



Birch Horton Bittner & Cherot  
*a professional corporation*

**MEMORANDUM** 16-091

**TO: KATIE KOESTER  
CITY MANAGER  
CITY OF HOMER**

**FROM: THOMAS F. KLINKNER**

**RE: SALES TAX DEDICATED TO FIRE DEPARTMENT OPERATING  
COSTS**

**FILE NO.: 506,742.221**

**DATE: MAY 3, 2016**

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**1. Summary and Conclusion**

You have asked whether the City of Homer may authorize a sales tax increase whose proceeds are dedicated to fire department operating costs. I conclude that:

- No statute restricts the dedication of City sales tax proceeds.
- The “dedicated funds clause” in the Alaska Constitution prohibits, with exceptions, the dedication of the proceeds of a state tax or license to a special purpose, but it is uncertain whether it would prohibit by implication a dedication of City sales tax proceeds.
- If a single vote approves both a City sales tax increase and a dedication of its proceeds to a special purpose, the tax increase is unlikely to survive invalidity of the dedication.

**2. Analysis**

**A. No Statute Restricts the Dedication of City Sales Tax Proceeds**

AS 29.35.250(a) authorizes the City to “exercise any power not otherwise prohibited by law.” The City’s power to levy a sales tax is subject to AS 29.45.670, which provides that “[a] new sales and use tax or an increase in the rate of levy of a sales tax approved by ordinance does not take effect until ratified by a majority of the

voters at an election.”<sup>1</sup> However, no statute limits the City’s authority to dedicate sales tax proceeds for a particular purpose.

**B. *It Is Uncertain Whether the “Dedicated Funds Clause” in the Alaska Constitution Prohibits the Dedication of City Sales Tax Proceeds***

The “dedicated funds clause” in the Alaska Constitution prohibits the dedication of “the proceeds of any **state** tax or license” (emphasis added) to any special purpose.<sup>2</sup> The dedicated funds clause does not address explicitly the dedication of the proceeds of a **municipal** tax. The Alaska Supreme has not decided whether the dedicated funds clause should be interpreted to prohibit by implication the dedication of the proceeds of a municipal tax. In the court’s only decision involving a municipal sales tax dedication the court declined to address the issue of the validity of the dedication:

We note that neither party addressed the issue of whether the ordinance [enacting the dedication] itself violates article XI, section 7 of the Alaska Constitution, prohibiting dedicated revenues. Our decision today should not be read as expressing any opinion on that question.<sup>3</sup>

Some aids to interpreting the Alaska Constitution support an argument that the dedicated funds clause was not intended to prohibit the dedication of the proceeds of a municipal tax. The report of the Finance Committee to the Alaska Constitutional Convention explained the purpose of the dedicated funds clause with specific reference to state government:

Even those persons or interests who seek the dedication of revenues for their own projects will admit that the earmarking of taxes or fees for other interests is a fiscal evil. But if allocation is permitted for one interest, the denial of it to another is difficult, and the more special funds are set up the more difficult it becomes to deny other requests until the point is reached

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<sup>1</sup> AS 29.45.700(a) provides that “A city in a borough that levies and collects areawide sales and use taxes may levy sales and use taxes on all sources taxed by the borough in the manner provided for boroughs.” AS 29.45.650(a) authorizes a borough to levy and collect a sales tax on sales, rents, and on services provided in the borough, subject to the voter approval requirement in AS 29.45.670.

<sup>2</sup> Alaska Constitution art. IX, § 7 provides:

The proceeds of any state tax or license shall not be dedicated to any special purpose, except as provided in section 15 of this article or when required by the federal government for state participation in federal programs. This provision shall not prohibit the continuance of any dedication for special purposes existing upon the date of ratification of this section by the people of Alaska.

<sup>3</sup> *City of Fairbanks v. Fairbanks Convention and Visitors Bureau*, 818 P.2d 1153, 1158 n. 7 (1991).

where neither the governor nor the legislature has any real control over the finances of the state. In one Rocky Mountain state the legislature is free to appropriate only 17 percent of the tax collections; the rest are dedicated. In Alaska at present, 27 percent of territorial funds are earmarked, primarily for school construction and roads.<sup>4</sup>

This explanation refers to preserving the governor's and the legislature's control of the state's finances. It makes no reference to local government. Moreover, the Alaska Constitution treats municipal taxation distinctly from state taxation: the former in article X regarding local government, and the latter in article IX regarding the finances of the state. Nevertheless, it remains uncertain whether a court would decide that the dedicated funds clause prohibits by implication a dedication of City tax revenues.

### **3. *The Sales Tax Increase Is Unlikely to Survive Invalidity of the Dedication***

I understand that the City voters will be presented with a single ballot proposition: to authorize a one percent increase in the City's sales tax, and to dedicate the proceeds of the increase to City fire department operating costs. A court decision that the dedication of the proceeds of the sales tax increase was invalid also probably would be fatal to the sales tax increase itself. In deciding whether to reject the sales tax increase along with the dedication of its proceeds, a court would consider (i) whether the tax increase alone could be given legal effect, and (ii) whether the voters intended that it be given effect.<sup>5</sup> The first part of this test would be met easily, because the sales tax increase could be given legal effect without the dedication of its proceeds. However, it would be questionable at best whether the voters would have approved the sales tax increase without the dedication of its proceeds. Indeed, the motivation for combining the sales tax increase and dedication in one ballot proposition is to increase the probability that the voters will approve the increase.<sup>6</sup>

TFK/lcj

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<sup>4</sup> Quoted in V. Fischer, *Alaska's Constitutional Convention*, 145 (1975).

<sup>5</sup> *Alaskans for a Common Language v. Kritz*, 170 P.3d 183, 213 (2007).

<sup>6</sup> See, *Interior Cabaret, Hotel, Restaurant & Retailers Association v. Fairbanks North Star Borough*, 135 P.3d 1000, 1004 (Alaska 2006), in which the court acknowledged that including tax exemptions in a sales tax ballot proposition "may have made the sales tax more palatable to some voters."