

# **Tax Policy Subcommittee\***

## **Report of Recommendations**

**October 26, 2005**

\* A subcommittee of the Assembly Finance Committee

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Date: October 10, 2005

To: Assembly Finance Committee  
David Stone, Chair

From: Tax Policy Subcommittee  
Jeff Bush, Chair  
Bruce Botelho  
Randy Wanamaker  
Stan Ridgeway

Subject: Tax Policy Subcommittee Report

This report presents the results and recommendations of the Tax Policy Subcommittee's work. The Subcommittee was formed in response to a Juneau Chamber of Commerce's resolution presented in September 2004. The Chamber's resolution contained several taxation recommendations. The Chamber's request followed on a report from the ad hoc Tax Depreciation Task Force Report presented in September 2003. Both the Chamber and Tax Depreciation Task Force requested the Assembly Finance Committee (AFC) consider an increase in the Business Personal Property assessment exemption from \$2,000 to \$100,000. When reviewing this request, the AFC felt that it would be more appropriate to review taxation issues on a broad basis. The AFC decided to form a special subcommittee, the Tax Policy Subcommittee, and task them with reviewing CBJ's property assessment and sales tax codes and policies.

The Tax Policy Subcommittee was formed, and the members appointed (Jeff Bush, Chair, Bruce Botelho, Randy Wanamaker and Stan Ridgeway), by the AFC on November 1, 2004.

In responding to the AFC's direction, the Subcommittee held 12 meetings over a period of 10 months. During this period, there were some delays to allow staff to address workloads during the FY06 budgetary development process. In the initial meetings, the Subcommittee identified a number of taxation issues they wished to review. The Subcommittee directed staff to compile and present historical, application, revenue and logic information, as available, for the following assessments and taxation provisions –

**Assessment and Property Taxation –**

- The Chamber's request to increase the base assessment exemption for Business Personal Property from \$2,000 to \$100,000.

- The Community Purpose property assessment exemption.
- The assessment exemption for boats (all), aircraft (personal\*) and licensed motor vehicles (personal\*).

*\* Note: Commercial aircraft and commercial licensed motor vehicles are assessed under the existing law.*

#### **Sales Taxation -**

- Exemptions #4 and #5, for the purchase of construction services and materials.
- Exemption #10, direct sales of newspapers by newspaper carriers.
- Exemption #12, purchases by and sales to non-profit organizations.
- Exemption #18, senior citizen and possible options including the potential for a rebate program.
- Exemption #19, non-residents.
- Exemption #24, commissions charged on the sale of travel, lodging and adventure [tours] and similar related services.
- Exemption #34, sales of plays on video gaming devices.
- Exemption #35, lobbying services.
- Exemption #38, warranty services.
- Exemption #39, sales/purchase leasing between related parties.

As the Subcommittee reviewed the taxation subjects, staff compiled and presented the available information on each issue. For the property tax assessments, the information was reasonably easy for staff to compile and present, because the Assessor's Office is directly responsible for generating the exemption data. For sales tax issues, the information tends to be more difficult to identify and analyze, because the exemption information is prepared by the merchants and generally not directly available to staff. Thus, the tax implications of eliminating or modifying sales tax exemptions may or may not be easily quantified. In these cases, staff presented best estimates of the issues and impacts.

As the Subcommittee proceeded through their review process, they identified several other taxation areas for review. The additional areas identified and discussed by the Subcommittee included –



- Appointing a lay board for the Board of Equalization appeal process.
- Implementing a nominal fee for filing real property assessment appeals.
- Sales taxation of school districts and rural education attendance areas (REAA).
- Sales tax interest rates.
- Sales taxation of business personal property rentals between related parties.

When reviewing the information, the Subcommittee felt it important to recognize how changes in taxation would impact CBJ, merchants and residents. In addition, the Subcommittee sought, to the extent possible, a balance between the services provided, taxpayer equity and taxation levels. The Subcommittee notes that CBJ's tax revenues are used as follows-

- Property assessments generate the property tax revenues that the CBJ uses to fund general governmental operations. CBJ levies property taxes on an areawide basis for general operations and debt service and on a service area basis for Police, Streets, Parks and Recreation, Capital Transit and Fire. The two largest uses of these revenues, excluding the debt service levy, are for education (in FY06 equivalent to 61% of the property tax levy) and police (in FY06 equivalent to 26% of the property tax levy).
- Sales tax (general) revenues are used to fund CBJ operations and capital projects. The general sales taxes are levied on an areawide basis. The total tax levy is 5% with only 1% of this being permanent. The remaining 4% is made up of two (a 3% and a 1%) temporary sales tax levies. The revenues from the 4% temporary sales tax levies are split between general operations and capital projects (approximately 50/50).

If a property tax exemption is modified, granted or deleted, the change will likely result in a shift of the tax burden to or from other taxpayers. If a sales tax exemption is granted or deleted there can be a combination of impacts. The sales tax revenues used for general operations may be shifted to or from the property taxpayers, but the amounts available for capital projects will generally just increase or decrease. In addition, changes in some of the sales tax exemptions can increase or decrease the burden to non-residents and affect our out-of-town sales and financial relationships with other communities. When reviewing the exemptions, the Subcommittee tried to reach a balance between taxation and services and the impacts to local merchants. In addition, the Subcommittee felt that it is important that the assessment and taxation laws, policies and procedures be logical, consistent and understandable.

The Subcommittee is making the following taxation amendment recommendations to the Assembly Finance Committee.



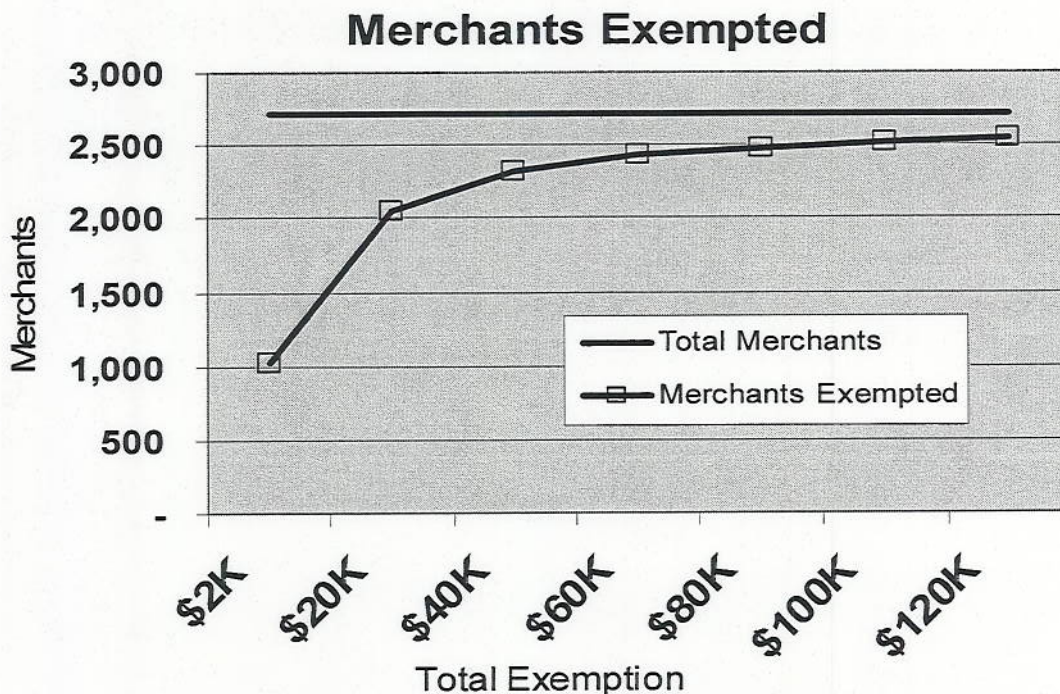
## The base assessment exemption for Business Personal Property

- **Recommendation**

Increase the exemption to \$20,000.

- **Rationale**

The CBJ currently provides a \$2,000 exemption for all business personal property (BBP) filers. The Subcommittee felt that there was some justification for increasing the BPP exemption to provide additional tax relief. However, the Subcommittee felt that there needs to be a balance between the tax relief, the revenue reductions and the merchants fully exempted. Increasing the exemption by \$18,000 (\$20,000 less the current \$2,000) per merchant would reduce property tax revenues by approximately \$176,000 per year (the amount would vary from year to year). This exemption increase would also fully exempt approximately 1,070 additional merchants from the BPP tax levy. So for each \$165 reduction in property tax revenues, one merchant would be fully exempted from the BPP tax.



As the exemption increases, the number of merchants fully exempted per dollar of exemption decreases. For example, if the exemption was raised by another \$20,000 per merchant (to a total of \$40,000), the property tax revenue would decrease by \$96,000 and the number of merchants fully exempted would increase by only 245. The additional \$20,000 exemption (a total of \$40,000) would result in a revenue reduction per merchant fully exempted of \$390. The Subcommittee felt that a total exemption of \$20,000 per merchant was the best



compromise between the tax relief, revenue impacts and the number of merchants fully exempted.

## **The property assessment exemption for Community Purpose Property**

- **Recommendation**

Eliminate this optional exemption.

- **Rationale**

Based on the following facts the Subcommittee is recommending elimination of this exemption.

- The State provides for a mandatory exemption for nonprofit religious, charitable, cemetery, hospital, or educational purposes.
- Many of the parcels currently exempted under the Community Purpose Exemption should be exempted instead under the State's mandated exemption.
- A significant number of the parcels do not meet the State's requirement for this optional exemption that the property be **used exclusively** for community purposes.
- This State optional exemption costs other taxpayers the equivalent of 4 mills of the exempted property's full and true value.

State Statutes grant the provisions under which the CBJ assesses and levies property tax. The State provides for both mandatory exemptions and optional exemptions. Under the Statutes, a municipality may, by ordinance, classify and exempt from taxation the property of an organization not organized for business or profit-making purposes and used exclusively for community purposes. In implementing the Community Purpose Exemption, the Assessor is charged with making the determination that the property meets the community purpose use and benefits a significant portion of the public. Over time, the number of parcels granted an exemption as community purpose has grown. After reviewing the exempted parcels, the Subcommittee has determined that a number of the parcels probably do not meet the State requirements of being used "exclusively for community purpose." In addition, the Assessor has determined that approximately half of these parcels should be exempted under State mandatory exemptions, not the Community Purpose optional exemption. The State requires local governments to exempt –

*Property used exclusively for nonprofit religious, charitable, cemetery, hospital, or educational purposes.*

The CBJ is currently providing \$10.8 million in exemptions to 16 real parcels of property. Optional exempted property is included in the State's Full and



True Value calculation (mandatory exemptions are excluded). This calculation requires the CBJ to contribute, and allows the State to withhold, 4 mills in educational support (ie: local governments are required to contribute and the State withholds 4 mills of full and true value).

## **The property assessment of boats, aircraft and licensed motor vehicles**

- **Recommendation**

Place a flat property tax, equivalent to 4 mills, on all boats and aircraft and not on licensed motor vehicles

- **Rationale**

State Statutes grant the provisions under which the CBJ assesses and levies property tax. The State provides for both mandatory exemptions **and optional exemptions**. Boats and aircraft are optionally exempted property. The CBJ is currently providing an estimated \$80 to \$85 million in exemptions for aircraft and boats. Optionally exempted property is included in the State's Full and True Value calculation (mandatory exemptions are excluded). This calculation requires the CBJ to contribute, and allows the State to withhold, 4 mills in educational funding support (ie: local governments are required to contribute and the State withholds 4 mills of full and true value). Under the State's funding formula, the CBJ is required to contribute approximately \$320,000 to \$340,000 for the optionally exempted boats and aircraft.

Not all residents of the CBJ own boats and aircraft. There are approximately 220 private aircraft (commercial aircraft are already taxed at approximately 4 mills) and 3,100 boats. The taxpayers who do not own boats and aircraft are subsidizing the individuals who do own these optionally exempted properties through the State's required local education funding. The Subcommittee felt that implementing a flat tax equivalent to 4 mills was appropriate in helping to balance this taxpayer inequity. Several other Alaska communities already impose a flat tax on these types of property.

The CBJ would implement a simplistic flat rate schedule. The ownership information for aircraft and boats (excluding documented vessels) is available online. Documented vessel information could possibly come from the Coast Guard or the Port Director. The estimated fees for aircraft would average approximately \$240 and boats would average \$75 for non-commercial and \$450 for commercial vessels per year. The Assessor estimates it would be necessary to add a half time position to assist the Business Personal Property Appraiser in appraising this property.



The Subcommittee felt that since most taxpayers own motor vehicles the issue of one taxpayer subsidizing another under the State Educational Funding Formula was not significant enough to support a separate flat tax for non-commercial licensed motor vehicles.

### **Appoint a lay board for the Board of Equalization appeal process**

- **Recommendation**

No change

- **Rationale**

The Assembly currently sits as the BOE for this function. The Subcommittee reviewed both the pluses and minuses of shifting this charge over to a lay board. The Subcommittee also reviewed what other communities do. After reviewing the issues, the Subcommittee feels that this is a responsibility the Assembly should retain.

This past year, the Assembly, sitting as the BOE, heard a great many appeals. It is hoped that this was an unusual year and that the implementation of a filing fee (see next recommendation) will help reduce the number of future appeals. However, if the number of appeals in the future continues to be high, the Assembly should reconsider this concept.

### **Implementation of a filing fee for real property assessment appeals**

- **Recommendation**

Implement a fee of \$20 to \$25 for real property assessment appeals.

- **Rationale**

This year the Assessor received approximately 600 assessment appeals. Appellants can file an appeal form, without a fee, within 30 days of receiving their assessment notice. In processing these appeals, a significant amount of time was expended in trying to reach individuals who had filed appeals, but who did not return calls or letters from the Assessor's Office. This resulted in a significant amount of delays and additional cost in having staff call appellants after working hours. In addition, it reduced the amount of time the Assessor's Office had to review material valuation issues and concerns.

In reviewing the issues, it became apparent that in many cases, the appellants had no idea of their property's market value and simply objected to their property's assessment being too high. Regardless of the reason for the appeal, the Assessor would attempt to conduct their normal process of



contacting the property owner to perform a physical inspection of the property. In a significant number of cases, perhaps 25% or more, the individuals were not responsive and did not carry their appeals forward. It appears that once these individuals took the time to consider the facts they decided to abandon the appeal process.

It is common for communities in Alaska to charge a property appeal filing fee. Anchorage, for example, set a nominal fee a few years ago that has reduced the total number of appeals being filed to less than half. The Subcommittee feels that a nominal appeal fee of \$20 to \$25 would be sufficient to discourage frivolous or non-substantive appeals yet not be so significant that property owners with real issues would be discouraged.

### **The sales tax exemption for construction services and materials, #4 & #5**

- **Recommendation**

Combine the "construction services" exemption (#4) with the "construction materials" exemption (#5) and eliminate the exemption for professional design services.

- **Rationale**

The intent of these sales tax exemptions appears to be targeted at exempting real property improvements that increase assessable property values (i.e.: increases the property tax base). In addition, the exemption provides an incentive for individuals to obtain a building permit before proceeding with incurring construction expenses. As such, the Subcommittee feels that retaining this exemption with one exception would be appropriate. The one exception would be to eliminate the exemption for professional design services. The elimination of professional services recognizes that many construction designs are never completed and do not add to the real property assessment base.

The Subcommittee does recommend modifying the language to combine construction services with materials into a single exemption. They feel this change will assist contractors in understanding and complying with the exemption requirements. The sales tax code includes one exemption for construction services and a second for construction materials. These two construction exemptions are two of the more difficult exemptions for the Sales Tax Office to explain to merchants. For example -

Exemption #4 exempts on-site building or construction *services* under a building or construction contract or subcontract that make physical changes to real property, including the delivery of materials to or away from the



construction site and professional services relating to the design and construction of work requiring a City and Borough building permit, but excluding services for the repair or maintenance of real property.

Exemption #5 exempts sales of building or construction *materials* if: (a) The materials become incorporated as a permanent part of a structure or site through work authorized by a building permit; and (b) The purchaser presents to the seller an individual builder sales tax exemption card describing work that would reasonably require the materials for which the exemption is claimed. A person may apply for an exemption card on forms provided by the City and Borough. The card is valid for a period reasonably necessary to complete the work described in it. The expiration date may be extended upon written application by the holder.

In exemption #4, the requirement is for the project to require a building permit, but one does not necessarily actually have to obtain one. Having a clear test of when a transaction is taxable or exempt assists both the buyer and the seller in determining their tax liability. In addition, having two separate exemptions, one for construction services and one for construction materials, adds some confusion for merchant reporting.

### **The sales tax exemption for direct sales of newspapers by carriers, #10**

- **Recommendation**  
Eliminate this exemption.
- **Rationale**  
Merchants have not claimed this exemption for a number of years. Our research determined that newspaper carriers are no longer required to collect fees at the time of delivery. As such, there is no basis for retaining this sales tax exemption. Eliminating this exemption will help clarify the sales tax code.

### **The sales tax exemption for purchases and sales to non-profit organizations, #12**

- **Recommendation**  
No change
- **Rationale**  
The sales tax code currently exempts both the purchases and the sales by organizations that have an IRS 501(c)(3) or (c)(4) status designations. The IRS code defines the purposes of these designations as follows –

*Code section 501(c)(3) includes charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and the prevention of cruelty to children or animals organizations.*

*Code section 501(c)(4) includes organizations operated exclusively to promote social welfare and operated primarily to further the common good and general welfare of the people of the community.*

The Subcommittee reviewed the possibilities of narrowing and expanding this exemption. The committee also reviewed the possibility of eliminating the sales but keeping the purchasing portions of the exemption. They reviewed having non-profits –

- collect tax on all sales,
- collect tax on just regular retail sales, and
- collect tax on just entertainment events.

From this review, the Subcommittee is recommending no change to this exemption. The Subcommittee felt that the services provided by an organization under the IRS code sections 501(c)(3) and (c)(4) do provide sufficient community-wide benefits to justify the purchases exemption, and the revenues collected would not justify the workloads placed on these organizations to collect and remit sales tax on their sales transactions.

### **Sales taxation of school districts and rural education attendance areas (REAA), #13**

- **Recommendation**

Expand the sales tax exemption to include unincorporated school district operations (REAA).

- **Rationale**

The City provides an exemption for retail sales, services and rentals of real or tangible personal property to or by the State or a municipality. The State of Alaska established school districts in unincorporated boroughs as political subdivisions or instrumentalities of the state. The CBJ currently has two rural education attendance areas operating correspondence programs within the borough. It recently came to the Sales Tax Office's attention that these organizations are not exempt from the sales tax under the current sales tax code. The exemptions in the Sales Tax Code are narrowly written and the exemption for government entities, CBJ 69.05.040(13), does not include school districts.



After reviewing the purposes of this exemption, the Subcommittee is recommending that the sales tax be expanded to include the REAA correspondence programs.

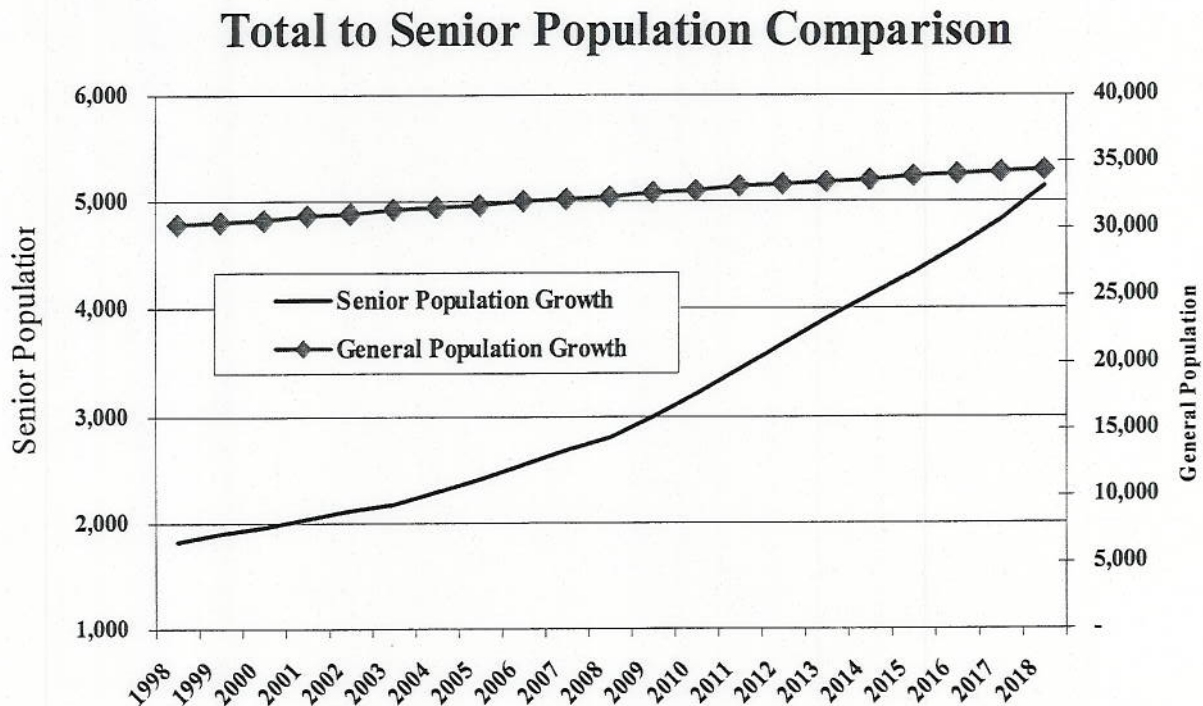
### The sales tax exemption for senior citizens, #18

- **Recommendation**

Modify the exemption to require qualifying seniors be 65 on or before January 1, 2006 and eliminate the program entirely on January 1, 2016.

- **Rationale**

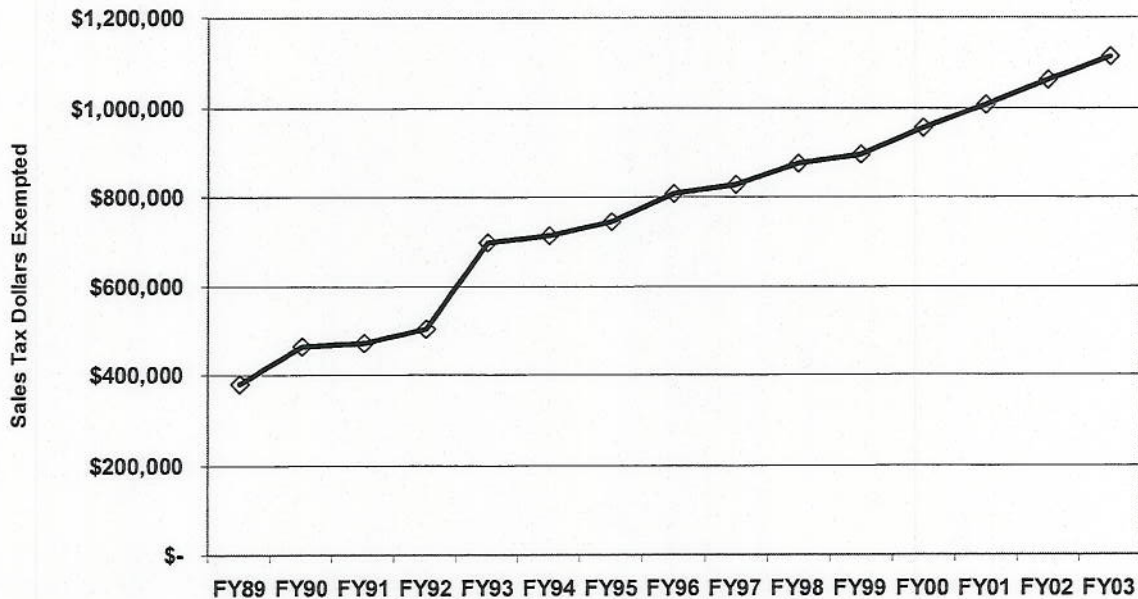
The CBJ provides both sales tax (optional) and property tax (both mandatory and optional) exemptions for seniors age 65 or older. The concern raised is the fact that our population is aging more quickly than our taxpayer population growth. The cost to our non-exempted taxpayers is becoming a greater and greater burden. The senior population in Juneau is currently approximately 7% of the total population, and by the year 2018 that percentage is projected to more than double.



*Note: Information provided by the Department of Labor*

In 2003, the total exempted was just over \$1.1 million.

### Senior Sales Tax Exempted



*Note: In FY93 the tax rate increased from 4% to 5%*

In addition to the growth in the total taxes exempted, the Subcommittee also was concerned with taxpayer equity. The Subcommittee recognized there are other individuals in our community at the lower level of the economic scale that do not receive any tax relief, while seniors receive tax relief for both property and sales.

The Subcommittee decided that there should be some containment in this tax exemption to alleviate the impacts of this exemption's growth and taxpayer inequity. The Subcommittee reviewed a number of options including a needs based exemption and a rebate program. After reviewing the options, the Subcommittee decided to recommend a phase out, rather than abruptly eliminating the exemption for those individuals who have become accustomed to and dependent upon the exemption. The Subcommittee is recommending the exemption be modified to require individuals be 65 prior to January 1, 2006 and the exemption be eliminated on January 1, 2016.



## The sales tax exemption for non-residents, #19

- **Recommendation**

Eliminate this exemption.

- **Rationale**

The sales tax laws preclude the CBJ from taxing products not locally purchased and consumed within the borough (mail order). The CBJ decided to implement an exemption in 1985 to include a provision to allow a nonresident to purchase items tax exempt if the items are consumed outside of Juneau. To do this the nonresident must acquire, through a mail out function, a \$20 exemption card from the Sales Tax Office. This exemption was put into place to promote Juneau as a shopping destination. However, most communities in Alaska do not provide for nonresident exemption cards. The following communities do not provide a similar exemption.

Kenai Borough	City of Petersburg
Ketchikan Gateway Borough	City and Borough of Sitka
City and Borough of Haines	City of Skagway

The CBJ is currently selling about 1,100 to 1,200 non-resident exemption cards per year and exempting approximately \$240,000 in sales tax. This means for every \$20 card sold an average of \$210 is exempted. The number of cards sold and the dollars exempted have decreased over the past 5 years.

<u>Calendar Yr</u>	<u>Sales Exempted</u>	<u>Taxes Exempted</u>
1999	\$7,315,562	\$365,778
2000	5,315,731	265,787
2001	5,217,881	260,894
2002	4,985,613	249,469
2003	4,769,389	238,469

*Note: Between 1999 and 2000, the non-resident exemption card was modified to be available by mail out only.*

The Subcommittee recognized that nonresidents have access to community services while visiting Juneau, and therefore should have an obligation to pay tax to support these services. In addition, the Subcommittee noted that keeping track of nonresident sales places a workload burden on merchants and staff. After reviewing the issues, the Subcommittee determined with the small number of individuals purchasing nonresident sales tax exemption card, the CBJ merchants would not be materially impacted if this exemption was eliminated, because the majority of nonresidents shopping in Juneau would continue to so with or without this exemption.



## **The sales tax exemption for commissions charged, #24 and #40**

- **Recommendation**

Modify the exemptions to clearly state that the full selling price of the sales are taxable.

- **Rationale**

Merchant sales where commissions are paid contain two different legal transactions: the sale by the owner or service provider (through the merchant agent) to the customer and the commission paid to the agent (the merchant) by the owner or service provider. Exemption #24 exempts the commissions charged on travel related services, and Exemption #40 exempts the commissions charged for negotiating the sale or lease of tangible personal property. These commission exemptions eliminate the perception of double taxation on these transactions.

In practice, agents sometimes withhold the commissions from the amounts remitted to the sellers (owners or service providers). In some instances, the sellers are reporting and remitting only the sales tax on the net amount that they receive. After reviewing these code sections, the Subcommittee is recommending that these two code sections be modified to clearly state that the full selling price of these transactions are taxable and the exemption only applies to the second part of the transaction, the commissions paid.

## **The sales tax exemption for video gaming devices, #34**

- **Recommendation**

Eliminate the exemption and the related video gaming-licensing requirement.

- **Rationale**

The video gaming license fee was adopted in lieu of sales taxation for these transactions. The sales tax exemption was placed in the code when the sales tax rate was increased from 4% to 5%. The video gaming merchants indicated that they could not add the 1% to their 25-cent selling price without increasing the play cost to 50-cents. At the time, it was felt that this would create a hardship on these merchants. The Assembly approved a \$12 per year licensing fee in lieu of the sales tax levy. The CBJ (the Clerk's Office) currently issues about 50 gaming licenses a year. The merchants are reporting to the Sales Tax Office approximately \$270,000 in exempt sales (\$13,500 in sales tax) per year. This works out to approximately \$470 in sales tax for each \$12 video gaming permit. The \$12 fee was to be equivalent to approximately 4% of the 5% sale tax levy.



The licensing fee charged is no longer reasonably equivalent to the actual sales tax exempted. In addition, this exemption does not apply to non-video gaming devices (pool tables, machines that sell merchandise, washer/dryers and public telephones). A number of other communities do not provide for a video gaming exemption:

Kenai Borough	City and Borough of Sitka
Ketchikan Gateway Borough	City of Wrangell
City and Borough of Haines	

The Subcommittee considered the option of increasing the video gaming license fee to be in relation to the 4% originally targeted for taxation. However, after reviewing the issues of this exemption, the Subcommittee felt that it would be more equitable and appropriate to remove the sales tax exemption and the licensing requirements.

### **The sales tax exemption for lobbying services, #35**

- **Recommendation**

No change

- **Rationale**

The City and Borough provides a sales tax exemption for lobbying services performed by lobbyists regulated by the State. There are approximately 160 registered lobbyists reporting \$13 million (2004) in fees to APOC. Lobbyists reporting to the CBJ Sales Tax Office are reporting approximately \$2.5 to \$2.8 million in exemptions annually. Due to the reporting by lobbyists not located in Juneau, it is not possible to accurately calculate the actual total of sales tax revenues exempted.

Staff advised the Subcommittee that services are taxed where rendered. Due to the nature of how lobbying services are provided, staff believe it would be very difficult for lobbyists to calculate or allocate the fees charged within Juneau. The Subcommittee also discussed this issue with the CBJ's lobbyist. After an extensive review, the Subcommittee is recommending no change in this exemption.

### **The sales tax exemption for warranty services, #38**

- **Recommendation**

No change

- **Rationale**

The CBJ provides a sales tax exemption for the sale of goods and services provided under a warranty or service contract and charged to a third party warrantor. This only applies to repairs and major maintenance and not to routine or scheduled maintenance.

In warranty cases, it is possible to tax the sale of the warranty or the work performed under the warranty. However, staff have found no examples where both have been taxed. CBJ presently taxes the sale of the warranty and exempts the work performed under the warranty. Since the warranty is more of an insurance against needed repairs that may or may not occur during the warranty period, the subcommittee determined that maintaining this exemption unchanged would be appropriate. The Subcommittee is recommending that we continue to tax the sale of the warranty and not tax the work performed under the warranty.

### **The sales tax exemption for rental of commercial real property between related parties, #39, and the exemption of commercial business personal property rentals between related parties**

- **Recommendation**

No change for expanding the provisions of commercial real property rentals. Continue reviewing the request for a sales tax exemption for business personal property rentals between related parties.

- **Rationale**

The CBJ provides a real property sales tax exemption for lease payments occurring between a lessor and lessee where the two groups comprise the same legal composition (ie: the same individuals, partnerships or corporations). In qualifying for this exemption the owners must meet the following conditions:

(1) The lessee:

(a) Comprises or is owned by the same persons who comprise or own the lessor, each of whom owns:

(i) At least 5% of each legal entity which is a party to the lease; or

(ii) The same percentage of the lessee as that person owns of the lessor;  
or

(b) Is a wholly-owned subsidiary or a parent corporation of the lessor; or



- (c) Is a trust, the beneficiaries of which are the same natural persons who comprise or own the lessor.
- (2) Neither party to the lease is a publicly traded corporation.

These code provisions allow for a related party real property sales tax rental exemption while avoiding situations where merchants can easily arrange or make less than substantive changes in ownership to avoid sales tax.

The Subcommittee received two requests to expand this exemption.

The first request was to allow more flexibility in the ownership between the lessors (owners) and the lessees (renters). The request was to expand or loosen the definition of identical ownership. The committee asked the requestors to provide additional information on the potential business structures. After reviewing the available information, the Subcommittee decided to recommend no changes be made to the commercial real property rental exemption.

The second request, which came to the Subcommittee very late in the process, was to expand or add a new exemption to include business personal property rentals between related parties. The requestor indicated that this change would allow him the flexibility to restructure his business for liability purposes without incurring additional sale tax. The specific request was to allow one business to rent equipment from another business, with identical ownership, without incurring a sales tax liability. Currently business personal property rental transactions are taxable under the sales tax code. Staff indicated that there was some potential concern with other corporate businesses that possibly rent equipment. After reviewing this request, the Subcommittee is recommending that staff do additional research on any possible unintended consequences of this change, and advise the Finance Committee on this sales tax exemption request.

### **Sales tax interest rates**

- **Recommendation**  
Set the sales tax interest rate to an index to allow it to adjust up and down with the financial market.
- **Rationale**  
The sales tax code imposes a 5% per month penalty, up to a maximum of 25%, and an interest rate of 15% per year on delinquent sales tax remittances. These are the maximum amounts allowed under State statutes. The penalties are intended as a punitive measure to get merchants to comply with the law. The interest, on the other hand, is intended to keep the CBJ whole for interest losses

and is set somewhat high to avoid merchants using the CBJ for financing. The sales tax code does provide staff with the authority to compromise and abate penalties and interest. It is reasonably common, for just cause, for staff to waive the 5% penalties. However, for consistency, the interest charges are seldom waived. The 15% rate was placed into the code many years ago. At the time, commercial lending rates were much higher than now and the 15% rate was reasonable. For the past few years, interest rates have dropped significantly. The 15% rate appears higher than necessary to accomplish the intended enforcement objectives.

After reviewing this issue, the Subcommittee determined that, under the current market rates, the sales tax interest rate is higher than necessary. As such, the sales tax interest rate is also acting as a punitive measure. The Subcommittee determined that this is inappropriate. The Subcommittee recommends that the sales tax interest rate be modified to allow it to float within a specified range. The recommendation is to modify the sales tax code to set the interest on January 2 of each year to a rate of 5% higher than the prime rate with a floor of 10% and a ceiling to the maximum amount allowed under State statute.

## **Summary**

It was the Subcommittee's goal to review these taxation issues with a target of finding, to the extent possible, the balance points between the services provided by the CBJ, taxpayer equity and taxation levels. When reviewing the information, the Subcommittee reviewed how any change in taxation would impact CBJ, merchants and residents. The Subcommittee feels their recommendations made in this report represent an improvement in the balance between taxation, services and taxpayer equity. As such, the Subcommittee is recommending to the Assembly Finance Committee that they direct staff to prepare the appropriate ordinances for submission to the Assembly for action.