



City and Borough of Sitka

100 Lincoln Street Sitka, Alaska 99835

Coast Guard City, USA

Memorandum

To: Assembly

From: Robin L. Koutchak, municipal attorney

Re: Municipal Taxation Options

Date: February 4, 2015

Attached for Assembly review is a draft done by Anchorage law firm, Wohlforth, Brecht and Cartledge, through attorney Mike Gatti. A home rule municipality, as is the City and Borough of Sitka, has broad discretion to adopt rules and exercise powers. This memorandum sets out these basic ideas. There is not magic bullet. Municipalities, in short, when searching for funds, are best served by using a multitude of ideas and techniques.

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MEMORANDUM

TO: Robin Koutchak, City and Borough Attorney

FROM: Michael Gatti

DATE: September 23, 2014

SUBJECT: Overview of Municipal Taxation

Municipalities in Alaska are vested with broad constitutional powers to engage in activities to provide services and facilities for the protection of the public's health, safety, and welfare. The Alaska Constitution states that the purpose and construction of local government in Alaska "is to provide for maximum local self-government with a minimum of local government units, and to prevent duplication of tax-levying jurisdictions. A liberal construction shall be given to the powers of local government units." Alaska Constitution art. X, § 1; and see, *Liberati v. Bristol Bay Borough*, 584 P.2d 1115 (Alaska 1978).

The constitution further provides that all local government powers are vested in boroughs and cities. The State may only delegate taxing powers to organized boroughs and cities, pursuant to Alaska Constitution art. X, § 2. The governing body for the organized borough is the assembly, whose composition is established by law or charter. Alaska Constitution art. X, § 4. The assembly may establish service areas to provide special services within the organized borough, which can include the levying of taxes, charges, or assessments within a service area to finance the special services. Alaska Constitution art. X, § 5. A home rule municipality, such as the City and Borough of Sitka ("CBS" or "Borough"), may exercise all legislative powers not prohibited by law or charter. Alaska Constitution art. X, § 11.

What all this means is that, unless prohibited by law, a home rule municipality is vested with broad discretion to adopt legislation and exercise powers in its best interest. It is within the foregoing framework that a municipality may adopt various revenue-raising measures to provide for public services and facilities.

A municipality when reviewing revenue options should also review its current revenue structure to ensure that it is capturing escaped taxes, fines, and fees. Oftentimes a review of ordinances, policies, and procedures can update or revise

revenue assessment and collection practices, which can result in found revenue. This effort should include an interdisciplinary approach, using the skills of the Borough Administrator, Attorney, Finance Director, and Assessor, to develop a report to advise the Mayor and Assembly of the status and issues underlining existing revenue programs.

I. Taxation of Real and Personal Property

Alaska Statute 29.45.010-.250 sets forth the requirement for real property taxation, which applies to municipalities, including those that are home rule. In accordance with Title 29, a municipality may tax real and personal property and adopt required or optional exemptions. For example, senior citizen and disabled veterans are required exemptions, which the Borough, along with other required exemptions, has incorporated into its code, pursuant to SGC 4.12.020.¹ Likewise, the Borough has adopted optional exemptions for community purpose property and business inventory.² A municipality may also levy a flat tax on personal property, pursuant to AS 29.45.055, which provides:

Sec. 29.45.055. Levy of flat tax on personal property.

(a) A municipality may by ordinance levy a flat tax on personal property that has been totally exempted from ad valorem taxes under AS 29.45.050(b). A municipality that levies a flat tax may classify the property as to type based on any characteristic and tax each item of property of the same type at a specific amount. A flat tax may be levied on all or on only some types of personal property. The flat tax ordinance must include a procedure under which the taxpayer may appeal the determination of ownership or classification of property subject to the tax. The municipality may establish procedures necessary to collect the tax.

(b) Except as provided in (a) of this section, adoption of a flat tax does not affect the authority of a municipality to levy other taxes or impose fees on the same or other personal property or on the use, possession, sale, or lease of the same or other personal property.

Although limited, a municipality may collect a property tax on refined fuel, but such fuel has to be physically loaded, unloaded, or stored in the municipality, pursuant to AS 29.45.101. This provision of Title 29 authorizes the limited taxation of fuel as personal property or business inventory. Since the Borough has exempted business inventory, taxation of this commodity would not be in order unless this exemption is

¹ Sitka Charter art. XIII, sets forth provisions related to taxation.

² Note, the cite contained in SGC 4.12.025(C) does not appear to be correct, since that relates to the relationship between city and borough tax structures.

repealed. Even though business inventory is exempt, it may be possible for a municipality to levy a flat tax on fuel in accordance with AS 29.45.101.³

II. Sales Tax

Sitka Charter 13.01(c) authorizes the Borough to levy a sales and use tax. It provides: "Any sales or use tax or change in rate thereof shall be by ordinance ratified by a majority of the qualified voters voting on the question." The implementation of the Charter's sales tax requirements is found in SGC 4.09.010(A), which states: "There is levied a consumer's sales tax on sales, rents, and leases made in the city and borough of Sitka." The ordinance includes implementation measures, a seasonal rate of levy, and a series of exemptions and procedures for the collection of the tax.

Sales tax collection is generally based on a self-reporting system, where a taxpayer provides a tax return to the Borough so that the Borough may assess and collect the tax. Because of the voluntary nature of sales tax remittance it is a good practice to periodically conduct audits of various businesses to determine the accuracy of sales tax remittance. The Borough's sales tax collection program should also be periodically reviewed to ensure that it is up to date and functioning in accordance with the code. This review is best assigned to the finance department, who should also regularly report the amount of outstanding delinquent sales taxes. The Borough's enforcement program should also be periodically reviewed for efficacy.⁴

Another issue that comes up from a review of the Borough sales tax code, is whether it is collecting a use tax for items purchased outside the Borough but used within the Borough. A use tax may generally be explained as a tax which "prevents

³ The Borough tax structure dedicates revenue to particular programs. The Attorney General has opined Alaska Constitution art. XI, § 7 does not prohibit the dedication of municipal revenue. 1988 WL 249509 (Alaska A.G.).

⁴ Note, SGC 4.09.410 authorizes sales tax audits.

consumers of retail products from buying out of state to avoid paying the in-state sales tax."⁵

III. Excise Tax

"Excise taxes are taxes upon the manufacture, sale or consumption of commodities, upon licenses to pursue certain occupations, and upon corporate privileges. They include any taxes which do not fall within the classification of a poll or property tax."⁶ In *Fannon v. Matanuska-Susitna Borough*, 192 P.3d 982 (Alaska 2008), the court was called upon to determine whether an excise tax on tobacco products was lawful. In concluding that it was, the court found that, due to the liberal construction of municipal powers and the broad taxing authority vested in municipalities, an excise tax on cigarettes was called for without a vote of the electorate. The Borough levies an excise tax on cigarettes and other tobacco products. SGC 4.26.010-.190.

A similar tax on alcohol would be limited by AS 04.21.010(c), which requires alcohol products to only be taxed in accordance with sales tax products. In *Lagos v. City and Borough of Sitka*, 823 P.2d 641 (Alaska 1991), the court reviewed this provision and held that, at the time, Sitka did not have authority to tax alcohol and therefore struck down the taxing ordinance.

IV. Excise Tax on Marijuana Products and Paraphernalia

On June 14, 2003, the Lt. Governor certified 13PSUM, an initiative application to tax and regulate the production, sale, and use of marijuana. The initiative would add a new chapter, AS 17.38 Regulation of Marijuana, to the Alaska Statutes, consisting of 14 provisions, including sections on local control and an amendment to AS 46.61 Excise Tax on Marijuana. If approved by the voters, the initiative would be adopted regulating various aspects of marijuana. The proposed initiative contains a section on local control, which provides authority for a local government to regulate marijuana activities. The initiative also contains a provision for a state excise tax on marijuana at \$50 per ounce or a proportionate part thereof. There may be certain parts of the marijuana plant that could be exempt from taxation or taxed at a different rate.

An interesting provision is contained in Section 3, which states that "[t]he provisions of this Act are independent and severable, and, except where otherwise indicated in the text, shall supersede conflicting statutes, local charter, ordinance, or resolution, and other state and local provisions."

It appears, notwithstanding the provisions of the proposed initiative, that state and local governments may tax marijuana use, consumption, and sale, along with its

⁵ 16 McQuillin Mun. Corp. § 44:254 (3d ed.). The ballot proposition adopting the sales tax should be examined.

⁶ 16 McQuillin Mun. Corp. § 44:242 (3d ed.).

paraphernalia, through their sales tax, since the sale of marijuana would constitute a retail sale. It may also be possible to tax marijuana as an excise tax without running afoul of Section 3 of the initiative, prohibiting inconsistent statutes, ordinances, or regulations. Simply because the State levies an excise tax on marijuana activities does not preempt a local government from doing the same. The State has a heavy burden to establish preemption of a local government measure. *Acevedo v. City of North Pole*, 672 P.2d 130 (Alaska 1983) helps to explain this concept:

State pre-emption of municipal enactments occurs when a particular exercise of authority has been prohibited to municipalities. *City of Kodiak v. Jackson*, 584 P.2d 1130, 1132 (Alaska 1978). "The prohibition must be either by express terms or by implication such as where the statute and ordinance are so substantially irreconcilable that one cannot be given its substantive effect if the other is to be accorded the weight of law." *Id.* (quoting *Jefferson v. State*, 527 P.2d 37, 43 (Alaska 1974)).

Assuming passage of initiative 13PSUM, a number of challenges arise.⁷ First, the question of what to do with taxes paid in cash must be solved. Since most marijuana retail establishments operate on a cash basis and pay their taxes in cash, there are concerns related to security and also how a municipality will deposit its cash in the bank. There is anecdotal evidence that banks are refusing to accept marijuana revenues because it could be considered drug money and they could be subject to money laundering problems by the federal government.⁸

Another consideration is a municipality's issuance of a business license to a marijuana retail establishment. One option is to adopt a licensing fee that is higher than your standard business license fee. For example, in Colorado to obtain a license to operate a marijuana facility, the City of Denver charges \$5,000.

V. Miscellaneous Charges and Fees

The Borough also has miscellaneous charges and fees established throughout its code, such as the driver facility charge (SGC 4.17), a hotel, motel, bed and breakfast transient room tax (SGC 4.24), and an excise tax on cigarettes and tobacco products (SGC 4.26).

⁷ Many questions associated with marijuana regulation and taxation are those of first impression in Alaska. How a court will address these issues will be based on the facts, circumstances, and law. The experience of other jurisdictions, such as Washington and Colorado, may be looked for guidance.

⁸ See attached publications.

VI. Motor Vehicle Registration Tax

Alaska Statute 28.10.431 authorizes a biennial motor vehicle registration tax ("MVRT"). A municipality may elect, by passage of an appropriate ordinance, to come under this section.⁹ To implement a motor vehicle registration tax, the municipality must file a written notice of election with the Department of Administration and may not rescind the notice for a subsequent fiscal year. The notice must be filed on or before January 1 of the year preceding the year election under this section is to become effective.

The MVRT is collected by the department and refunded to the municipality, less an eight percent charge for collection costs. A borough that collects the tax must allocate money received to a city, area outside the city, and a service area within the borough. The payment of the registration tax is in lieu of all local use taxes and *ad valorem* taxes. If the municipality elects to come under the provisions of the MVRT, it may not levy a use or *ad valorem* tax on motor vehicles, subject to the registration tax during a fiscal year in which the election is in effect. A municipality may also increase or decrease the scheduled amount of tax described under (b) or (l) of this section by passage of an appropriate ordinance, but must provide notice to the department by January 1 of the year preceding the year in which the change in tax is to take effect. The amount of the tax may not be changed for two years and the department may charge the municipality a one-time fee to cover the cost of the department implementing a change under this section.¹⁰

VII. Service Areas

Municipalities are constitutionally authorized to establish service areas, pursuant to Alaska Constitution art. X, § 5, and may levy taxes, charges, or assessments within a service area to finance special services. Sitka Charter art. XIV authorizes the establishment of service areas. Section 14.0 sets forth the purpose for a service area, which is to provide services not provided on an area-wide basis or to provide a higher level of service than that provided on an area-wide basis. A service area must be established by ordinance or by petition. Charter § 14.03 sets forth the criteria for service areas, which requires they be established according to criteria of need and economic operating efficiency, and comprise the area to which the services shall be provided. A new service area shall be established only after assembly determination that such services cannot be provided reasonably by an existing service area or by alteration of an existing service area. The service area may be financed by taxes,

⁹ The Borough has prepared two draft tax ordinances, 2014-27A-1 and 2014-27A-2, regarding motor vehicle registration taxes and other revenue raising measures. These ordinances should undergo further review and revision if the Assembly wishes to proceed with them.

¹⁰ On June 20, 2014, the Governor signed HB 19 establishing a permanent motor vehicle registration for vehicles eight years and older.

assessments, or other charges within a service area to finance the services. Service area revenue shall not be used for any other purpose outside of the service area.¹¹

Because the service area may be established to provide a higher level of services, it may be possible to establish a service area to provide financing to improve deteriorating roads in the community.

VIII. Local Improvement Districts

Sitka Charter art. XV provides authority for the establishment of a local improvement district. According to § 15.01, the purpose of local improvement districts is to "confer the special benefits of any municipal improvement." The costs of the improvement are paid out of the proceeds of special assessments levied against benefitted property. Section 15.02 sets forth the local improvement procedures, which requires the assembly to proscribe the procedures by ordinance, which are contained in Sitka Charter art. XV and SGC Title 17.¹² The assessment must be in proportion to the benefit.¹³ There are a number of methods associated with the assessment of the cost for the local improvements in the district.

IX. Municipal Debt

Alaska Statute 29.47 *et seq.* sets forth various financing mechanisms available to municipalities. They include revenue anticipation notes, bond anticipation notes, general obligation bonds, revenue bonds, refunding bonds, and other miscellaneous provisions. Some of the financing mechanisms are well-known to most communities, such as general obligation bonds, which can be established on a taxable or tax-exempt basis through voter authorization. AS 29.47.180. General obligation bonds pledge the full faith and credit of the municipality and are not subject to any taxing limitations for repayment. AS 29.47.200, AS 29.45.100.¹⁴

A municipality may issue revenue bonds, where the debt service is repaid from the revenue from the activity. Unless required by charter or ordinance, revenue bonds are not subject to a vote of the people, but may be approved by the assembly. A municipality may also issue bonds to finance or make loans to finance the acquisition, construction rehabilitation, or development of public improvements in improvement areas.¹⁵ AS 29.47.400.¹⁶

¹¹ AS 29.35.400-.490 addresses service areas; see Sitka Charter art. XIV; and see SGC 1.16.010.

¹² SGC 17.04, 17.08, 17.12, 17.16, 17.20, 17.24, 17.28, and 17.32 set forth the ordinance requirements for the establishment of local improvement districts.

¹³ See *Wasilla v. Wilsonoff*, 698 P.2d 656 (Alaska 1985); *Miller v. Matanuska-Susitna Borough*, 54 P.3d 285 (Alaska 2002).

¹⁴ See Sitka Charter § 12.02(B).

¹⁵ And see generally AS 29.47.010-.040; AS 29.47.080-.140; AS 29.47.180-.200; AS 29.47.240-.260; AS 29.47.300-.340; AS 29.47.390-.480.

X. Severance Tax

A municipality may also adopt a severance tax on resources. A 1986 Attorney General's opinion addresses this issue.¹⁷

XI. State and Federal Appropriations

Any overview of revenue-raising measures should also include a comment about the Borough seeking state or federal appropriations for major capital projects, such as road improvements.

CONCLUSION

The foregoing list of revenue raising options is presented to the Borough as a general overview to assist it in evaluating the best approach to address fiscal concerns, such as roads and other public facilities and services. Any legislative decision of the Mayor and Assembly to proceed with any particular revenue-raising measure should have a thorough fiscal analysis to determine its viability, as well as a dialogue with the community to receive its input on the matter. We remain available to answer questions and further assist in this matter.

¹⁶ See Sitka Charter art. XII.

¹⁷ 1986 WL 81094 (Alaska A.G.). Colorado and Washington are involved in litigation challenging their marijuana tax programs

ATTACHED PUBLICATIONS

1. For Your Information (FYI) - Excise 23: Excise Tax on Retail Marijuana; Colorado Department of Revenue, Taxpayer Service Division (April 2014).
2. Definitions, Colorado Article 28.8 of Title 39.
3. 1986 WL 81094 (Alaska A.G.).
4. Section 314(b) Fact Sheet, U.S. Department of the Treasury (October 2013).
5. Guidance Regarding Marijuana Enforcement, U.S. Department of Justice, Office of the Deputy Attorney General (August 29, 2013).
6. BSA Expectation Regarding Marijuana-Related Businesses, Department of the Treasury, Financial Crimes Enforcement Network (February 14, 2014).
7. Marijuana: Medical and Retail - An Abbreviated View of Selected Legal Issues, Todd Garvey, Legislative Attorney, and Charles Doyle, Senior Specialist in American Public Law (March 25, 2014).
8. 1988 WL 249509 (Alaska A.G.).
9. A Comprehensive Plan to Legalize and Regulate Marijuana in Maryland, Hon. Heather R. Mizeur, Maryland State Delegate (September 2014).
10. Alaska State Legislature HB 19.