

**ALASKA STATE LEGISLATURE
HOUSE STATE AFFAIRS STANDING COMMITTEE**

January 29, 2002
8:03 a.m.

MEMBERS PRESENT

Representative John Coghill, Chair
Representative Jeannette James
Representative Hugh Fate
Representative Gary Stevens
Representative Peggy Wilson
Representative Harry Crawford
Representative Joe Hayes

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE JOINT RESOLUTION NO. 35
Relating to urging the United States Congress to amend the tax
code to permanently repeal the death tax.

- MOVED HJR 35 OUT OF COMMITTEE

PREVIOUS ACTION

BILL: HJR 35
SHORT TITLE: REPEAL ESTATE TAX
SPONSOR(S): REPRESENTATIVE(S) JAMES

Jrn-Date	Jrn-Page		Action
01/22/02	2029	(H)	READ THE FIRST TIME - REFERRALS
01/22/02	2029	(H)	STA
01/22/02	2029	(H)	REFERRED TO STATE AFFAIRS
01/29/02		(H)	STA AT 8:00 AM CAPITOL 102

WITNESS REGISTER

HEATH HILYARD, Staff
to Representative Jeannette James
Alaska State Legislature
Capitol Building, Room 214
Juneau, Alaska 99801

POSITION STATEMENT: Testified on behalf of the sponsor regarding HJR 35.

ACTION NARRATIVE

TAPE 02-3, SIDE A
Number 0001

CHAIR JOHN COGHILL called the House State Affairs Standing Committee meeting to order at 8:03 a.m. Representatives Fate, Crawford, Hayes, and Coghill were present at the call to order. Representatives James, Stevens, and Wilson arrived as the meeting was in progress.

HJR 35-REPEAL ESTATE TAX

Number 0063

CHAIR COGHILL announced that the only business would be HOUSE JOINT RESOLUTION NO. 35, Relating to urging the United States Congress to amend the tax code to permanently repeal the death tax.

Number 0102

HEATH HILYARD, Staff to Representative Jeannette James, Alaska State Legislature, presented HJR 35 on behalf of Representative James, sponsor. He compared HJR 35 to HJR 34 - which was introduced by Representative Coghill during the Twenty-First Alaska Legislative Session - as being similar in wording and nearly identical in intent. He explained the main reason [the sponsor] had chosen to revisit the issue was that in 2002, President Bush signed into law a tax-relief Act that included a temporary repeal of the so-called death tax that would "sunset" in 2010.

MR. HILYARD forewarned the committee that his scope of knowledge on federal tax policy was limited, but said he had received a "crash course" while researching [HJR 35]. He stated his belief that there is ample evidence to support the repeal of the death tax and, therefore, to support [HJR 35].

Number 0189

MR. HILYARD offered the following:

As indicated in the sponsor statement, not only does the death tax disproportionately tax several ... demographic groups, it also does not justify its own existence from a fiscal perspective.

In the same study cited in the sponsor statement, using very sophisticated econometric models, analysts believe that had the tax been repealed in 1996, the nation's economy would have yielded an average of \$11 billion in additional output, created an average of [145,000] new jobs, and personal income would have increased by an average of \$8 billion over the following nine years. The overall increase in the national economy would have created enough additional revenue to compensate for that ... which had been generated by the tax.

MR. HILYARD noted that he had recently received a statement of support for HJR 35, included in the committee packet, from the National Federation of Independent Business [NFIB], Alaska. He read from that statement as follows:

In addition to the tax itself, thousands of small businesses are impacted each year by expensive fees paid to attorneys, accountants, and life insurers necessary to ... prepare for an eventual death tax [debt].

MR. HILYARD welcomed questions from the House State Affairs Standing Committee.

Number 0322

REPRESENTATIVE FATE asked Mr. Hilyard to define the difference between death tax and estate tax.

MR. HILYARD responded that his understanding was that the death tax and estate tax, although not identical, are part of the same tax Act under federal law. He explained that the death tax would tax the earnings of inheritors with respect to the total value of the estate. Regarding the determination of value and amount of tax applied, Mr. Hilyard noted there are "somewhat complicated models."

Number 0389

CHAIR COGHILL stated his understanding that the death tax encompasses the estate tax.

Number 0420

REPRESENTATIVE FATE said [he supported HJR 35]; however, he asked if the nomenclature was proper. He suggested that the term "death tax" connotes that there is one tax - it's singular. He noted that there are "several winding roads" when considering estate taxes, which are not simple. He stated that he hoped that [the resolution] does not connote that a death tax is a simple thing. He expressed his concern that the language of the resolution could be misinterpreted.

Number 0493

MR. HILYARD told Representative Fate that he believed the formal title of the federal Act relating to [the death tax] could be found [on page 1, lines 4-5 of HJR 35], which reads in part: "the federal estate and generation-skipping transfer tax".

Number 0517

REPRESENTATIVE FATE reminded Mr. Hilyard that the federal legislation "would not encompass it if it was piecemeal." He continued as follows:

It did not address the whole broad spectrum of inheritance taxes. It only just chewed away at a little bit. And there was some cause for some concern about the lack of all-encompassing taxes, as a matter of fact, in that. So, we cannot compare what the legislation was at the federal level with what this says.

Number 0556

REPRESENTATIVE JAMES agreed that estate tax is a complicated issue. If it should "go away," as the resolution proposes, many other changes would have to be made, particularly in regard to capital gains, she added. She mentioned all-encompassing decisions and removing unfair tax. She continued:

Probably, if people were to, as an example, inherit some property, the way it is currently, they inherit the property at the fair market value at the time of the death. And that's where the recipient pays no

taxes, but the tax is paid from the estate. If that were to change, then ... the amount that you would receive, you would have to get it at the base value, not the fair market value. So, at some time in the future when that property was sold for more money, someone would be paying taxes on that capital gain.

I don't think that we have any intent to do away with making some capital gains not taxable at all and others taxable, because that wouldn't be fair. People understand what fairness is. So, it's assumed that when they do this that they'll make all the other adjustments that they have made, in order to tax this entity, as opposed to taxing the people who are the recipients - that those changes will be made.

And Representative Fate is absolutely correct. Every single tax we have on the books, and in a particular case, if we were to say here, repeal the income tax, how entangled that would be to fill out that whole bundle of changes over the years. And yet there's an awful lot of other adjustments that have to be made to make it fair and equitable over time. I don't think there's any intent to not have people pay taxes on capital gains. I think the issue is: do you need to sell it to pay the taxes when the death occurs. And sometimes that destroys family businesses, and I don't think that's fair.

Number 0752

REPRESENTATIVE WILSON referred to [lines 1-2] of the resolution, which read, in part, "to permanently repeal the death tax." She said that appeared to be "pretty encompassing." She emphasized the importance of supporting [HJR 35], because the population that is adversely affected by [the death tax] includes minorities and small businesses in Alaska. Representative Wilson added that the [misconception] is that [the resolution] would solely help rich people.

Number 0827

REPRESENTATIVE CRAWFORD asked Mr. Hilyard at what point the death tax "kicks in." He asked whether it is the total valuation or the net valuation. He added, "As far as I know, it's the assets minus the liabilities."

Number 0876

MR. HILYARD answered that regarding the point at which it "kicks in," he understood it ranged between \$10,000 and \$100,000. He stated his suspicion that those numbers were "accelerators" in terms of the total tax rate. He suggested Representative James would have more knowledge of the matter. With respect to total valuation, he said the other standard tended to be fair market value. He surmised that fair market value would be determined by combining assets and liabilities to derive the total value.

Number 0949

REPRESENTATIVE JAMES mentioned the accelerated value of property and rising "past the estate-tax level." She remarked that she had not done a generation-skipping tax return for approximately 15 years. Because she has not done consulting recently, Representative James said she was not certain of the "level"; however, she said it was formerly at \$600,000. She said many people were considered rich who were not actually wealthy, because of the assets which they had accumulated. Homesteads and property values have accelerated so much over the years, she noted, that there would be considerably more people in Alaska now versus in the past who would be subject to generation-skipping tax, without the bequeather making arrangements prior to their deaths to transfer their property by allowable, nontaxable methods. She concluded:

I don't know what that answer is, but regardless of what the answer is, I believe that it grossly, negatively affects an awful lot of families when they've been able to accumulate valued property that has a lot of capital gains on it over the years.

Number 1071

MR. HILYARD repeated that he could not answer what the current standards are. He said one key piece of legislation currently before Congress is S. 275, the Estate Tax Elimination Act of 2001. He noted that this bill proposes to repeal all federal death taxes immediately, to exempt approximately \$3 million in family assets from capital gains taxation, and to tax intergenerational wealth transfers above [this amount] and cap that at about 20 percent.

Number 1145

CHAIR COGHILL commented that he did not know when [Americans] got to the place where they thought the government had the first claim on their inheritance. He emphasized his appreciation of the resolution. Though the [House State Affairs Standing Committee] would not be settling the actual dollar amount, Chair Coghill expressed the need for the committee to send the resolution to Congress to encourage its members to consider how much of people's life inheritance should be taken from them.

Number 1205

REPRESENTATIVE CRAWFORD mentioned that Congress had debated this issue and had decided that "if two parents die, the first \$1.2 million is for free." He said he was not certain to what amount that may have been raised. He stated his opinion that an inheritance of more than \$1.2 million, whether it was stocks and bonds or real estate, should still be considered income; therefore, it was unfair to tax those with incomes from regular employment, but not tax those who inherit more than \$1.2 million [in assets]. He said, "It seems to me like a real unfair tax break for somebody to get so much money at one point and not have to pay a tax on it."

Number 1334

REPRESENTATIVE JAMES responded as follows:

What they're capitalizing here is the two times [\$]600,000, which is the threshold as to when you even have to file a generation-skipping tax ... return. And like I said, it's been awhile since I have done it. ... If you get \$1.2 million worth of property, if it's cash, that's one thing; but if it is property, there's a basis in that property. And the only reason it is in this estate is because they have never sold it.

The whole issue of capital gains is a real debatable issue as to when you're forced to sell what you have, to be able to pay your taxes. And so, I honestly believe that in the end result, ... they probably will transfer this \$600,000 worth of property to the various, different beneficiaries, and the beneficiaries will put it on their books at the basis, not the value.

That's the ... issue. ... If there's no tax on it, then it comes to you at the basis. If you have a piece of property that the basis of it is \$250,000 and it's now worth \$700 million and you inherit this piece of property, it's going to be worth \$250,000 to you. And if you sell it, you're going to have to pay taxes on the value of it - you, because now you're the one that's earning that capital gain. I don't believe there's any intent in doing away with the inheritance tax, doing away with allowing people to enlarge their estate. ... And when they liquidate it, it gets taxed, not before. And what ... the problem is with inheritance tax is it's taxed the minute the person dies and so, therefore, no one gets the opportunity to have that property at its basis, instead of at the ... accelerated price.

Number 1469

REPRESENTATIVE FATE clarified that the issue was inheritance, not gifting to someone outside the immediate family. He cited the example of parents who do not have a large cash flow, but do have property, bequeathing that property to their offspring. At the time of the parents' death, he continued, that property is taxed to the extent that their inheritors can't pay the taxes and lose the property. He added, "Why even have the incentive to produce all your life, if you can't pass it on to your children."

Number 1555

REPRESENTATIVE CRAWFORD cited an example of a personal friend who had inherited stocks and bonds from her parents - an estate valued at approximately \$10 million. The first \$1.2 million was tax-free, but she'd had to pay tax on the stocks and bonds exceeding that amount. Representative Crawford asked if that sort of income would be exempt or included under this plan.

Number 1595

REPRESENTATIVE JAMES responded that the provision is part of the inheritance tax - the federal estate and generation-skipping transfer tax. If that law is taken off the books, she said, then those issues will have to be addressed separately in laws, because this exemption would not still exist, since it is part of the federal estate tax. Representative James stated that she did not believe that [Congress] would transfer large amounts of

property to persons at the fair market value at the date of death, if the estate tax is abolished. Conversely, [the property] would be transferred at the basis - or cost - of it, and when [the inheritor] liquidates [the property], tax will be due on the income.

Number 1673

CHAIR COGHILL credited Representative James for making an excellent point. He issued a reminder that the property in the aforementioned example had already been taxed through [the benefactor's] lifetime, so the government had already received its share of any capital gain "all the way down the road anyway." He reiterated Representative James's comment that the property would be taxed when liquidated, and he added that therefore the government would be receiving its share. He clarified the point was to ask if, at the termination of the bequeather's life, the asset could be transferred without the government's getting more than the inheritors.

Number 1710

REPRESENTATIVE CRAWFORD expressed the need for further clarification. He referred to his previous example and pointed out that, to his knowledge, the stock had never been taxed, other than dividends; none of the gain had ever been taxed, from the time that his friend's parents bought the stock until the time she inherited it from them. Her parents had given her gifts of \$10,000 for each birthday to "transfer that, so that they could beat some of those taxes at death," he said; however, there was still a considerable amount of taxable money left at the time of their deaths.

Number 1759

REPRESENTATIVE JAMES stated that the provisions of giving \$10,000 a year tax-free and getting the \$1.2 million exempt would no longer exist if the federal estate tax and generation-skipping transfer taxes were abolished. She continued:

What happens, then, is the same as if anybody would give you anything today: Your family transferred this property to you, which is worth \$1 million, or whatever, and it never has been sold. They transfer it to you before they die, and you take it at the basis. In other words, if they had \$250,000 in it, you take it. The tax is not paid until that property

is liquidated, and then the capital gains is recognized by whoever is selling it. That's part of the estate tax that we're talking about, is the unfairness that's in the estate tax. If the estate tax goes away, we'll be having the same provision as if I gave you something today. If I gave you something today and it was an inheritance type or whatever, I'd have to pay the tax. If I gave you something that was worth \$10,000, that I only had \$2,000 in it, and if I give that to you today, I have to pay the tax immediately on the difference between the two and the ten. You don't have to pay anything because it's a gift to you.

... If you take the estate tax away, if I want to give you something that is \$10,000 worth and I only have [\$2,000] in it, the only thing I can do is will you that at the \$2,000 value at some time in the future. And you liquidate that - then you'll have to pay the taxes because you're the one that's getting the benefit from selling the property.

... All those other little things are kind of like the income tax, where we have something, and then we have to fix this, and this, and this. My personal belief is that that tax goes away, all of those things get [put back] into perspective, and there is no real ... windfall for people without the taxes having been paid on the ... accelerated capital gains on these properties. That's my personal opinion.

Number 1876

REPRESENTATIVE FATE, as one example of how complex this subject is, admitted he didn't have an understanding of how far spousal exemptions extend. He stated that without an expert present to testify, it was beyond his capability to make a decision. He acknowledged Representative James's former experience in the tax field. Representative Fate expressed his suspicion that the committee was saying things that were not quite correct. He said HJR 35 was a "plain bill to correct some inequities," and he supported it.

Number 1984

REPRESENTATIVE WILSON indicated a need for clarification of terminology. For example, she mentioned "basis" as a

potentially unfamiliar term. She said whether it's land or stocks and bonds that are inherited, it is worth nothing in terms of cash to the person who inherited it, until it is sold. Representative Wilson concurred with Representative James that the point of sale is when the inheritor is taxed. She stated her understanding that if an inheritance tax is levied at the point of inheritance, often the inheritor is forced to sell the inheritance to get the money [to pay the tax].

Number 2063

REPRESENTATIVE CRAWFORD surmised that according to Representative James's previous example, if his aforementioned friend never sold the stock that she inherited and passed it on to her children, there still would not have been a transfer of wealth. He said, "Maybe she doesn't feel like she's gotten wealth, because she hasn't spent it all yet, but she sure seems richer than me. And it certainly seems to me that income is income." He said before he would give the resolution his approval, he would like to know if land and businesses were being treated separately from cash and stocks and bonds.

Number 2129

REPRESENTATIVE FATE moved to report HJR 35 out of committee with individual recommendations and the accompanying zero fiscal note.

REPRESENTATIVE HAYES asked Mr. Hilyard what the vote in Congress was.

MR. HILYARD clarified that Representative Hayes was inquiring about the temporary appeal. He said he did not know the final vote; however, at the time of the analysis which he studied, it was his belief that [congressional] H.R. 330 was widely supported, with 149 cosponsors.

[An objection was stated to the motion.]

Number 2185

A roll call vote was taken. Representatives Fate, Hayes, James, Stevens, Wilson, and Coghill voted for moving HJR 35 from committee. Representative Crawford voted against it. Therefore, HJR 35 was moved out of the House State Affairs Standing Committee by a vote of 6-1.

CHAIR COGHILL stated his intent to cosponsor the resolution.

REPRESENTATIVE FATE indicated the same. [HJR 35 was moved out of committee.]

ADJOURNMENT

Number 2290

There being no further business before the committee, the House State Affairs Standing Committee meeting was adjourned at 8:40 a.m.