

MEMORANDUM



DATE: May 2, 2022
TO: Assembly Finance Committee
FROM: Jeff Rogers, Finance Director

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SUBJECT: Follow Up on COW Questions about Sales Tax on Food

In previous meetings, the Assembly has expressed a consensus interest in repealing sales tax on food for home consumption. Recently, the Assembly Committee of the Whole considered modifications to several existing exemptions, which resulted in some questions for research.

Single Item and Single Service Caps

I've attached a list of single-item/service sales tax caps from across Alaska. This list has been provided by the Alaska Remote Sellers Sales Tax Commission (ARSSTC), so it is inclusive of all member communities but it does not include the few small communities who are not yet members of the ARSSTC. As you'll see, single-item/service caps vary widely: many communities have no cap at all while some communities have single item caps as low as \$200 (max \$11 tax per single item). I've attached a brief summary from Avalara on statewide sales tax caps. Sales tax caps at the state level are rather rare, but they do exist, especially for certain items. See attached for a breakdown of exempt sales and foregone revenue for both Single Item and Single Service caps.

Of note, a single item/service sales tax cap makes sales taxation more regressive. As in, lower caps require higher tax rates to generate the same municipal tax revenue. Higher tax rates with lower caps mean that everybody pays more tax on lower-priced items and less tax on higher-priced items. Hence, lower tax caps may shift the tax burden from higher-income individuals/businesses who buy more higher-priced items to lower-income individuals/businesses who buy fewer higher-priced items.

Potential Revenue from Repealing Exemption of Sales by Non-Profits

In 2021, CBJ exempted approximately \$27 million of sales by non-profit organizations, which foregoes approximately \$1.4 million in annual revenue. However, of that \$27 million, \$16 million is in the category of senior & disability services or health & housing. Of that amount, the CBJ Sales Tax Office estimates that at least \$12 million would remain exempted as health care or assisted living services (this estimate could be low). Repealing the exemption for Sales by Nonprofits for remaining \$11 million of sales could generate as much as \$550,000 in new sales tax revenue, but not likely more. That \$550,000 in sales tax would be generated principally from non-profit sales in the broadcasting & education/youth categories, with a smaller portion being generated from non-profit sales in the arts, cultural, recreation, and affinity group categories.

Winter (6 mos)	Summer (6 mos)	Gained/(Lost) Revenue
5.00%	5.00%	\$ (6,200,000)
5.25%	5.25%	\$ (3,900,000)
5.50%	5.50%	\$ (1,600,000)
5.75%	5.75%	\$ 700,000
6.00%	6.00%	\$ 3,000,000
5.00%	5.25%	\$ (4,800,000)
5.00%	5.50%	\$ (3,300,000)
5.00%	5.75%	\$ (1,800,000)
5.00%	6.00%	\$ (400,000)
5.00%	6.25%	\$ 1,100,000
4.00%	6.00%	\$ (3,700,000)
4.00%	6.25%	\$ (2,300,000)
4.00%	6.50%	\$ (800,000)
4.00%	6.75%	\$ 600,000
3.00%	7.00%	\$ (1,200,000)
3.00%	7.25%	\$ 200,000
2.00%	7.75%	\$ (200,000)
0.00%	9.00%	\$ 400,000

Various Rate Possibilities

The Assembly requested to see rate options and their impact on CBJ sales tax revenue. The table to the right has been prepared from the most recent sales tax model, which is based on the FY19 actual sales tax returns (pre-pandemic local spending) adjusted to total FY22 forecasted sales tax. In the table, SNAP foods have been exempted. These estimates are the most accurate that the Finance Department can produce, but they are still generally low confidence and subject to significant variability.

Misconception of a Tax Increase

As the Assembly has considered and discussed the question of increasing the base sales tax rate to offset the lost revenue from the exemption of sales tax on food, I have sometimes heard commenters say “I don’t support a tax increase.” To be perfectly clear, nothing that is currently under consideration by the Assembly would increase sales taxes paid by residents. In fact, strategies under consideration would demonstrably reduce sales taxes paid by residents.

I’ve attached an analysis completed in November 2019 that indicated that 5%/6% seasonal rate with food exempted would result in an average annual tax reduction of \$143.47 per household. As a percentage of household expenditure, the greatest tax relief accrues to those individuals in the lowest income brackets. As detailed in the attached narrative and calculation, this happens in large part because a higher base rate with food exempted shifts a greater portion of the sales tax burden to non-residents (visitors), with the analysis describing that each summer visitor would pay about \$1.00 more in sales tax during their visit. These results might be slightly less favorable if calculated with a year-round increased rate, but the general trend would hold.

By way of comparison, reducing average annual household sales taxation by \$143.47 is roughly equivalent to reducing the property tax mill rate by 0.4 mills for a family with a \$350,000 home. Reductions to the property tax mill rate provides tax relief to families in proportion to the value of their home—those who own the most expensive homes get the greatest relief and those who own or rent more modest homes would see the least relief. However, the exemption of food from sales tax offset by a higher rate provides the greatest tax relief to lower income households.

Recommendation

I strongly recommend that the Assembly refrain from exempting food from sales tax without a strategy to either: 1.) Replace most or all of the lost revenue, or 2.) Reduce city expenditures sufficiently to offset lost revenue. To reduce city revenue by more than \$6 million without new revenue or an offsetting reduction in expenditures would almost certainly create a substantial structural deficit that would require a future Assembly to eviscerate city services and infrastructure investments in order to balance the annual budget.

I applaud the effort to evaluate and potentially repeal or reduce existing exemptions. However, every existing exemption has a logic—there was a strong reason that a prior Assembly chose to implement it. And every existing exemption has a constituency—repealing an exemption always impacts a group may choose to be vocal in its own interest. For these reasons, repealing or reducing exemptions has rarely been an easy task. There may be good policy motivations to repeal or reduce current exemptions, but those policy motivations are likely separate and unrelated from the need to raise revenue to replace sales tax lost by exempting food. Hence, I recommend that you decouple efforts to repeal or reduce current exemptions from trying to remove sales tax on food.

In consideration of the long history of this subject and the Assembly’s recent discussion, I recommend that you put the question to the voters. Quite simply: Does the public support exempting food from sales tax and replacing that lost revenue with a higher rate on non-food items?