 that went against the state of North Dakota on the nexus issue.

In its 2018 ruling, the Supreme Court noted that the South Dakota Legislature had determined “the inability to collect sales tax from remote sellers was ‘seriously eroding the sales tax base’ ... causing revenue losses and imminent harm.” Allowing online sellers to avoid collecting sales taxes, the court

said, “has come to serve as a judicially created tax shelter for businesses that decide to limit their physical presence and still sell their goods and services to a state’s consumers.”

The court ruling does not require online merchants to do anything unless a state’s sales and use tax is written to apply to online orders (remote merchants). If a state chooses not to extend its sales and use tax to online orders, the Supreme Court decision does not require merchants to voluntarily collect and remit the tax. The decision is up to each state.

“The Supreme Court did not rule that the South Dakota statute was constitutional; it only eliminated the physical presence standard,” wrote sales tax expert and university professor Richard Pomp in a recent paper on the issue, “Wayfair: Its Implications and Missed Opportunities.” Pomp has also served as a consultant to cities, states and the Multistate Tax Commission. His casebook, “State and Local Taxation,” has been used in more than 100 schools.

Of interest to Alaska cities and boroughs, the word “municipality” appears nowhere in the Supreme Court decision. The case, the briefings, the court discussion and the order focused solely on state-level taxes. However, the same reasoning and the same legal questions considered by the justices likely would apply to municipal sales taxes: Are they discriminatory against interstate commerce? Do they pose an undue burden on interstate commerce? Are they administered fairly to all parties? If the answers are “no” to all the questions, the court ruled that such a state tax would be legal (absent any other legal problems). That’s the goal for Alaska municipalities in this effort.

## **Side trip to Oregon and Washington**

Alaska is the only state that allows municipal sales taxes without an overriding set of rules from a state-administered general sales tax. Oregon came close, but no cigar. Well, actually, Oregon does tax cigars and other tobacco products, but the state has no general sales tax, nor do any of its cities or counties.

“The Wayfair decision does not affect Oregonians purchasing goods or services online because Oregon does not have a general sales tax,” the Oregon Department of Revenue says on its website. One municipality, Ontario, Oregon, population 11,000, adopted a 1 percent general sales tax in 2017, but voters overturned the tax in a 2018 referendum. At least a couple of Oregon cities tax prepared food and beverages, but no city has a general sales tax. Hood River County voters will cast ballots May 21 to decide on a 5 percent tax on prepared foods and beverages “intended for immediate consumption.” But, as with all sales taxes, the definitions are the tough part. For example, under the proposed Hood River County ordinance, a single pastry from a bakery would be taxed as an immediate consumption item, but an order of six or more pastries would not be taxed (the assumption being that no one would “immediately consume” six pastries).

It’s probably worth explaining at this point — and of interest to Alaskans — that while the state of Washington has a sales tax, it grants an exemption from the tax for non-resident shoppers from U.S. states and Canadian provinces that lack a general retail sales tax or impose a sales tax of less than 3 percent. The exemption applies only to goods used outside the state, such as Alaskans who shop in Seattle and take home or ship home their purchases.

It's also interesting to note that under Washington law, retailers are not required to make tax-exempt sales to nonresidents — it's up to the discretion of each merchant. Furthermore, the law says, if a merchant chooses to collect the tax and remit it to the state, “buyers cannot request a refund from the Department of Revenue.”

But the days of tax-free shopping for Alaskans in Washington state will soon get complicated, and Alaskans will have to pay the tax at the store's cash register. Washington lawmakers in early May approved a change to state law — effective July 1 — that will require non-resident shoppers to submit an annual application to the Washington Department of Revenue to receive reimbursement of state sales taxes paid, but only if the taxes total \$25 or more in the year. Non-residents can start applying for tax refunds on Jan. 1, 2020. The state of Washington expects the change will generate more than \$25 million a year in additional revenue, as many non-resident shoppers will not bother, or qualify, for the tax refund.

### **Legal check-off list**

Getting back to Alaska, the challenge for municipalities is to craft their local sales tax codes to adhere to the guidance of the Supreme Court decision in *Wayfair*. There is no court-mandated check-off list to pass the legal test. Alaska cities and boroughs have to make this up as they go along.

There is guidance, however, in the following statement from the court's *Wayfair* decision:

“South Dakota's tax system includes several features that appear designed to prevent discrimination against or undue burdens upon interstate commerce. First, the Act applies a safe harbor to those who transact only limited business in South Dakota. Second, the Act ensures that no obligation to remit the sales tax may be applied retroactively. Third, South Dakota is one of more than 20 states that have adopted the Streamlined Sales and Use Tax Agreement. This system standardizes taxes to reduce administrative and compliance costs: It requires a single, state-level tax administration, uniform definitions of products and services, simplified tax rate structures, and other uniform rules. It also provides sellers access to sales tax administration software paid for by the state. Sellers who choose to use such software are immune from audit liability.”

Rachelle Bernstein, tax counsel for the National Retail Foundation, in an interview with the AML contractor on this project, said: “Nobody can give you an absolute legal answer” as to how far municipalities can stray from the guidance in *Wayfair*, how much municipalities can differ in their tax codes and administration, and still survive a legal challenge if a remote seller decided to contest the sales tax world of Alaska's multiple municipal code definitions, procedures and exemptions.

Her advice? Adhere to the definitions of the national Streamlined Sales and Use Tax Agreement (SSUTA) as much as possible. The streamlined tax campaign started in 2000 when several states decided they needed to “simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance” on remote sellers, hoping that someday either the Supreme Court or Congress would change the law. The court went first.

No federal law requires states to sign on for the Streamlined Sales and Use Tax Project, but doing so makes it easier for states to capture maximum revenues from remote merchants and increases the likelihood of surviving any legal challenge from an online retailer. The more that Alaska municipalities can follow the SSUTA, the better the odds of achieving full compliance from online merchants. As of April 2019, two dozen states (including South Dakota) had signed on to the agreement, representing almost one-third of the country's population (Tennessee, which is not yet fully in compliance, is an associate member).

The closer that Alaska municipalities can come to a common tax base, definition and procedures, as outlined in the SSUTA, “the safer ground you are on,” a representative of TaxCloud, a sales tax compliance service for online merchants, told the AML contractor on this project.

To reach that “safer ground,” I recommend Alaska municipalities amend their tax codes with this key point in mind: They can keep their own tax rates — that’s not the issue. It’s the widely varying definitions and taxation standards that would make it difficult — if not impossible — for more than 100 taxing municipalities in the state to take full revenue advantage of the *Wayfair* decision.

In a final note before offering specific recommendations, it’s worth considering how much money might be at stake if Alaska municipalities can collect in local sales taxes from remote sellers. A November 2017 report to Congress by the U.S. Governmental Accountability Office estimated sales tax collections nationwide from remote sellers could total \$8 billion to \$13 billion a year. Using the GAO estimate and doing the math for the less-than-half of Alaska’s population that lives in a city or borough with a sales tax, the number comes to a potential \$10 million to \$15 million a year in additional revenue for municipalities. That assumes Alaskans shop online at the same frequency and volume as the rest of the country, which seems unlikely in a state where residents and businesses have long relied on mail-order shopping. That low estimate also misses out on residents who live in an area without a sales tax but who shop in a jurisdiction with a sales tax (such as shopping in Palmer or Wasilla for residents of the tax-free Matanuska-Susitna Borough.)

Considering Alaskans’ familiarity and frequency with purchasing goods from out of state as needed, especially in rural areas of the state that lack many retail choices, I’ve seen estimates that Alaskans may order from remote sellers at 50 percent or higher of the national average. That could put the revenue estimate at more than \$20 million a year for the 100+ cities and boroughs with a sales tax.

Another way to check the number is to look at Juneau, population 30,000, and the Kenai Peninsula Borough, population 59,000 (with its mix of city and rural residents who can drive to Anchorage to avoid the local sales tax). The Kenai Borough last year collected about \$15 million from its 3 percent general sales tax on retail goods — and that is with the highway option for shoppers and a 1965 law that shuts off sales tax after the first \$500 in value of an individual transaction. Juneau’s tax receipts totaled more than \$22 million, in large part because it shuts off tax collections at \$12,000, not the \$500 limit in Kenai, and because it has a 5 percent tax. Extrapolating the Kenai Peninsula Borough’s 3 percent sales tax collections on 59,000 residents to 735,000 Alaskans statewide, and doing the same for Juneau’s 5 percent tax collections, then adjusting for tax-free populations in Anchorage, the Matanuska-Susitna Borough, Fairbanks North Star Borough and some smaller municipalities, and further adjusting for the fact that a large portion of the Kenai Borough’s and Juneau’s retail sales tax receipts come from motor fuel sales, I’d say the statewide total for potential online sales tax receipts in Alaska looks to be within the range of \$20 million based on an average 3 percent municipal tax rate. That also assumes Alaskans spend more online than the national average.

## **Specific recommendations**

- **Statement of legislative intent**

Any city or borough that lacks a statement of purpose/intent or legislative findings in its sales code should add one to bolster its case should tax collection responsibilities imposed on remote merchants become a legal issue. The Supreme Court in *Wayfair* positively referenced South Dakota's legislative findings in its ruling for the state. The findings in South Dakota's legislation include:

- The inability to effectively collect the sales or use tax from remote sellers who deliver tangible personal property, products transferred electronically, or services directly into South Dakota is seriously eroding the sales tax base of this state, causing revenue losses and imminent harm to this state through the loss of critical funding for state and local services;
- The harm from the loss of revenue is especially serious in South Dakota because the state has no income tax, and sales and use tax revenues are essential in funding state and local services;
- The structural advantages of remote sellers, including the absence of point-of-sale tax collection, along with the general growth of online retail, make clear that further erosion of this state's sales tax base is likely in the near future;
- Remote sellers who make a substantial number of deliveries into or have large gross revenues from South Dakota benefit extensively from this state's market, including the economy generally, as well as state infrastructure;
- In contrast with the expanding harms caused to the state from this exemption of sales tax collection duties for remote sellers, the costs of that collection have fallen. Given modern computing and software options, it is neither unusually difficult nor burdensome for remote sellers to collect and remit sales taxes associated with sales into South Dakota;

For historical reference, states began to adopt general sales and use taxes shortly after the Great Depression began in 1929. By 1940, 21 states and the Territory of Hawaii had adopted general sales taxes.

- **Sales and use tax**

I recommend that any Alaska municipality that wants to participate in the cooperative effort to create a statewide centralized tax administration for online sellers (remote merchants) amend their code to a sales and use tax. For multiple reasons:

- The Supreme Court ruled in *Wayfair* on a sales and use tax.
- The SSUTA requires that its members adopt a sales and use tax, and replicating as close as possible the SSUTA offers comfort that remote merchants and sales tax service providers will be familiar with the rules.

- As the retail world has changed, moving from local stores to catalog sales to telephone orders to online merchants and voice-activated shoppers like Amazon’s Alexa to who knows what’s next, sales taxes, too, have evolved. No longer is the central debate whether an item was sold in a taxing jurisdiction as long as it was used in that jurisdiction — thus, the issue of including a use tax in municipal codes.
- The certified service providers (CSPs, see Page 9) interviewed for this project recommend a sales and use tax. CSPs are private contractors certified by the Streamlined Sales Tax Governing Board that handle an online merchant’s sales and use tax functions, providing a one-stop service for following each state’s tax codes and tax filing requirements.
- And without the “use” provision, it could be harder to require collection of the tax if no physical part of the transaction took place in the city or borough other than the item was used within the jurisdiction. “The use tax is a backstop to a sales tax. The use tax applies to goods bought outside a state but used in that state,” Pomp explained in “Wayfair: Its Implications and Missed Opportunities.” Because voluntary compliance with a use tax “is notoriously low by individuals,” Pomp explained, “hence the pressure to make sure the vendor collects the use tax.” He concluded: “The risk-adverse way to proceed” is to draft a post-Wayfair statute with a use tax. “After Wayfair, both foreign and domestic remote vendors without a physical presence are now obligated to collect the use tax.”

Adopting a sales and use tax no doubt will raise debate among local residents who argue they have no intention of voluntarily reporting and paying tax on items they purchase while traveling out of town for use when they’re back in town. Of course, municipalities can make the wise decision not to direct any enforcement efforts to such items, the same as any decision to allocate public resources.

One option to defuse — at least partially — the public’s objection to a use tax would be to adopt a code provision that exempts from sales and use taxes goods purchased out of town by the end user and brought to town by the end user for personal use or consumption up to a specific dollar amount, say, \$1,000 per purchaser per transactional event. Legally, I’m not so sure this would work. It would mean taxing the same items differently, based on whether a local resident buys them over the counter in Los Angeles and brings them home as checked luggage vs. buying them online from a remote seller that collects and remits the municipal sales tax. But, for the sake of political acceptability in Alaska, I believe it is worth pursuing.

- **Tax-collecting threshold for remote sellers**

This is another area in which I have a strong recommendation. Alaska municipalities that want to participate in a coordinated online sales tax administration all need to work under the same threshold for requiring remote merchants to collect and remit local sales taxes.

I’d suggest \$100,000 in annual sales across Alaska for the prior year. It worked for South Dakota in *Wayfair*. The list of states with the legally tested \$100,000 threshold is growing and includes Indiana, Iowa, Kentucky, Michigan, Minnesota, New Jersey, North Dakota, Utah, Vermont, Washington and Wyoming, according to an August 2018 report from the Tax Foundation, an 82-year-old independent tax policy research organization. Even more states were moving in that direction as of the date of the report, including Nebraska, Nevada, North Carolina, Rhode Island and Wisconsin.

I would suggest that the \$100,000 threshold be calculated on a merchant's total sales within Alaska, rather than determined one municipality at a time. For several reasons:

- Ease of administration.
- It would provide more certainty — less burden — on remote sellers to determine each year whether they would be required to collect and remit taxes on any Alaska sales.
- It would be an enticement for smaller communities in Alaska to sign on with the AML cooperative effort.
- It would expand the number of remote sellers required to collect and remit municipal sales taxes in Alaska.

In addition to the monetary threshold, most of the states also impose a transactional threshold of more than 200 transactions within the state in the previous calendar year. It's an either-or proposition in those states: \$100,000 a year in sales or 200 transactions, whichever comes first. I would recommend only the \$100,000 threshold for Alaska.

Overall, the \$100,000 test seems a reasonable (arbitrary, but reasonable) standard to apply so as to avoid placing an undue burden on interstate commerce among small-volume merchants. And it strikes me as more appropriate for Alaska than a transaction threshold, such as 200 sales per year statewide. Think of the hypothetical jewelry maker in Wenatchee, Washington, who may have 201 sales a year spread across multiple Alaska municipalities, totaling \$10,000 a year. In the similar vein of undue burden, is it really a smart use of municipal resources to track, administer and enforce tax laws on the plethora of small-volume remote merchants that come and go constantly through the online marketplace?

Yes, a \$100,000 threshold for remote sellers vs. a much lower (or no) threshold requiring local merchants to collect the sales and use tax could be construed as discriminatory to local sellers. There are several points to consider, however, in rejecting that argument:

- The U.S. Supreme Court accepted the differing thresholds in its *Wayfair* decision.
- Multiple other states have adopted the standard, without court rulings to the contrary.
- Federal law prohibits discrimination against interstate commerce but does not apply the same standards to a local decision regarding commerce within its own jurisdiction.
- Multiple national sales tax observers interviewed for this contract explained that local sellers generally are accepting of the differing thresholds for tax compliance because they are eager for a “level playing field” in their competition for sales against the larger nationwide online merchants rather than worrying about smaller remote sellers.

If Alaska municipalities are uncomfortable with a total exemption from tax collecting and reporting requirements for remote sellers with less than \$100,000 in annual sales statewide, one option would be to adopt a code provision similar to Washington state, Colorado, Louisiana, Vermont and Rhode Island: Give remote merchants with less than the threshold in annual jurisdictional sales the option of collecting and remitting the sales and use tax or reporting their sales to the tax jurisdiction for collection efforts from the individual buyers. Colorado was particularly effective in its use of this collect-or-report option in nudging Amazon to drop its legal challenges and start collecting and remitting sales tax in the state.

The assumption is that remote sellers would find it easier — especially with approved CSPs determining, calculating and filing tax returns for the merchants — to apply municipal sales and use taxes to all transactions rather than transmitting the name, address, item and dollar amounts of individual sales to tax authorities.

Just as with the adoption of “sales and use tax” language, the cap on individual taxable transactions, and the collection threshold for remote sellers to collect and remit taxes, all municipalities that participate in the AML effort would need to reach the same decision on whether they want to require remote merchants to report all sales below the threshold for collection by local authorities.

- **Taxation limit on individual transactions**

Separate from the threshold for requiring a merchant to collect the tax is the issue of setting a per-transaction limit on taxes charged. Currently, Alaska municipalities are all over the 663,300-square-mile map of taxation thresholds. Most have no limit — the entire transaction is subject to sales tax. At the low end statewide is North Pole, where only the first \$200 of a transaction is subject to sales tax. There are nine municipalities that set the cap at \$500 or less, almost a dozen where the tax shuts off at \$5,000 or less, and half a dozen that collect tax on more than \$5,000 of each transaction. Some are creative, such as Kotzebue and Nome, which have no taxable limit except for the sale of boats, boat motors, cars, trucks, ATVs and snowmachines, where the tax stops after the \$1,000 of value in Kotzebue and \$1,500 in Nome.

Considering all the years of debate to tailor those taxation limits to local concerns, I recommend leaving them untouched in this effort. The recommendation recognizes the political and economic difficulty (impossibility) of pushing Alaska’s cities and boroughs to adopt a common taxation limit for local commerce. There would be winners and losers in local tax revenues in changing the taxable limits, and nothing with losers is ever politically easy to implement.

I believe the existing varying taxation limits could be handled in software and used by remote merchants and CSPs to determine the correct tax to collect and remit — so long as any applicable definitions are common throughout the state, with no oddball or erratic or loosely defined exceptions to the limit in individual municipalities. This also points out the need for the software to be kept current as municipalities change their taxable limits.

- **Tax look-up map**

This one is essential, for multiple reasons. Considering that ZIP codes — even ZIP+4 — don’t always precisely align with municipal (taxation) boundaries in Alaska, there must be an easily and quickly accessible method for remote sellers, and CSPs, to determine the correct tax rate and taxation rules for each sale. An online tax look-up map, similar to one maintained by Washington’s Department of Revenue and other jurisdictions, would work well for Alaska municipalities.

With an accurate, complete tax look-up map, a remote seller could enter the customer’s delivery address (point of the taxable transaction), or directly link the map to its online order software, to determine whether the item is subject to that municipality’s sales and use tax and the tax rate.



The key to a tax map is inputting correct information and keeping it up to date. The 2017 GAO report made note of this concern: “Several people familiar with the use of sales tax software said that errors in mapping products can expose businesses to liability in the form of uncollected taxes.”

I recommend that the AML cooperative is best prepared to accurately fulfill the role of mapmaker by contracting for the service, making the map software available at no cost to remote sellers, CSPs and any other vendors that need access to facilitate tax collections. Though CSPs say they maintain tax look-up maps nationwide, the accuracy is only as good as the input and maintenance by companies unfamiliar with Alaska — not sufficient for flawless tax collections across multiple jurisdictions in Alaska’s geographically challenging map of cities and boroughs. An example would be small communities where residents may not have a street address, only a post office box or general delivery. The GIS map would need to be constructed so that it defaulted to the ZIP code of such small towns if the customer’s delivery address were insufficient for a location on the map.

Certainly, there would be a cost to creating and maintaining the GIS map, with building the map and software a bigger upfront cost than ongoing maintenance. For example, the state of Washington’s tax look-up map is available online and as a mobile app. It requires staff equal to about one full-time equivalent employee a year to maintain the map. Washington, however, has 320 cities and counties, all providing updates, such as addresses in new subdivisions, boundary changes, annexations and new tax rates. Alaska has one-third that number of municipal sales taxes, likely reducing the amount of time required to maintain the map software. Washington state statute requires municipalities to provide the Department of Revenue with quarterly updates of new addresses and such, and the AML effort could accomplish the same thing as a requirement of participating in the program.

Rough, informal estimates for a contractor to build the map are in the neighborhood of hundreds of thousands of dollars, not millions. For example, the Colorado Legislature appropriated \$900,000 to create such a map for their state, with many more taxing jurisdictions than Alaska. Oklahoma contracted with a university GIS department to build its map, building off an existing map maintained by the state elections office.

- **Administrative issues**

The more that participating Alaska municipalities adopt uniform tax rules, definitions and administration, the better chance of surviving any possible legal challenge and the better odds of robust tax collections. The more that municipalities make the process uniform and less complex to collect and remit taxes, the lower the cost that municipalities will have to pay CSPs. Under the SSUTA, member states agree to pay the cost of CSP services utilized by remote merchants — not only to lessen any risk of losing sales tax revenues to legal challenges but, just as important if not more so, to increase revenue collections with an efficiently functioning partnership between the municipalities and CSPs.

In addition to working with CSPs, the Alaska Municipal League is on the right path in its effort to establish an AML-affiliated entity to function as a full-service administrator of remote sellers for municipal sales and use taxes. As noted in the Institute on Taxation and Economic Policy’s March 2018 report, Alaska municipalities lack “a coordinated effort, or a negotiator, working to see that

sales taxes are collected by e-retailers selling into the state.” This AML effort seeks to remedy that shortcoming. (In addition to recommending that Alaska municipalities band together, the institute’s report also urged cities and boroughs in the state to add “use” to their sales tax codes.)

Providing remote sellers with a single point of contact and eliminating the need for a seller to file multiple returns would be a significant simplification of Alaska municipal taxes for remote merchants. That coordinating, statewide entity also would allow for a single registration by remote sellers doing business in Alaska, rather than requiring every online merchant to register with every municipality in the state one at a time.

All of this could be accomplished by creating a new entity that acts on behalf of the participating municipalities. This entity would be responsible for maintaining rate and boundary information, accepting registrations, tax returns and tax payments (which would include all the information necessary to distribute the tax proceeds to the correct local jurisdiction), distributing tax receipts to local jurisdictions, and coordinating audits and other activities. AML could contract with a third-party to perform these functions.

I would recommend, however, that AML limit this new entity to administration of remote sellers’ tax returns only, leaving each city and borough to continue tax administration of local merchants. This would allow municipalities to retain their local jobs in registration, enforcement and audits, while providing more effective collection, oversight and communication with local merchants.

To advance this single-administrator option for remote merchants, I recommend AML continue at a brisk pace with its discussions of creating an independent entity, working toward adopting governance bylaws for the entity. Participation in the entity would be voluntary. The advantage for municipalities to participate would be the expectation of increased sales tax collections over the prospect of going it alone with remote sellers.

Going with a single administrator for all participating Alaska municipalities would replicate the requirement of SSUTA that member states operate with a single statewide administrator.

At the same time, I recommend that AML develop and distribute a Request for Expression of Interest, to gauge the availability, approximate cost and timeline of potential third-party contractors to prepare the tax look-up map and software necessary for administration of municipal sales taxes in Alaska on remote sellers.

- **Seasonal taxes and seasonal tax rates**

Some Alaska municipalities collect sales taxes seasonally, such as only during the summer tourism season, while some municipalities vary their rate (higher) during the summer season. Though such seasonal variations add complexity to any tax system, I believe they would be manageable as incorporated into the AML central administrator’s software and accompanying CSP and seller software. That assumes, however, that municipalities notify the software providers far enough in advance of any changes so that sellers have access to accurate tax information in a timely fashion. And that assumes that any changes in taxability or tax rates occurs only at the start of a new sales and use tax reporting period — no changes in the middle of a tax report cycle.

Similar advice applies to municipalities that allow “tax holidays,” such as tax-free purchasers of clothes and school supplies in advance of the opening of schools every fall. The more complicated such holidays are (definitions, dates, limitations and such), the harder it will be for remote sellers to get it right. Keep it simple, keep it tight, stick with existing definitions, set the dates far in advance — and it might work. Honestly, I would recommend against the continuation of such tax holidays as Alaska municipalities enter the world of taxing online sales. It’s just too prone to complications, such as: In applying a before-school tax holiday to remote merchants, a municipality would have to decide: Would the tax-free date of the sale be the date the order was placed, the date the order was shipped and charged to the customer, or the date of delivery? It has to be one of them if enforcement is to be fair and equitable. And, any sales tax holidays would have to be based on specific categories or items defined in municipal code, not on the basis of the use of the goods.

And don’t even think of granting tax-free days for local, in-store purchases but not for online sales. I believe such a tactic would fail in court as discriminatory against interstate comment.

- **Certified Service Providers**

Certified Service Providers (CSPs) were created under the SSUTA to allow businesses to outsource most of their sales tax administration responsibilities. Nationally, CSPs are certified by each member state to the SSUTA. As of April 2019, there were six CSPs certified by SSUTA member states. In Alaska’s case, the CSPs would be certified by the AML-led tax administrator, which, in coordination with the municipalities, would verify the information and accuracy of each CSP for certification.

The software system of the CSPs interface with the merchant’s accounting system to:

- Identify which products and services are taxable in each municipality.
- Apply the appropriate tax rate in each municipality.
- Maintain a record of the transaction.

The CSPs also provide the services necessary to:

- Prepare and file the required tax returns.
- Remit the merchant’s tax collections to the tax administrator.
- Resolve any notices or audits by the tax administrator.
- Protect the privacy of the tax information it obtains.

A CSP is not responsible for the merchant’s obligation to remit the taxes owed, and a CSP does not handle other locally focused taxes on services, such as lodging or tourism tax. Those are the responsibility of each business.

Use of a CSP is not mandatory; remote merchants can make their own decision whether to contract with a CSP or determine the taxability and file returns on their own with each Alaska municipality.

SSUTA member states compensate the CSPs for providing the services by “paying” them as a percentage of tax collections, and I would recommend that Alaska municipalities do the same. The Supreme Court cited in *Wayfair* this provision as an example of avoiding an undue burden on

interstate commerce. As part of that compact between the states, remote merchants and CSPs, sellers are not liable for errors in remitting an incorrect tax if the error was due to a CSP relying on erroneous data, tax rates, boundaries, taxing jurisdictions or tax definitions as provided and/or verified by the state. This same agreement could apply to Alaska municipalities.

- **No retroactivity**

To follow Wayfair, and to be realistic, Alaska’s municipalities should ensure that their codes explicitly state there will be no retroactive enforcement or collection actions against remote sellers for sales that occurred before the effective date of the new code provisions covering remote sellers.

- **Refunds**

I recommend the AML effort require that remote sellers issue refunds of any erroneously collected sales taxes, not the municipalities. Although it might be more popular among consumers if they could obtain refunds from their local city hall, that’s really not a workable system. As merchants report aggregate sales, not individual sales, the municipality will have no idea if it ever received the taxes in question. If the remote merchant collected the tax in error, or if a consumer wants to contest a tax collection, best to require that the merchant resolve the problem. They collected the money; they have the individual sales records; and they are best prepared to ensure that the consumer’s specific issue is addressed.

- **Municipal code changes**

To start — as municipalities prepare for the eventuality of an organized effort at collecting sales and use taxes from remote merchants — I recommend two important changes to local codes:

- If a municipality rejects the recommendation to adopt a use tax, the municipality should at least remove from its code any reference to a seller’s physical presence that could be construed as contrary to the effort to require remote merchants to collect and remit sales taxes. Though the codes may also reference remote sellers and their legal requirements, any reference to physical presence of a merchant in the municipality could complicate the issue.
- Add a provision to code to explicitly state that the law applies to remote sellers. I would suggest that Alaska municipalities edit and adopt the following edited version of South Dakota’s code (or similar language, subject to better legal minds than mine):

*Notwithstanding any other provision of law, any seller selling tangible personal property, products transferred electronically, or services for delivery into \_\_\_\_\_, who does not have a physical presence in the municipality, is subject to Sections \_\_\_\_\_ and shall remit the sales and use tax and shall follow all applicable procedures and requirements of law as if the seller had a physical presence in the municipality.*

I believe the best way for this project to draft a model “Alaska Online Sellers Sales and Use Tax Addendum/Revisions to Municipal Codes” would be to assemble a working committee of maybe four or five members, drawn from the ranks of municipal officials (finance and legal) statewide who are familiar with the details of sales tax administration and definitions. This will require a lot of work — a lot of reading, meetings and thoughtful drafting — to achieve a set of code provisions that not only is legally defensible but also politically attainable in Alaska’s current taxation climate. But I believe an Alaska municipally drafted model code would be preferable to turning over the task to a single contract tax attorney.

- **Changing the definitions in municipal codes**

This may be the hardest part of this effort. Whereas different tax rates among Alaska municipalities should not be a problem for administration of sales and use taxes on remote merchants, multiple and widely varying definitions of the same taxable or non-taxable items would be a deal breaker to this effort. Software can easily apply a 5% rate in Juneau, a 7% rate in Wrangell and a 2% rate in North Pole to the same item — but not if each of dozens of Alaska municipalities define that same item differently.

The problem is illustrated by Chief Justice John Roberts in his dissenting opinion in *Wayfair*.

*“Over 10,000 jurisdictions levy sales taxes, each with different tax rates, different rules governing tax-exempt goods and services, (and) different product category definitions.” He noted that New Jersey collects sales tax on yarn purchased for art projects but not on yarn made into sweaters. “Texas taxes sales of plain deodorant at 6.25 percent but imposes no tax on deodorant with antiperspirant.” Illinois categorizes Twix bars as food and Snickers candy, and taxes them differently, the chief justice noted, only because Twix includes flour.*

For the Alaska Municipal League’s coordinated effort to succeed, the participating cities and borough must agree on common definitions and essential tax administration laws — not just to define candy or antiperspirant, but a long list of decisions. These could be provided in a model code, drafted by AML and its online sales tax working group, and offered to all municipalities. It’s essential that the definitions must be the same, while still allowing municipalities to make their own decisions whether a category is taxable or not. Think of it as an on/off switch in the software for the taxation of each defined category.

For example, some municipalities could continue their tax exemption for purchases by senior citizens while others could continue to tax purchases by seniors — so long as all participating cities and boroughs define “seniors” the same and provide tax-exempt certificates which the buyer can submit to the remote merchant to verify their tax-exempt status. With the same definitions, the software could easily accommodate an on/off switch for taxation. For quality assurance, each municipality could review and certify that the AML-created software accurately reflects the local decisions.

I propose the following definitions or, when I don’t have clear and concise language to offer, I propose what I believe the definition should cover. This is far, far from a complete list, it’s just an initial effort to start delineating the definitions that should be common in code among participating municipalities.

- **Point of taxation**

To start, it's essential that municipalities agree on the point of the taxable transaction: Where did it occur? For example, if a consumer with a North Pole ZIP code orders an item online and takes delivery at the North Pole post office (within the city limits), but lives outside the boundaries of the city of North Pole, does the city of North Pole collect sales tax on the item? That is where it was delivered. To define the point of the taxable transaction otherwise would require the remote seller to differentiate the delivery address from the buyer's residential address in determining the sales tax. It's the same dilemma for other areas of the state, where the consumer may live outside the taxing jurisdiction from where the purchase is delivered.

I recommend that the AML coordinated effort adopt the delivery address as the point of taxation. That would be similar to local sales that are taxed at the point of purchase, not whatever location the consumer may eventually consume or use the good. The remote merchant will always have the buyer's delivery address but may not have the buyer's home residential address. In the interest of avoiding an undue burden on interstate commerce and in the interest of a tax structure that is clear and enforceable, I recommend the delivery (receipt) address of the purchase as the point of taxation. To adopt the point of consumption as the taxation location would introduce an uncontrollable and often unknown variable to administration of sales taxes on remote sellers.

Yes, it would mean that a consumer who lives outside a city's limits but picks up packages at the post office within the city's limits would be required to pay sales taxes on that item. Just as they pay sales taxes when they shop at stores within the city. If the consumer objects to paying taxes on their online purchases, they could make arrangements to have the items delivered directly to their residence outside the city limits (such as by FedEx or UPS) rather than delivery to their post office box. That option may not always be available, or the lowest cost for the consumer, but it's their choice.

And there is one more problem: What if a local buyer walks into a store and buys an item and asks the merchant to ship it to the buyer's brother, the buyer's fish camp in another municipality, the buyer's in-laws in another state. Is sales tax charged at the point of purchase (as is normally the case for Alaska municipalities), or is the point of taxation the place of delivery (as discussed above)? And can Alaska municipalities designate one point of taxation for local in-store purchases and a different point of taxation for goods shipped into the jurisdiction from an online (or phone) order?

I would recommend adopting the "sourcing" language in the SSUTA:

The retail sale, excluding lease or rental, of a product shall be sourced as follows:

- When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.
- When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's recipient, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or recipient) known to the seller.

And more complication: The federal Internet Tax Freedom Act of 1998, which prohibits “state and local governments from taxing Internet access, or imposing multiple or discriminatory taxes on electronic commerce” (as explained by a Congressional Research Service report of April 13, 2016).

Pomp, in his 2019 paper on *Wayfair*, acknowledges:

“It is tempting for a state having local sales taxes to require a remote vendor to collect a local use tax based on the delivery address because that is obviously known to the vendor and easily audited. It is also tempting for a state to require local retailers to collect a local sales or use tax at the local rate that applies at the location of the retailer, even if the customer has those goods shipped to an address in another location in the state. This way the local retailer only has to master one set of local rules and regulations. This difference in rules, however, leads to both a constitutional problem and a violation of the Internet Tax Freedom Act.

“Arizona provides an example. Arizona provides different sourcing rules for remote vendors and in-state vendors. A sale by an in-state retailer is sourced to the “seller's business location if the seller receives the order at a business location in this state,” regardless of where the order is shipped. By comparison, a sale by a remote vendor is sourced “to the purchaser's location in this state,” regardless of where that person resides.

“To illustrate, suppose a resident of local Jurisdiction X shops at a store in local Jurisdiction Y and has the purchase shipped back to X. The local sales tax will be based on rates in Y. If that same person were to order over the Internet, however, the remote vendor would charge tax based on rates in X. This discrimination in rates has been held to be unconstitutional. In addition, this discrimination would violate the Internet Tax Freedom Act.”

Maybe there is a legally defensible answer which would allow Alaska municipalities to avoid the Internet Tax Freedom Act question. The Congressional Research Service report notes: “The ban on discriminatory taxes prohibits additional taxes or an alternative tax rate on a good, service, or information delivered electronically that would differ from the tax or rate applied to the same, or similar, good, service, or information if it were purchased through traditional commerce (e.g., brick and mortar stores, catalog sales). In other words, under the moratorium (Internet Tax Freedom Act) the same tax rate must be applied to similar items regardless of how they were purchased. For example, purchasing a book through a local book store’s website cannot be taxed at a higher rate than purchasing it at the local book store’s physical location.” Could Alaska municipalities argue that they are not imposing “additional taxes or an alternative tax rate” on the same goods, but rather are merely setting sourcing rules to avoid any undue burden on remote sellers? That’s what the SSUTA does, and it seems to work.

- **Marketplace facilitator law**

This one is essential to ensuring orderly — and consistent — sales tax collections from online merchants that act as a “marketplace facilitator” for other sellers.

“The problem of recalcitrant foreign vendors would be avoided for sales taking place on major platforms, like Amazon.com, Alibaba, Target.com, Etsy, eBay, or Walmart.com in states requiring the collection of use taxes on all third-party sales,” Pomp wrote in his *Wayfair* paper. “These so-called marketplace facilitator laws, which vary in detail, have been enacted by Alabama, Connecticut, Iowa, Minnesota, New Jersey, Oklahoma, Pennsylvania, Rhode Island, South Dakota, and Washington, with many more in the drafting stage.” Though Pomp references “foreign vendors” in his discussion, the marketplace facilitator issue applies to domestic vendors, too.

Avalara, a CSP under the streamlined sales tax project, sees the same expanding future for facilitator laws as Pomp: “The number of states looking to hold marketplace facilitators responsible for collecting and remitting sales tax on behalf of all marketplace sellers is steadily increasing.”

Already Amazon includes an explanatory note on its website:

“A Marketplace Facilitator is defined as a marketplace that contracts with third-party sellers to promote their sale of physical property, digital goods, and services through the marketplace. As a result, Amazon is deemed to be a marketplace facilitator for third-party sales facilitated through [www.amazon.com](http://www.amazon.com). Marketplace Facilitator legislation is a set of laws that shifts the sales tax collection and remittance obligations from a third-party seller to the marketplace facilitator. As the marketplace facilitator, Amazon will now be responsible to calculate, collect, and remit tax on sales sold by third-party sellers for transactions destined to states where Marketplace Facilitator and/or Marketplace collection legislation is enacted.”

As an example for Alaska municipalities consider, Washington state law RCW 82.13.010 defines a “market facilitator” as:

- (3) "Marketplace facilitator" means a person that contracts with sellers to facilitate for consideration, regardless of whether deducted as fees from the transaction, the sale of the seller's products through a physical or electronic marketplace operated by the person, and engages:
- (a) Directly or indirectly, through one or more affiliated persons in any of the following:
    - (i) Transmitting or otherwise communicating the offer or acceptance between the buyer and seller;
    - (ii) Owning or operating the infrastructure, electronic or physical, or technology that brings buyers and sellers together;
    - (iii) Providing a virtual currency that buyers are allowed or required to use to purchase products from the seller; or
    - (iv) Software development or research and development activities related to any of the activities described in (b) of this subsection (3), if such activities are directly related to a physical or electronic marketplace operated by the person or an affiliated person; and
  - (b) In any of the following activities with respect to the seller's products:
    - (i) Payment processing services;
    - (ii) Fulfillment or storage services;
    - (iii) Listing products for sale;
    - (iv) Setting prices;
    - (v) Branding sales as those of the marketplace facilitator;
    - (vi) Order taking;
    - (vii) Advertising or promotion; or
    - (viii) Providing customer service or accepting or assisting with returns or exchanges.



In this next section — in no particular order of importance — I have listed almost two dozen definitions that this project will need to discuss and incorporate into its common codes. There are dozens more that will need to be resolved. This project could start with the SSUTA definitions, and then whittle down the list to something more appropriate for Alaska. Not everything in code will need changing; only those provisions that could affect online merchants. For example, a municipality’s code provisions for real property rentals and interest and penalties owed on late payment, along with enforcement actions, could remain unchanged.

- **Purchaser**

A person — defined as an individual, trust, estate, fiduciary, partnership, limited liability company, limited liability partnership, corporation or other legal entity — to whom a sale of tangible or intangible personal property is made or to whom a service is furnished.

- **Retail sale**

Any sale, lease or rental for any purpose of tangible or intangible personal property other than for resale, sublease or subrent, unless otherwise excluded in this chapter.

- **Sales price**

The total amount of consideration, including cash, credit, property and services, for which personal property or services are sold, leased or rented, valued in money, whether received in money or otherwise, without any deduction for the following:

- The cost of materials used, labor, services, transportation paid by the seller, taxes imposed on the seller, or any other expenses incurred by the seller.
- Delivery charges to the buyer if included in the total invoice for the item(s) and paid by the buyer at the same time as payment for the goods.
- Installation charges if included in the total invoice for the item(s) and paid by the buyer at the same time as payment for the goods.
- Credit for any trade-in.

The taxable sales price is the full amount charged to the customer, regardless of any portion retained by an order fulfillment service or other service provider that has a role in receiving, processing, packing or delivery of the item. The intent here is that Amazon, for example, must charge sales tax on the full purchase price it charges to buyers on all orders, regardless whether it is an Amazon product or is supplied by a third-party vendor. The taxable amount would include the amount forwarded by Amazon to the vendor of the goods and the amount retained by Amazon as its sales fee or commission. (See the marketplace facilitator section above.)

- **Delivery charges**

Includes all handling, crating, packaging, preparations for shipment and similar charges that are added, included or incorporated into the invoice for a retail sale are subject to sales taxes.

Delivery charges billed separately to the buyer by the service provider shall not be considered as part of the retail sale and shall be taxed as per other sections of this code for freight and delivery services.

- **Senior citizens**

Sales to any person 65 years or older at the time of the purchase shall be exempt from sales and use taxes if they obtain a tax-exempt certificate from the municipality. This exemption applies only to the purchase of goods and services for the personal use or consumption of the senior citizen, his or her spouse or domestic partner. *(Requiring a tax-exempt certificate would provide protection for online merchants to verify a buyer's tax status.)*

- **Food**

The cleanest way to define “food” for whether it is taxable or tax-exempt would be to link the definition in municipal codes to the federal Supplemental Nutrition Assistance Program (food stamps) and Supplemental Nutrition Program for Women, Infants and Children (WIC). If a municipality chooses to exempt food from local sales tax for all purchasers, the standard could be whether the item is exempt from taxes when purchased with food stamps or under WIC. If the item is allowable under those programs, it would be tax-exempt regardless how the customer pays for the items. If the item is not allowable under food stamps or WIC, it would be taxable in those municipalities that do not exempt food from sales taxes.

This would be the cleanest definition to administer, as point-of-sale software for merchants and CSPs already is programmed for the tax-exempt sale of items eligible under the food stamp and WIC programs.

Yes, using the food stamp-eligibility standard would mean taxing such household items as diapers, paper goods, soaps, vitamins and pet foods. Admittedly, it's not a perfect system, but it is a perfectly clear system.

Or, if municipalities prefer, they could adopt their own definition of food as a tax-exempt item — **as long as it is uniform across all of the participating cities and boroughs.** Going this route, however, leads to a seemingly endless line of judgmental decisions as to what is tax-exempt food vs. taxable food, such as processed vs. non-processed food, prepared vs. non-prepared food, heated or refrigerated food sold for immediate consumption or later consumption at home. I would advise against this route. It would open up this effort to constant lobbying and debate over the definition, and subsequent changes. Such as:

- Is an apple sold at a grocery store tax-exempt as a food, but an apple sold at a coffee shop taxable even if the purchaser takes it home for later consumption (the same as the store-bought apple)?
- If you define tax-exempt foods as non-prepared items that require cooking and taxable foods as items that may require reheating, define the difference between cooking and reheating.

- **Goods for resale**

The sale of goods by a manufacturer, wholesaler or distributor to a retail vendor shall be exempt from sales and use tax until such time the goods are sold to the end user or consumer, at which point the goods are subject to tax as a retail sale unless otherwise exempted elsewhere in this section.

- **Manufacturing components**

The sale of goods purchased by a manufacturer which become a component part of a manufactured item are exempt from sales tax. The sale of the manufactured item itself is subject to tax as a retail sale unless otherwise exempted elsewhere in this section.

This is close, for example, to Wasilla's exemption definition: "Sales of raw material to a manufacturer, which raw material becomes an ingredient or component part of a manufactured product or a container thereof or is consumed in the manufacturing process." A broad definition would be useful, rather than attempting to list every conceivable manufacturing input. For example, it should be broad enough to cover tomatoes that a restaurant buys and "manufactures" into a salad sold to a consumer.

Or, another example would be Texas, where the state comptroller website explains: "Texas sales and use tax exempts tangible personal property that becomes an ingredient or component of an item manufactured for sale, as well as taxable services performed on a manufactured product to make it more marketable. The exemption also applies to tangible personal property that makes a chemical or physical change in the product being manufactured and is necessary and essential in the manufacturing process. Some items, such as hand tools, are excluded from the exemption. A hammer, for example, is taxable even if it is used in fabricating a product for sale."

- **Medical equipment and supplies, and prescriptions**

All medicines, medical goods or equipment prescribed by a health care provider licensed to practice in the United States shall be exempt from sales tax.

- **Feminine hygiene products**

Tampons, panty liners, menstrual cups, sanitary napkins and other similar tangible personal property designed for feminine hygiene in connection with the human menstrual cycle are exempt from sales tax.

- **Software downloads**

Software, applications, services and other digital programming for computers, tablets, smartphones and other electronic devices shall be subject to sales and use taxes. This includes online subscriptions or purchases of news services, publications, audio books and other similar electronic versions of printed materials.

- **Streaming services**

Digital streaming services, such as videos and audio files, shall be subject to sales taxes.

- **Dues (such as Costco dues and Amazon Prime membership dues)**

Dues paid to a business for the purpose of qualifying or becoming eligible for its goods and services, or discounts to its goods and services, are subject to sales tax. *(Admittedly, this would be a controversial code amendment in Alaska municipalities, but if the cities and boroughs want to adopt an all-encompassing of online commerce, this one makes sense.)*

- **Construction materials**

As several municipalities exempt from sales tax any materials, goods, components, fixtures or other items that are incorporated into construction of real property, this is another area that needs a common definition for use by all municipalities that choose to exempt the items. Such as:

Materials, goods, components, fixtures or other items that are incorporated into the construction of real property and become a permanent component of that real property are exempt from sales taxes. *(For example, this would apply to paint but not paint brushes, nails but not a nail gun, lumber but not the sawblade to cut the lumber.)*

- **Farming supplies**

Animal food, seed, plants, fertilizers and other consumables used in an agriculture business that sells its harvested grains, produce, meats, animal products or other farm production. *(Some municipalities exempt such farming inputs from sales taxes, which makes this one of those categories that needs a common definition.)*

- **Sales to and by nonprofits, government, tribes and churches**

Sales to or by charitable organizations (exempt from federal taxation under 26 U.S.C. 501(c)(3), government agencies (federal, state or municipal), federally recognized tribes and tribal corporations, and religious organizations (which meet the Internal Revenue Service criteria for a 501(c)(3) organization) are exempt from collecting the sales and use tax from buyers of their goods or services and are exempt from paying the tax on their own purchases. *(I am not recommending that all municipalities adopt this position. Rather, that those which choose to exempt such sales do so under the same code language.)*

- **Tobacco**

Tobacco products, including cigarettes, loose tobacco, cigars and smokeless tobacco, are subject to sales and use tax, regardless if a municipality has a separate, additional tax on tobacco products. E-cigarette and vaping products also are subject to sales taxes.

- **Alcohol**

Alcoholic beverages are subject to sales and use tax, regardless if a municipality has a separate, additional tax on alcoholic beverage products.

- **Marijuana and marijuana products**

Marijuana and marijuana products, including cannabidiol (CBD) oils and products, are subject to sales and use tax, regardless if a municipality has a separate, additional tax on marijuana and CBD products

- **Precious metals**

Any precious metal, including but not limited to gold, silver, platinum and palladium, that has been put through a process of refining and is in such a state or condition that its value depends upon its precious metal content (such as an ingot or bar) and not its form (such as jewelry or artwork) shall be exempt from sales tax. *(This definition seems like it's needed in Alaska.)*

- **Gasoline, heating fuels and other consumable fuels**

Though online commerce has not advanced to the point of shipping gasoline, heating fuel and natural gas via FedEx, it's certainly conceivable that a consumer could, someday, click online and buy (and pay for) fuels from a remote seller, and then take delivery of the fuels at a location within an Alaska municipality. Anticipating that possibility, the common Alaska municipal sales tax code should address that potential sale as taxable or non-taxable.