

Analysis

The positions reflected in this narrative are the author's independent opinions and are not at this time official departmental (Department of Revenue) positions.

Section 2: Reduced tax rate for direct marketing fisheries business.

This section reduces the tax rate for processing by qualified licensees on vessels to the rates applicable to shore based processors. The reduced tax rates will be attractive to all floating processors and therefore should be accompanied by provisions to prevent non-targeted floating processors from slipping in under the fence. Specific recommendations are reflected in the relevant sections below. The Single most important provision not already contemplated is to specify that the tax rate on resources processed by a custom processor for a direct marketing fisheries business should be the rate otherwise applicable to the custom processor. This rule will prevent non-targeted floating processors from setting their fishermen up as "straw man" direct marketers to achieve a lower tax rate.

Section 3: Exclusion from fisheries business tax.

The bill expands the existing exclusion for on-board processing by eliminating the freezing requirement that exists in current law. The exclusion is also mandatory under the bill. These changes expand and simplify the exclusion and will improve the efficiency of administration. Because the exclusion applies to all fisheries resources the committee should consider whether or not to include shelling, shucking, or other processing activities not specific to salmon or other finfish. An expansive mandatory exclusion will tend to concentrate the tax with fewer taxpayers, simplify the tax, and reduce the impact of the fisheries business tax on business decisions.

Section 4: Direct marketing fisheries business license.

The bill authorizes a new form of license for direct marketers. Qualified applicants are individual commercial fishermen who own a limited entry permit or quota share, own and operate a vessel 65 feet or less, and conduct limited processing activities. The license entitles the holder to process on one or more vessels and a single shore based location. The licensee may conduct limited processing of their catch, but may not purchase fish from or

process fish for another licensee. The licensee is subject to the same \$25 fee applicable to other fisheries businesses; however, unlike other licensees the fee may cover more than a single processing facility.

The 65 foot vessel limitation and restriction to individuals (only) help prevent non-targeted applicants from taking advantage of the bill. However, the bill requires only a nominal ownership interest in the vessels and therefore remains subject to manipulation. A meaningful ownership interest coupled with a requirement that the fishermen be the sole beneficial owner of the resource from the point of harvest through sale would help prevent abuse without limiting the intent of the bill. In addition, a separate license for each vessel will help discourage “straw man” schemes and may be easier for this and other department’s to administer. A single license for multiple vessels avoids the need for fishermen to account and file separately for each vessel. Revenue can deal with single or multiple vessel licenses without material degradation of our function. However, DEC (and perhaps ADF&G as well) probably cannot issue a single permit for multiple vessels. Intuitively it seems doubtful that the number of direct marketers using multiple vessels warrants the complexity and risks of providing for multiple vessel licenses. It may prove simpler for fishermen and state agencies to license/permit each vessel in which case DOR could explore a consolidated return or other administrative simplifications to minimize the impact on fishermen operating multiple vessels.

The bill prohibits on board processing by restricting processing activities to limited on-shore processing. The prohibition against on-board processing appears unintentional. The intent of the bill appears to be to allow processing on-board the licensed vessel(s) and at a single shore based location. Some modification of the language is required to achieve this intent.

The nature or purpose of the “limited processing” restriction is unclear at this time. Further clarification will allow the department to draft meaningful regulations.

The committee should consider changing the restriction against purchasing fisheries resources from a licensed fisheries business to a restriction prohibiting the purchase of fisheries resources for sale or processing for sale. This restriction would prohibit commercial purchases from any source without restricting purchases for personal use or bait for example.

The final subsection (d) places the burden of proof for taxable value upon the direct marketing licensee. The language gives context to the prevailing price rule set out in section 5. This prevailing price valuation method is a codification of what is sometimes referred to as the grounds price method that was widely used and widely abused in years past. By placing the burden of proof on the taxpayer, the bill enables the department to correct abusive taxpayers while retaining the taxpayer's ability to report low values based on the facts and circumstances. In short, the department would have the upper hand in disputes over taxable value thereby restricting aggressive claims. Our experience indicates that the prevailing price method will produce widespread abuse without this or a similarly functioning provision. It must be said however, that the language will require responsible administration on the part of the department to maintain a fair result in all cases.

Section 5: Taxable value.

The bill applies the prevailing price method to sales by a direct marketer to a buyer who is not a licensed fisheries business. For transactions between the direct marketer and another licensed fisheries business, taxes are based on the actual price received by the direct marketer.

The prevailing price method can be extremely subjective. Taxpayers may become frustrated in their attempt to come up with the prevailing price and face uncertainty over the possibility of an additional assessment by the Department. A potential solution is to establish some sort of safe harbor; a price point or range at which the taxpayer can evaluate their estimate for reasonableness and have confidence that their reported value will not be challenged by the Department. The cost and complexity of a formal system of safe harbor values is probably prohibitive. It may be possible for the Department to develop and implement a minimalist safe harbor policy using regulations and other administrative tools.

Sales to a licensed fisheries business are taxed on the price paid for the fisheries resource. This method has the potential of taxing value added by the direct marketer. We cannot predict the degree to which resources with significant value added will be sold to licensed fisheries businesses. However, it is reasonable to predict that most "direct marketer to licensed fisheries business" transactions will involve minimally processed resources simply because of the underlying economics. Processors can generally

process much cheaper than individual fishermen and will pay for pre-processed product based on their costs, not actual or opportunity costs of fishermen. Thus, the level of inequity is unlikely to be material. On balance, this bill is the most effective and affordable proposal to eliminate the taxation of value added by direct marketers that the author has reviewed to date.

The advantages and disadvantages of the proposed method of calculating taxable value are:

Advantages:

- It is fairly effective in eliminating tax on value added by the fishermen.
- It serves to roughly equalize the tax burden for direct marketers and the average tax burden for the rest of the industry.
- It is less expensive to administer and should produce taxable values that reflect market value.
- Fisheries businesses that purchase from direct marketers and other fishermen use a single, consistent method of determining value.

Disadvantages:

- Because taxable value for direct market sales is inconstant with the method of determining taxable value elsewhere, the bill may create new inequities by ignoring quality, seasonal price fluctuations and other variables (the result however is likely to be more equitable than existing law).
- It taxes value added by the direct marketer on sales to licensed fisheries businesses.
- Direct marketers do not have a fixed value to rely on and are subject to potential assessments by the department.

Sections 7-15: Elimination of the “purchaser” loopholes.

Current law specifies that the buyer must withhold and remit salmon enhancement and marketing taxes. There is no requirement that the fishermen pay their tax in the event the buyer does not withhold it from them. Few non-licensed buyers are aware of their requirement to withhold and pay and the department is unable to enforce the requirement. These sales therefore go untaxed at this time and generate a disparity between similarly situated taxpayers of up to 4% of value. Direct marketing will contribute to this disparity. The bill closes the loophole by requiring

fishermen to file and pay tax on sales to unlicensed buyers who did not withhold the tax at the time of purchase.