

ALASKA STATE LEGISLATURE
HOUSE STATE AFFAIRS STANDING COMMITTEE

February 26, 2002

8:10 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

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 199

"An Act relating to taxation, including taxation of income of individuals, estates, and trusts."

- HEARD AND HELD

HOUSE BILL NO. 303

"An Act relating to the levy and collection of a sales tax; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 398

"An Act relating to disposition of income of the Alaska permanent fund; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

PREVIOUS ACTION

BILL: HB 199

SHORT TITLE: INCOME TAX: INDIVIDUALS/TRUSTS/ESTATES

SPONSOR(S): REPRESENTATIVE(S) HUDSON

Jrn-Date	Jrn-Page	Action
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03/19/01	0650	(H)	READ THE FIRST TIME - REFERRALS
03/19/01	0650	(H)	STA, FIN
03/23/01	0712	(H)	COSPONSOR(S): SCALZI
01/18/02	2002	(H)	SPONSOR SUBSTITUTE INTRODUCED
01/18/02	2002	(H)	READ THE FIRST TIME - REFERRALS
01/18/02	2002	(H)	STA, FIN
01/18/02	2002	(H)	REFERRED TO STATE AFFAIRS
02/14/02		(H)	STA AT 8:00 AM BUTROVICH 205
02/14/02		(H)	Heard & Held MINUTE(STA)
02/23/02		(H)	STA AT 10:00 AM HOUSE FINANCE 519
02/23/02		(H)	Heard & Held MINUTE(STA)
02/26/02		(H)	STA AT 8:00 AM CAPITOL 102

BILL: HB 303

SHORT TITLE: STATEWIDE SALES TAX

SPONSOR(S): REPRESENTATIVE(S) WHITAKER

Jrn-Date	Jrn-Page		Action
01/14/02	1954	(H)	PREFILE RELEASED 1/4/02
01/14/02	1954	(H)	READ THE FIRST TIME - REFERRALS
01/14/02	1954	(H)	STA, FIN
01/16/02	1992	(H)	COSPONSOR(S): FATE
02/04/02	2152	(H)	COSPONSOR(S): LANCASTER
02/12/02		(H)	STA AT 8:00 AM BUTROVICH 205
02/12/02		(H)	Heard & Held
02/12/02		(H)	MINUTE(STA)
02/26/02		(H)	STA AT 8:00 AM CAPITOL 102

WITNESS REGISTER

REPRESENTATIVE BILL HUDSON
Alaska State Legislature
Capitol Building, Room 502
Juneau, Alaska 99801

POSITION STATEMENT: Testified as the sponsor of SSHB 199.

LARRY PERSILY, Deputy Commissioner
Office of the Commissioner
Department of Revenue
PO Box 110400
Juneau, Alaska 99811-0400

POSITION STATEMENT: Testified on SSHB 199.

SCOTT GOLDSMITH, Director
Institute of Social and Economic Research
University of Alaska Anchorage
3211 Providence Drive
Anchorage, Alaska 99508

POSITION STATEMENT: Testified on SSHB 199, commenting on trigger mechanisms and impacts; during hearing on HB 303, provided information relating to different taxation and budget-reduction approaches.

KATHRYN KURTZ, Attorney
Legislative Legal Counsel
Legislative Legal and Research Services
Legislative Affairs Agency
State Capitol
Juneau, Alaska 99801-1182

POSITION STATEMENT: As the drafter of SSHB 199 and HB 303, answered questions relating to Version J of both bills.

REPRESENTATIVE JIM WHITAKER
Alaska State Legislature
Capitol Building, Room 411
Juneau, Alaska 99801

POSITION STATEMENT: Testified as the sponsor of HB 303.

ACTION NARRATIVE

TAPE 02-18, SIDE A
Number 0001

CHAIR JOHN COGHILL called the House State Affairs Standing Committee meeting to order at 8:10 a.m. Representatives Coghill, James, Fate, Stevens, Wilson, and Crawford were present at the call to order. Representative Hayes arrived as the meeting was in progress.

CHAIR COGHILL announced, "The plan today is to try to amend up the three different categories into three different bills." He also announced that he didn't intend to move the bills from committee, but rather to make a bill. Chair Coghill said he felt a flat tax would be the best place to begin [the discussion].

HB 199-INCOME TAX: INDIVIDUALS/TRUSTS/ESTATES

[Contains discussion of HB 413, HB 35, and HB 303]

CHAIR COGHILL announced that the first order of business would be SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 199, "An Act relating to taxation, including taxation of income of individuals, estates, and trusts."

CHAIR COGHILL reminded committee members that on February 23, 2002, Representative Hudson had provided the committee with an amendment [22-LS0753\J.1, Kurtz, 2/18/02] to consider.

Number 0440

REPRESENTATIVE BILL HUDSON, Alaska State Legislature, testified as the sponsor of SSHB 199. He began by saying SSHB 199 is an attempt to fill a portion of the broad and difficult fiscal gap. This bill simply reimposes an income tax, as a percentage of the federal adjusted gross income. It uses a flat tax of 1 percent of the adjusted gross income for the first year, which increases to 2.25 percent of the adjusted gross income and continues on at that rate.

REPRESENTATIVE HUDSON pointed out that the revised fiscal note specifies that in the first year - because half of the year is at 1 percent and half is at 2.25 percent - the total revenue will be \$258 million. That revenue will increase to \$283 million [in the next year]. He added that this tax would be less than one-half of the taxes paid by Alaskans when Alaska had an income tax.

REPRESENTATIVE HUDSON related his belief that on average the tax would be less than the permanent fund dividend (PFD), even at the reduced rate. However, the more money one earns, the more taxes one pays. If imposed, this tax could be deducted from the federal income tax. According to a statement by Governor Knowles regarding his [proposed] tax, Representative Hudson reported that perhaps as much as \$50 million that now goes to the federal government could be retained by Alaskans. Representative Hudson remarked that he'd written this bill aiming for an equal contribution from the people of Alaska, which is why he believes a flat tax is appropriate. He mentioned that the fiscal note would probably be challenged in the House Finance Committee because the administrative costs are higher than originally submitted on the last governor's bill.

Number 0879

REPRESENTATIVE HUDSON turned to the amendment he'd offered at the last committee hearing. He recalled that when the committee had reviewed the three tax measures [SSHB 199, HB 10, and HB 413] members were enamored with the trigger mechanism in the governor's bill [HB 413], which he said he likes as well. Therefore, the amendment labeled 22-LS0753\J.1, Kurtz, 2/18/02, was developed, which read as follows:

Page 1, line 12:
Delete "(1)"

Page 1, line 13:
Delete ";"
Insert "."

Page 1, line 14, through page 2, line 1:
Delete all material and insert:

"As soon as practicable after September 30 of each year, the department shall publish the applicable tax rate under this subsection for the following calendar year. The applicable tax rate for a resident individual is

(1) two and one-fourth percent of the individual's taxable income if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was equal to or less than \$2,000,000,000;

(2) one percent of the individual's taxable income if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was more than \$2,000,000,000 but less than \$2,500,000,000; or

(3) zero if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was \$2,500,000,000 or more."

Page 2, line 3:
Delete "(1)"

Page 2, line 6:
Delete ";"
Insert "."

Page 2, lines 7 - 10:
Delete all material and insert:

"As soon as practicable after September 30 of each year, the department shall publish the applicable tax rate under this subsection for the following calendar year. The applicable tax rate for a nonresident or part-year resident individual, or for an estate interest is

(1) two and one-fourth percent of the individual's, estate's, or trust's taxable income, multiplied by a fraction, the numerator of which is taxable income from sources in the state and the denominator of which is taxable income from all sources, if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was equal to or less than \$2,000,000,000;

(2) one percent of the individual's, estate's, or trust's taxable income, multiplied by a fraction, the numerator of which is taxable income from sources in the state and the denominator of which is taxable income from all sources, if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was more than \$2,000,000,000 but less than \$2,500,000,000; or

(3) zero if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was \$2,500,000,000 or more."

REPRESENTATIVE HUDSON explained that the amendment ties an individual's taxable income and the income taxes and percentages to the unaudited balance in the Constitutional Budget Reserve (CBR). The amendment specifies that if there is less than \$2 billion in that reserve, the tax is 2.25 percent. If the reserve has more than \$2 billion but less than \$2.5 billion, the tax is 1 percent. If there is more than \$2.5 billion, the tax is 0 percent. Therefore, there is an incentive for the state to do things such as oil exploration and development that will enrich and enhance the CBR.

REPRESENTATIVE HUDSON highlighted that whether [the proposal] is an income tax or using the earnings of the permanent fund, the idea is to preserve a large value in the CBR, which is the rainy-day fund, emergency and disaster fund, and growth and opportunity fund. Continuing to consume the CBR would leave the state with no "enterprise funds."

REPRESENTATIVE HUDSON specified that his proposal attempts to preserve at least \$1.5 billion in the CBR. If a significant portion of the CBR can be maintained, oil revenues could be bolstered by the earnings of the CBR when necessary. At a 5-percent payout, the [reserve in the] CBR will bring in \$50 million. Furthermore, \$1.5 billion will bring in \$75 million, which is significant. In conclusion, Representative Hudson offered the amendment and requested that the committee adopt it.

Number 1175

REPRESENTATIVE FATE moved that the committee adopt the aforementioned amendment [Amendment 1].

REPRESENTATIVE JAMES objected. She explained that she isn't enamored with the CBR [because it] requires repayment of any money taken out, which she views as problematic. Representative James specified that either the CBR should be filled up, as [state statute] specifies, or it should be eliminated. Furthermore, she felt that the three-quarters vote required to access the CBR is problematic because it empowers the [legislative] minority to ignore the intentions of the majority. However, in our system the majority rules. Therefore, Representative James said she would be more comfortable if the CBR were changed to the earnings reserve account (ERA) [of the permanent fund], where she felt the money would best be managed. Although she believes it laudable to have a trigger mechanism, she said she isn't sure this is the appropriate trigger.

Number 1360

REPRESENTATIVE FATE recalled that Representative Hudson had said this bill would be a stimulus for oil exploration and development, which bothered Representative Fate. He suggested that usually a tax is a disincentive for economic development. Furthermore, the trigger mechanism doesn't seem to allow room for capital growth. He stressed that part of Alaska's problem is that there is no economy beyond the oil fields. "It just seems to me that ... this still keeps the capital growth of the state in check," he said. He noted his confusion with regard to how [SSHB 199] could be used and still maintain the capital growth that is necessary.

REPRESENTATIVE HUDSON answered that he believes [Amendment 1] encourages the state, now and in the future, to place more money into the CBR, [in order] to do more oil exploration and other things that can direct money into the CBR and thus reduce taxes.

The reduction in taxes would be the stimulus to increase the money in the reserves, which could be made available for economic development. Admittedly, making this money available would require a [three-quarters] vote. Representative Hudson recalled that the goal of the [three-quarters] vote was to restrain the growth of government by placing a higher vote requirement to access the money. Therefore, Representative Hudson said he believes that the maintenance, development, and growth of the CBR is one of the only opportunities to have money available to do economic development and expansion, as well as to provide for emergency services.

CHAIR COGHILL reminded everyone that if [SSHB 199] were implemented with the trigger mechanism, it wouldn't be the only income that would be coming into the state.

REPRESENTATIVE FATE acknowledged that may be true, but pointed out that [SSHB 199] is what the committee is dealing with now. He said taking money from the CBR, regardless of the vote required, politicizes it. He suggested that by taking money from the CBR for capital growth, therefore, there will be a political fight, which may misdirect the capital growth. Representative Fate emphasized that he has concerns with regard to what "we" expect Alaska to be in the future.

Number 1613

REPRESENTATIVE JAMES acknowledged that there will be other bills [related to the filling the fiscal gap] and thus one has to think in terms of this bill's fitting in with other issues. Representative James identified one purposes of a tax as trying to fill [the fiscal gap]; therefore, it's difficult to discuss [SSHB 199], which doesn't fill the gap. Furthermore, there is a [proposed] constitutional amendment that would require a spending cap, which could be increased with more than a majority vote.

REPRESENTATIVE JAMES said it seems that at the spending cap would be where the excess money would materialize, which she estimated to be "down the road a ways." Therefore, she said she wouldn't be bothered by stopping the income tax when it appeared that more money would be taken in than necessary for the budget; that would seem to be a valid trigger. However, the [trigger in Amendment 1] seems to be a pacifier for people to believe that the tax won't be present forever. Representative James said during this period in Alaska's history when there has been no personal [state] income tax, an unhealthy attitude has been

created. A 1-percent tax on the adjusted gross income is miniscule in relation to the services provided to citizens of the state.

REPRESENTATIVE HUDSON noted his agreement. He explained that he wasn't certain the trigger [in Amendment 1] could be reached. Furthermore, once a flat tax is started, perhaps no less than 1 percent should be charged because there is the need for the mechanism to be available. Representative Hudson pointed out that [Amendment 1] was offered at Chair Coghill's request, and that its fate is the committee's prerogative.

CHAIR COGHILL related his understanding that once a tax is implemented, it would endure. He characterized the [previous] repeal of Alaska's personal income tax as an anomaly. Chair Coghill expressed his desire to discuss how to trigger tax relief at the point when there's enough.

Number 1905

REPRESENTATIVE WILSON related her belief that some trigger is necessary because it would reassure the public. However, this trigger is nothing more than smoke and mirrors. It would be some time before it would kick in. Instead, triggers reflecting reality should be in place. Representative Wilson stated her dislike of [Amendment 1] and her agreement with Representative James that this trigger should relate to [the ERA].

Number 2010

LARRY PERSILY, Deputy Commissioner, Office of the Commissioner, Department of Revenue, explained that the trigger was placed in the governor's bill [HB 413] because he felt it was necessary to provide the public with hope that the tax rate would decrease if times got much better. Mr. Persily offered his belief that government shouldn't collect more than it needs. Therefore, \$2 billion to \$2.5 billion would be more than necessary for a shock absorber, and thus the amount coming in should be reduced.

REPRESENTATIVE FATE highlighted the fact that some capital needs haven't been met. He expressed concern that the CBR would never be replenished, although there would be a scramble to do so with money that should be going into the capital sector. Furthermore, the public's expectation to raise the level of the CBR such that taxes can be reduced would remain. Therefore, on one hand there is the attempt to develop the state, while on the other hand there is the task of building the CBR, which takes

money from that. Again, the public would have the expectation [that the tax rate would decrease during good times].

MR. PERSILY informed the committee that the Department of Revenue has a few increment requests for the 2003 budget, which will help raise more revenue. Therefore, if those come to a vote, he hoped that he could count on Representative Fate for support for those increment requests.

MR. PERSILY turned to Representative Fate's concern. He explained that the legislature would be replenishing the CBR because [the tax would be generating] more than necessary. However, if the legislature - before the money gets to the CBR - says with a simple majority vote that it wants to spend money on a railroad or road development, for example, then the legislature can spend it. Then there wouldn't be a surplus to return to the CBR. "Until it gets to the CBR, it's a simple 21 and 11 [vote] to spend it," he explained. "So if the needs are there, you'd have the freedom to meet those needs."

REPRESENTATIVE FATE commented that it's never a simple 21-11 vote. He reiterated that [the CBR] will politicize it.

MR. PERSILY agreed that spending limits, putting money in the CBR to cut the budget, and spending it for infrastructure will all be political.

Number 2235

CHAIR COGHILL recalled Representative James's comments in regard to the replenishment of the CBR under the legislature's current mandate. He inquired as to Mr. Persily's view of that.

MR. PERSILY explained that a constitutional amendment says the accounts are to be "swept" at the end of fiscal year June 30 and that money is to be put back in [the CBR]. Since establishment of the CBR in 1991, that has happened twice, and about \$100 million has been repaid. He estimated that the state general fund (GF) owes the CBR \$4.2 billion to \$4.3 billion as of today. He highlighted the advantage of the state GF, which is that it has no interest, forever. Mr. Persily related his belief that no one believes the state will ever be able to repay \$4.3 billion.

Number 2293

REPRESENTATIVE JAMES expressed the need to discuss whether there should even be a CBR, which she doesn't believe serves a purpose. Representative James pointed out that there is no interest accruing on the CBR to begin with. She reiterated that the CBR should either be repealed or refilled. She noted that the other piece is the spending limit, which she believes illustrates that the government won't run amok. Furthermore, there is a statutory budget reserve, which has been empty for quite some time. With the statutory budget reserve, if there were more money than actually spent, that money would automatically be placed in the statutory budget reserve.

MR. PERSILY replied that he wasn't familiar with that account.

REPRESENTATIVE HUDSON explained that the [excess] money has to be appropriated into the account; it isn't automatically placed into the statutory budget reserve.

REPRESENTATIVE JAMES related her understanding that the statutory budget reserve account existed before the CBR. She inquired as to how the statutory budget reserve account worked.

REPRESENTATIVE HUDSON recalled that it worked as a shock absorber that was available with 21 votes. He also recalled that it came into existence in 1980 or 1982 when there was some [extra] money due to high oil revenues and heavy [oil] production.

REPRESENTATIVE JAMES reiterated her suggestion that perhaps any extra money should be placed in the earnings reserve [account] (ERA) of the permanent fund - which would have political consequences - if the intent is to create an incentive regarding keeping a handle on spending. Representative James emphasized that spending requests come from the public, not the legislature. Therefore, if the money is in the ERA - from where the money is taken - it seems that it would be an incentive to keep the legislature in line because it would impact the amount of the PFD, provided the dividend program is kept over the long term.

Number 2499

MR. PERSILY posed a situation in which the CBR is abolished, the money is placed in the ERA, and the percentage of market value is adopted, which would limit the distribution from the permanent fund to 5 percent per SSHB 199. The ERA is [part of] the permanent fund, and no more than 5 percent of the total

market value of the fund can be taken. If there were a bad year for oil prices and dividends had to be paid, there could be a problem with that 5 percent.

REPRESENTATIVE JAMES pointed out that the 5 percent has been discussed as a statutory requirement, not as a constitutional requirement. She announced that she wasn't willing to go with a constitutional amendment on that because she wasn't convinced that some inflation-proofing might have to be reduced. However, she said she felt that a spending limit was reasonable based on the money being spent. With regard to infrastructure, Representative James mentioned that she had constituents from Arctic Village and the Circle school showing her photos of what their schools look like. She remarked that it's almost criminal that there are children trying to obtain an education in such conditions. "We just haven't been spending the correct amount while we've been not paying any taxes," she said. She concluded by reiterating her opposition to [Amendment 1].

CHAIR COGHILL remarked that anytime the word "permanent" is attached to any "shock absorber" fund, there will be a political problem. He said that's why he favors using the CBR. Chair Coghill asked Mr. Goldsmith to comment on the trigger mechanism incorporated in [Amendment 1].

Number 2670

SCOTT GOLDSMITH, Director, Institute of Social and Economic Research, University of Alaska Anchorage, said he hasn't seen [Amendment 1]. In general terms, Mr. Goldsmith said he believes trigger mechanisms are a good idea. In regard to SSHB 199, Mr. Goldsmith expressed the need to think carefully about the structure of it. In some instances, Alaskans might end up paying income tax to the state while having no federal liability, because in calculating the federal liability, people are able to take exemptions from the standard deduction. Therefore, those with lower incomes could end up not paying a federal tax while still having a state liability. Perhaps some thought should be given with regard to the implications of that.

Number 2731

REPRESENTATIVE HAYES referred to a document from Mr. Goldsmith regarding the impact on the economy in relation to the measure that is chosen. He said there was no such impact as relates to SSHB 199. He asked if the impact to the economy [from] SSHB 199

would be the same as from the governor's income tax bill [HB 413].

MR. GOLDSMITH explained that he hadn't reviewed the income tax measures specifically, but had reviewed the impact of an income tax that raised \$350 million. Although there would be differences in whom the money would be extracted from and what the economic incentives would be, he felt those were of secondary importance in relation to the amount of money extracted from the private sector, which reduces the purchasing power in the private sector.

Number 2787

CHAIR COGHILL returned to [Amendment 1] and its trigger mechanism. He explained that he likes two things about it. First, there has to be some end in sight for those who pay taxes. The idea that the tax could diminish has to be forwarded in order to illustrate that the government doesn't need to take all it can get all the time. Second, the political pressure with regard to keeping the CBR whole creates another layer of political pressure. In regard to how the CBR could be repaid, Chair Coghill [indicated agreement] with Mr. Persily's assessment that perhaps there is no intention to repay it. There is no incentive to repay the CBR. Chair Coghill specified that one of the reasons he likes the trigger mechanism is because of the incentive that the tax could diminish. He didn't feel that taxes would provide a connection [between the people and the government] in regard to how the money is spent.

Number 2909

REPRESENTATIVE CRAWFORD related his belief that [SSHB 199] must be considered in the context of the entire package being considered. One component that has been discussed the most lately is taxing 50 percent of the dividend, which is a flat tax that is bottom-loaded and thus takes a larger percentage of income from those at the bottom. [Another component] is the statewide sales tax, which also takes a larger percent of the income from those at the bottom.

TAPE 02-18, SIDE B
Number 2970

REPRESENTATIVE CRAWFORD pointed out that when [revenue] is in excess of \$2 billion, the amount of tax would only be [decreased] from the income tax, rather than from [the other

options such as the sales tax]. There has been testimony that the income tax is trying to balance, with its "progressive" side, the nonprogressive side of the flat tax on the dividend and the sales tax. Therefore, it seems if there is to be a trigger on the income tax, then there should be one on the dividend tax and the sales tax, and perhaps even the alcohol tax. Representative Crawford requested that this fairness issue be discussed.

REPRESENTATIVE HUDSON replied that although he has introduced legislation that would tax the dividend, he hasn't requested a hearing because he isn't convinced that is the path to follow. Therefore, there is no active legislation that would tax the dividend. He explained that HB 35 isn't a tax on the dividend, but is a distribution method that takes 50 percent of the 5-percent payout and gives half to the dividend and the other half to the GF. Representative Hudson explained that SSHB 199 is the reimposition of an income tax at an extremely low level. This legislation would bring in \$285 million.

REPRESENTATIVE HUDSON remarked that the committee would need to determine whether it believes there should be a trigger, and this is the place to do so. If the committee doesn't like the CBR as the trigger, then it could find something else. However, the important thing is to not get weighted down with regard to whether there should be a trigger or not. He pointed out that the legislature can always refund taxes. Representative Hudson offered that the committee could amend [Amendment 1] by deleting [both occurrences of] paragraph (3) [in Amendment 1]; therefore, the tax would never fall below 1 percent or rise above 2.25 percent. Furthermore, it would be tied to the amount of money in the CBR.

REPRESENTATIVE HUDSON said he doesn't personally believe the CBR will be eliminated until Alaskans are convinced to do so. The [three-quarters] vote provides the public some satisfaction that a simple majority [vote by legislators couldn't] make decisions that use the money to expand the size of government. Representative Hudson specified, "We're here to serve the people of Alaska, not some particular party." He opined that the CBR has worked, although he expressed the need to eliminate the "sweep provision." He said he didn't foresee the state's ability to repay the \$4.4 billion that has been borrowed from the CBR.

Number 2685

REPRESENTATIVE JAMES moved that the committee adopt the following conceptual amendment to [Amendment 1]. She explained that [first] the conceptual amendment would delete [both occurrences of] paragraph (3), which read as follows:

"(3) zero if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was \$2,500,000,000 or more ."

REPRESENTATIVE JAMES referred to paragraph (2) on page 1, line 16, of Amendment 1, which read:

"(2) one percent of the individual's taxable income if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was more than \$2,000,000,000 but less than \$2,500,000,000; or"

REPRESENTATIVE JAMES specified that [second] the conceptual amendment to Amendment 1 would change paragraph (2) to read as follows:

"(2) one percent of the individual's taxable income if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, was completely replenished as required by law"

REPRESENTATIVE JAMES clarified that the change to paragraph (2) would also be necessary on the second page of Amendment 1.

Number 2580

CHAIR COGHILL objected for discussion purposes. He remarked, "I think that takes the smoke and mirrors to a higher level."

REPRESENTATIVE JAMES disagreed.

CHAIR COGHILL reiterated his like of the trigger mechanism.

REPRESENTATIVE JAMES said this state could have a huge economy, which could replenish the CBR over time. She stressed that the purpose for [the amendment to Amendment 1] is because the law specifies that the CBR be replenished.

CHAIR COGHILL asked if the language proposed by the amendment [to the Amendment 1] would work.

Number 2521

KATHRYN KURTZ, Attorney, Legislative Legal Counsel, Legislative Legal and Research Services, Legislative Affairs Agency, speaking as the drafter, answered that she didn't view the amendment to Amendment 1 as changing a lot or as problematic, offhand.

CHAIR COGHILL removed his objection. Therefore, the amendment to Amendment was adopted and Amendment 1 as amended was before the committee.

Number 2459

REPRESENTATIVE WILSON commented that the amendment to Amendment 1 is an improvement, especially regarding the elimination of paragraph (3).

REPRESENTATIVE FATE highlighted the need to be aware that what [the legislature] does now will impact Alaska's future economic development. He noted that he didn't want to discourage [the state's] progress [with economic development] because the state needs more than just the oil and gas industry. He highlighted that the gas industry will not take the place of the oil industry as far as dollars into the state government. Therefore, broad-based economic progress needs to occur in this state. He expressed the need to keep that thought in mind with every decision.

Number 2351

REPRESENTATIVE HAYES moved that the committee adopt Amendment 1 [as amended]. There being no objection, Amendment 1 [as amended] was adopted.

Number 2320

CHAIR COGHILL announced that he had an amendment to the effective date that he wanted the committee to review. He surmised that the policy call is with regard to whether there is a desire to have [SSHB 199] be retroactive.

Number 2298

REPRESENTATIVE JAMES began discussion of what would become conceptual Amendment 2. She said she didn't want [SSHB 199] to

be retroactive because she viewed that as a slap in the face of the public. Furthermore, [such retroactivity] makes it difficult to administer. Therefore, she suggested [SSHB 199] should be effective January 1, 2003.

REPRESENTATIVE JAMES offered the foregoing as conceptual [Amendment 2].

CHAIR COGHILL referred to page 4, Section 6, subsection (a), and asked if the December 31, 2002, date would have to be moved up one year as well.

REPRESENTATIVE JAMES replied no. She pointed out that December 31, 2002, is the day before [the tax withholding on wages] starts. Representative James clarified that the bill would merely have an effective date of January 1, 2003.

CHAIR COGHILL announced that he would request that a conceptual amendment for an effective date of January 1, 2003, be drafted [in a committee substitute].

CHAIR COGHILL, after determining that there was no objection, indicated conceptual Amendment 2 was adopted.

Number 2165

REPRESENTATIVE JAMES turned to the issue of a flat tax on the adjusted gross income. She said she agreed with not going to the itemized deductions and credits - the parts that the federal government manipulates in order to determine the tax. She suggested perhaps there should be a floor with regard to the number of exemptions [an individual can claim]. Perhaps it would be best, she said, to specify an amount per exemption. However, she didn't want to tie it to the federal tax. Once it's established, the [exemption] could increase in relation to the cost of living; perhaps between \$3,000-\$5,000 would [be appropriate for this exemption]. Therefore, the decision would be whether to tax the first dollar an individual earns.

REPRESENTATIVE HUDSON noted that he'd spoken with Representative James, and although he hadn't developed a proposal, he thought it might be of value. He pointed out that such a determination would be left to the federal government. Therefore, it has to be a reasonable modification to the adjusted gross income in a way that best serves Alaskans. Representative Hudson said he didn't know how to rewrite this [to do what Representative James

is suggesting]. He expressed the need to forward a letter to the House Finance Committee regarding this possible exemption.

REPRESENTATIVE JAMES explained her view that [the proposed tax] would eliminate the potential for an individual to "play with this." Representative James said she really likes this flat tax, which she views as fair and simple. She predicted that there would be less auditing by the department, which she views as important. Representative James offered to do this in a letter to the next committee of referral. However, she said, she would feel more comfortable having the language incorporated into the legislation before the bill is forwarded.

CHAIR COGHILL pointed out that the definition of "poverty level" is really composed of several different levels for various things. Therefore, he suggested that a number be specified.

REPRESENTATIVE HUDSON highlighted that the money [the tax] would collect is to sustain programs that, for the most part, impact those at the lower end of the economic scale. Therefore, everyone would contribute, while the money would be largely funneled to the lower end of the economic scale. If the collections at the lower end of the economic scale are going to be modified, then one must seriously consider the amount taken from everyone else. He said he likes the idea that those at the lower end of the economic scale will have to pay something.

Number 1695

REPRESENTATIVE STEVENS expressed appreciation for Representative Hudson's approach of keeping this tax simple in order to avoid more expenses related to the collection of these taxes. Representative Stevens offered his belief that adjusted gross income would include the federal cost-of-living allowance (COLA). He asked whether Representative Hudson had considered providing credit for property taxes.

REPRESENTATIVE HUDSON confirmed that COLA is included in the adjusted gross income. However, [SSHB 199] doesn't taken into consideration exemptions for a property tax or senior exemptions. He related the difficulty in choosing a base, but the thought was that the adjusted gross income was the most equitable way in which to acquire an equitable contribution.

REPRESENTATIVE STEVENS agreed with the need to be simple.

Number 1549

REPRESENTATIVE JAMES recalled that nearly 30 years ago when she was involved with the Head Start program, she would advise parents that even saving a little is important. Although 1 percent is small, if everyone pays a little, then it's more fair. She emphasized that many of the people that are of concern don't have an adjusted gross income. Therefore, even if the adjusted gross income is used, Representative James said she didn't feel anyone would be destroyed with a 1 percent tax. However, there is the perception that those with more children need extra money - but to have those children was their choice.

CHAIR COGHILL commented that "we" aren't trying to institute something that resembles the federal income tax. Chair Coghill turned to the issue of the trust industry and related his belief that it will have to deal with this tax. Furthermore, he said he understood that the trust industry already has a premium tax. He asked if Representative Hudson had considered any change in regard to the trust industry.

REPRESENTATIVE HUDSON recalled that when the trust legislation was passed, the idea was to provide economics in Alaska such that those who wish could bring their money to Alaska for management and that Alaska would receive a percentage for its management. He said he was amenable to modifying the bill to address the trust industry in order that it continue. However, he wasn't sure how to make the modification and thus he'd asked Representative Murkowski to assist with that.

CHAIR COGHILL noted that addressing the trust industry in SSHB 199 would play into his consideration of forwarding the bill.

REPRESENTATIVE HUDSON said it is [the same] for him as well. He reassured Chair Coghill that he would work on a modification that would address the trust industry.

Number 1261

CHAIR COGHILL explained to the committee that he'd requested that the sales tax legislation [HB 303] be heard first because it included [conditional-effect language] that he had considered inserting in [SSHB 199]. The amendment he referred to read as follows:

Page 6, line 4:

Insert new Section 10:

Section 10. The uncodified law of the State of Alaska is amended by adding a new Section to read:

CONDITIONAL EFFECT. This Act takes effect only if

(1) the Twenty-Second Alaska State Legislature passes

(A) a version of Senate Joint Resolution 23, proposing amendments to the Constitution of the State of Alaska relating to an appropriation limit and a spending limit,
or

(B) a version of House Joint Resolution 36, proposing an amendment to the Constitution of the State of Alaska limiting the rate of state individual income taxes and sales taxes; and

(2) at least one of the propositions for the amendments in the resolutions described in (1) of this section is approved by the voters at the 2002 general election.

***Sec. [10] 11**

CHAIR COGHILL further explained that he was trying to offer language such that whatever is done with regard to taxation is equal to what is done to reduce government.

Number 1107

MS. KURTZ informed the committee that there is a potential constitutional problem if the effectiveness of a bill passed by the legislature is contingent on a resolution amending the constitution passed by the legislature and then approved by the people. She explained that, in effect, the [conditional-effect language] makes the underlying bill contingent upon the approval of the voters. The conditional effectiveness sort of blends the two distinct and parallel processes by which the constitution [allows] for making law - that is, through the legislature and by initiative. Although this question hasn't directly been decided by the courts in Alaska, the majority of states have decided that such [conditional-effect language] isn't [appropriate].

MS. KURTZ, in response to Chair Coghill, said she didn't think making [the bill effective] contingent on its passage out of the legislature poses the same issues. Still, there are difficulties when passage of one bill in the legislature is contingent upon the passage of another bill in the legislature.

Therefore, she expressed the need to be sure that the single-subject requirement is adhered to in both pieces of legislation.

CHAIR COGHILL specified that he was trying to avoid any "trouble" while providing a balance between the passage of a tax and the pressure [to decrease] government. He asked if the aforementioned amendment without references to the resolutions would be as powerful as intent language.

MS. KURTZ noted that intent language is different [because] it wouldn't be codified. Removal of the references to the resolutions would be helpful in addressing the single-subject requirement.

REPRESENTATIVE HUDSON inquired as to the effect on the effective date of the SSHB 199. How would one determine the actual effective date of the bill and the subsequent increases? Representative Hudson related his understanding that Chair Coghill is interested in finding a nexus between developing a tax-collection mechanism with the approach to reduce or hold the line with expenditures. Representative Hudson said he could see how such intent language could be used without upsetting the intent of the bill. However, he agreed with Ms. Kurtz that the language in the aforementioned amendment, including references to the resolutions, would be tantamount to [requiring] a public vote on something for which the legislature is responsible.

CHAIR COGHILL said that, too, was his concern. Furthermore, he expressed concern that such a change would make a majority vote issue [on legislation] contingent upon a super-majority [two-thirds] vote. He specified that that wasn't his intention, although he understood that even still, the problem with the two-thirds vote would surface.

MS. KURTZ agreed and pointed out that it would be problematic even when the legislation is contingent on the legislature via a resolution.

CHAIR COGHILL surmised that if [passage of SSHB 199] were made contingent upon a vote of the people, it wouldn't pass the constitutional test. Contingency based on passage from the legislature would probably be safer ground.

MS. KURTZ specified, "It's an undecided question whether hanging it on a vote of the people would be a problem in Alaska." The bulk of the decisions elsewhere don't seem to be favorable. Although conditional-effect language relating to passage from

the legislature would move away from that concern, it would still be problematic in relation to the majority vote [on the average tax bill].

CHAIR COGHILL said he is looking for a self-leveling mechanism.

Number 0533

REPRESENTATIVE HUDSON related his perception that a majority of [legislators] are willing to consider a responsible spending-limit opportunity on which the people can vote. Although he indicated agreement with the need for a nexus, he agreed that tying passage of this to the passage of other specific legislation would be constitutionally problematic.

CHAIR COGHILL concluded by pointing out that the tax [proposal] that is forwarded from this committee will likely be an enduring [tax]. Therefore, he [expressed the need] to balance that tax with some downward pressure in order to provide some enduring effect. In the past, the legislature has done a good job holding the line and placing money into the corpus of the permanent fund. Chair Coghill announced that he would order a committee substitute. [SSHB 199 was held over.]

HB 303-STATEWIDE SALES TAX

Number 0343

CHAIR COGHILL announced the final order of business, HOUSE BILL NO. 303, "An Act relating to the levy and collection of a sales tax; and providing for an effective date."

CHAIR COGHILL inquired about the need to change the language on page 3 regarding the conditional effect. He then pointed out that there was a proposed committee substitute (CS), Version J.

Number 0230

REPRESENTATIVE FATE moved [to adopt the proposed CS, version 22-LS1206\J, Kurtz, 2/16/02, as the working document]. There being no objection, Version J was before the committee.

Number 0182

REPRESENTATIVE JIM WHITAKER, Alaska State Legislature, sponsor of HB 303, referred to the issue of a conditional effect raised by Chair Coghill [in that day's hearing on SSHB 199]. He said

there are two cost-control mechanisms currently before the legislature: HB 35 and SJR 23. There are differing opinions regarding the constitutional validity of attempting to make this conditional upon a vote of the people. He'd requested a legal opinion from Legislative Legal and Research Services, he reported, and Tamara Cook had said it is questionable with regard to its constitutional validity, but had cited a contrary opinion of the attorney general.

REPRESENTATIVE WHITAKER read from Ms. Cook's final opinion, however [dated February 25, 2002, page 4], which stated, "Having said that, it must also be observed that a law has been submitted to the voters for a binding vote, and so far as I can tell, that action has never been challenged." He commented:

I think there's some real question as to whether or not there is constitutional validity. If we're timid, we probably accept the notion that it may be questioned. But [when] we're talking about a subject that's [as] significant as this, I don't think it's the time for timidity. And so while we want to be cautious and approach it with some wisdom, I think, too, that there's reason to think that ... it would withstand a constitutional challenge.

Number 0030

REPRESENTATIVE JAMES remarked that whether or not it faces a constitutional challenge, Kathryn Kurtz [bill drafter from Legislative Legal and Research Services] had informed the committee that when legislation is tied to a constitutional amendment, the legislation itself requires a two-thirds vote.

REPRESENTATIVE WHITAKER concurred. He added, "There's no reason for us to think that we don't have the opportunity to acquire a two-thirds vote."

TAPE 02-19, SIDE A
Number 0001

REPRESENTATIVE WHITAKER suggested a measure of that nature will probably pass if it goes before the [voters].

Number 0088

REPRESENTATIVE JAMES referred to Version J, page 1, beginning at line 6, which read:

Sec. 29.45.750. Collection of municipal sales and use tax by the state. The Department of Revenue may collect a sales and use tax levied by a municipality under AS 29.45.650 or 29.45.700 and remit it to the municipality if requested to do so by municipal ordinance.

REPRESENTATIVE JAMES asked whether there is any requirement that the municipality must then "succumb to the methodology" used for the state sales tax.

REPRESENTATIVE WHITAKER said no.

REPRESENTATIVE JAMES noted that it says "may" and asked whether the department isn't required to do it, then.

REPRESENTATIVE WHITAKER said that was correct.

REPRESENTATIVE JAMES remarked that she would like to hear from the department, but noted that the department representative was no longer present.

REPRESENTATIVE WHITAKER offered:

Our intent should not be to impose. Our intent should be to facilitate. And by having the language "may", we are indeed accomplishing that end. We are giving the opportunity to facilitate the collection of the tax, and if it's most beneficial to a community ... to do that, then the opportunity is there. If they choose to do otherwise, they may do so. I don't think that we can write better language.

Number 0240

REPRESENTATIVE WILSON requested confirmation that the bill doesn't make any accommodation for the areas that already have a sales tax, but just says [a municipality] may collect it "the way the state does."

REPRESENTATIVE WHITAKER affirmed that.

REPRESENTATIVE WILSON said she is highly concerned about that. Many communities have experienced decreasing options because of a declining timber industry, for example, or other situations. Those communities have had to add a sales tax or otherwise

become creative in order to provide services, but at a very high cost to the people who live there. If there isn't some accommodation for those situations, she said, it will make it much more difficult for those communities to survive. Right now, people are "hanging on" and buying locally, but an added [state] tax will make a huge difference, and people will start to buy more over the Internet or go to Seattle or Anchorage. She reiterated her desire to see some accommodation for those areas.

REPRESENTATIVE WHITAKER agreed it is an area of concern and that the concerns raised are valid. He referred to his testimony on February 12, 2002, that there is no perfect tax.

Number 0438

CHAIR COGHILL remarked that the "whole municipal title kind of came crashing down on us the very first time this was mentioned, and how we would fit that into some of the municipality taxing." He added, "At this point, it ... gives a permissive alignment and gives them some relief, to benefit from some of the tax collected, as ... it does the individual collector. So, I think that's the best incentive without going into a total rewrite of the municipal title."

REPRESENTATIVE WHITAKER agreed, adding, "If we open Title 29, we don't know where it stops, and we don't know what it will lead to. ... And it's certainly a task that goes well beyond the scope of the subject at hand."

Number 0523

REPRESENTATIVE JAMES began discussion of what would become Amendment 1 to Version J. She noted that alcoholic beverages are still [exempt] in the bill and questioned the reasoning. Referring to separate legislation that relates to a tax on alcohol at the wholesale level, she said 3 percent on alcoholic beverages is at least 5 cents a drink, and she would prefer to have it [included here] "for lots of reasons."

REPRESENTATIVE WHITAKER responded that he would consider an amendment to that end to be a friendly amendment.

REPRESENTATIVE JAMES said, "I so move, Mr. Chairman."

CHAIR COGHILL clarified that Amendment 1 would delete line 18, page 2, paragraph (5). He asked whether there was any objection. There being no objection, Amendment 1 was adopted.

Number 0697

REPRESENTATIVE WILSON referred to an e-mail [from Scott Goldsmith] relating to the effects of different taxes; she asked whether it was a good time to discuss it.

CHAIR COGHILL said he was going to invite Mr. Goldsmith to speak at the end of the discussion. He then said the discussion has been good, but that the committee will have to address this further. He advised members that there were other amendments he would like to include as well; for example, many states have a 1 percent [sales tax] on some medical supplies, prescription drugs, and food, which he would like to committee to discuss.

Number 0772

REPRESENTATIVE CRAWFORD referred to page 2 [lines 23-24], which read, "(8) that part of the selling price of a single item or the periodic selling price of a single service that exceeds \$2,000". He stated, "I have a problem with the tax being the same, whether a person's buying an '89 Chevy Celebrity or they're buying a 2002 Mercedes. That seems to fly in the face of the only part of the 'progressivity' of a sales tax."

Number 0850

REPRESENTATIVE WHITAKER reiterated that the perfect tax won't be found, and said it is difficult to have a graduated sales tax. He added that he wouldn't object to any change that would improve the bill.

REPRESENTATIVE JAMES agreed with Representative Crawford, adding, "I don't see any reason for [capping] the tax. I think it's more difficult to manage, and I would prefer that it didn't have a limit." She then commented that she wasn't pleased about tying it into "the other amendment of the constitution" but said she wouldn't "make a lot of noise on that." She concluded:

My evaluation of where we're going on filling this hole is that I believe we need to have a fair and equitable, small amount of income tax, and we also have to have a sales tax, too, and some use of the earnings of the permanent fund, or we're never going

to get there. And ... we're going to have to take another look at the way we currently do the permanent fund dividend and make it be ... more rational, at this time, if we're going to protect it over the long term. Otherwise, it will just go away, on its own.

Number 0975

REPRESENTATIVE FATE asked Ms. Kurtz whether there could be an effective date for the legislation that is contingent upon the vote of the people on a constitutional question. If the people didn't vote in the affirmative, the bill would become moot, he suggested.

Number 1009

KATHRYN KURTZ, Attorney, Legislative Legal Counsel, Legislative Legal and Research Services, Legislative Affairs Agency, answered that having an effective date be contingent upon action by the voters of the state - as opposed to the legislature - also may be problematic for some of the same reasons. She offered to provide a more detailed explanation [later].

CHAIR COGHILL remarked that Representative Whitaker had said, "Either we can be bold and test it or we can just forget it." Chair Coghill said there needs to be more of that discussion.

Number 1050

REPRESENTATIVE CRAWFORD informed the committee that he wanted to offer a conceptual amendment, but noted that Representative James had just left.

Number 1080

CHAIR COGHILL suggested bringing in some other amendments [as well]. He agreed with the need to look at a sales tax, an income tax, and permanent fund earnings simultaneously, but emphasized the desire to make each piece of legislation a "whole unit" unto itself. He then commented that Mr. Goldsmith's comparison [in his e-mail] of the three different bills had been interesting. He invited Mr. Goldsmith to comment further.

Number 1168

SCOTT GOLDSMITH, Director, Institute of Social and Economic Research, University of Alaska Anchorage, testified via

teleconference, noting that an e-mail he'd sent expands on his testimony the previous week. He stated:

Whatever sort of tax mechanism or dividend-reducing mechanism or budget-reducing mechanism we employ to try to reduce the size of the fiscal gap, it's going to draw purchasing power out of the private sector. It's going to take dollars out of the private sector, and that's going to result in a job loss to the private sector. There's no way that we can painlessly take money away from the private sector, reduce the budget. ...

One of the questions for consideration, then, becomes what is the impact on the economy - how many jobs would be lost from the various methods that we're thinking about? And very, very roughly, it depends upon three or four things. It depends upon whether there's any sharing ... by the federal government in paying for the tax, and that's where the income tax comes in, because the federal government will, in effect, pick up part of the cost of paying a state income tax, because some people ... who itemize their reductions are able to reduce their federal income tax if there's a state income tax.

The other measures generally don't have that nice feature, although reducing the dividend, again, results in some reduction in federal tax payments.

Number 1336

MR. GOLDSMITH turned attention to nonresidents and said:

The other important factor is how much of this tax or dividend reduction would be paid by nonresident Alaskans, by outsiders. And that's where a sales tax gives the appearance of being attractive, because there are a lot of visitors during the summer season, and the appearance is that they spend a lot of money, and so taxing them would reduce the burden on Alaskans if there were a sales tax.

But, in fact, if you combine the federal effect and the nonresident effect, the income tax generally - and I'm not talking about any specific tax structure now - but generally the income tax results in fewer dollars

being pulled out of the Alaskan economy for every hundred dollars collected (indisc.) the sales tax. ... Reducing the dividend falls in the about the same range as the sales tax.

On the other hand, if we look at cutting the operating budget, which is primarily personnel, either directly paid for as state government employees or transfers to local government and local government employers, most of the state budget is people. And if you cut the operating budget - and that's what most of the general fund is - ... then you're going to be directly cutting jobs. And in addition to directly cutting those jobs, [if] those employees lose their income, they have less [to spend in] the private sector, so purchasing power in the private sector goes down from that measure as well.

CHAIR COGHILL interjected to inform Mr. Goldsmith that committee members had to leave. He expressed appreciation for his e-mail and said he would formulate questions regarding the methodology for further discussion. He mentioned that Bob and Jane Murray were present from Anderson, Alaska, and thanked them for their patience.

CHAIR COGHILL announced his intention to discuss at a future hearing what the best approach would be and what effects it would have, and then to put some "sideboards" on it. [HB 303 was held over.]

ADJOURNMENT

Number 1498

There being no further business before the committee, the House State Affairs Standing Committee meeting was adjourned at 10:04 a.m.