

ALASKA STATE LEGISLATURE
SENATE JUDICIARY COMMITTEE

March 18, 2002
1:38 a.m.

MEMBERS PRESENT

Senator Robin Taylor, Chair
Senator Dave Donley, Vice Chair
Senator John Cowdery
Senator Gene Therriault
Senator Johnny Ellis

MEMBERS ABSENT

All Members Present

COMMITTEE CALENDAR

SENATE JOINT RESOLUTION NO. 33

Proposing an amendment to the Constitution of the State of Alaska relating to limiting the rate of state income and sales and use taxes.

HEARD AND HELD

SENATE JOINT RESOLUTION NO. 37

Proposing an amendment to the Constitution of the State of Alaska relating to officers and employees of the executive branch.

MOVED SJR 37 OUT OF COMMITTEE

SENATE JOINT RESOLUTION NO. 38

Proposing amendments to the Constitution of the State of Alaska relating to information regarding proposed expenditures.

MOVED SJR 38 OUT OF COMMITTEE

PREVIOUS SENATE COMMITTEE ACTION

SJR 33 - No previous action to record.

SJR 37 - See State Affairs minutes dated 2/26/02.

SJR 38 - See State Affairs minutes dated 2/26/02.

WITNESS REGISTER

Mr. Larry Persily
Deputy Commissioner
Department of Revenue

PO Box 110400
Juneau, AK 99811-0400

POSITION STATEMENT: Answered questions about income and sales taxes.

Senator Pete Kelly
Alaska State Capitol
Juneau, AK 99801-1182

POSITION STATEMENT: Presented SJR 37 and SJR 38.

ACTION NARRATIVE

TAPE 02-9, SIDE A

Number 001

CHAIRMAN ROBIN TAYLOR called the Senate Judiciary Committee meeting to order at 1:38 a.m. All members were present. The committee took up SJR 33.

#SJR 33

SJR 33-CONSTITUTIONAL AMENDMENT: TAX CAP

SENATOR ALAN AUSTERMAN, explained that SJR 33 limits the amount of income and sales tax that can be imposed on the populace of Alaska. He introduced this measure after he participated in discussions to find a way to devise a long-range financial plan and balanced budget based upon the income of the State of Alaska. During those discussions it became apparent to him that within the near distant future other revenues will be placed upon the populace, such as an income or sales tax. He heard concern expressed about Alaska having a "runaway" government based on its ability to tax. He and Representative Harry Crawford have introduced this resolution to satisfy that concern.

SENATOR COWDERY asked what the administrative costs of collecting an income tax will be and how much money will be collected. In addition he asked what percent the last income tax was set at.

SENATOR AUSTERMAN deferred to the Department of Revenue for answers to those questions. He noted the resolution places a maximum limit at 5 percent so a 1 percent income tax could be imposed.

SENATOR COWDERY asked how many hard dollars the income tax might raise.

SENATOR AUSTERMAN said he does not have a hard dollar figure because it would depend on the percentage.

SENATOR COWDERY asked if a formula is available for every percent collected.

SENATOR AUSTERMAN again deferred to staff from the Department of Revenue.

SENATOR THERRIAULT indicated the committee has a proposed committee substitute that expands the language with regard to the income tax so that no matter what method is used to calculate the state income tax, the tax will be limited to five percent. He asked Senator Austerman if he was involved in drafting the proposed committee substitute.

SENATOR AUSTERMAN said he was not able to sit in on the House hearings where that change was made to the House resolution. He submitted the proposed committee substitute to make the Senate version comparable to the House version. He pointed out the objective is to limit state income tax to five percent of the federal gross income tax and the five percent limit would be imposed on any method used to calculate the tax.

CHAIRMAN TAYLOR informed members that his staff worked on preparing the committee substitute but that Senator Austerman had no objections to it.

SENATOR THERRIAULT moved to adopt the proposed committee substitute to SJR 33 as the working document of the committee.

SENATOR ELLIS objected and asked if the proposed document was a sponsor substitute or a committee substitute.

CHAIRMAN TAYLOR clarified that it is a sponsor substitute.

SENATOR ELLIS removed his objection.

CHAIRMAN TAYLOR said he was not sure that was an appropriate procedure but if not, the committee will correct it. He explained that if the committee adopts the proposed document, it will become a Senate Judiciary Committee substitute but if Senator Austerman introduces it on the Senate floor, it will become a sponsor substitute.

SENATOR DONLEY noted that once a bill has a hearing, a sponsor substitute cannot be introduced.

CHAIRMAN TAYLOR clarified that the appropriate motion is to adopt the document as a committee substitute. He noted that with no

objection to that motion, the document was adopted as the Senate Judiciary Committee substitute (22-LS1413\C).

SENATOR COWDERY referred to page 1, line 12, and asked if "the rate of a sales tax" refers to the retail or wholesale cost of products. He commented that there has been talk that some cities already have retail sales taxes so the thought was to impose a sales tax on the wholesale level for the state. He asked Senator Austerman what his intention is.

SENATOR AUSTERMAN said his assumption is that it would be both on a statewide basis.

SENATOR COWDERY asked, "On retail sales or wholesale sales?"

SENATOR AUSTERMAN replied, "First off, retail sales for sure. Now - I don't think that - the discussion hasn't come up. I don't have an answer for you other than to say that we have not discussed that."

SENATOR DONLEY said he was initially concerned about that question when he first read the bill because he didn't want this rate to impact the excise taxes. He said the state wants to have the flexibility to charge a higher rate for certain commodities through excise taxes, which he believes are wholesale taxes. He asked a representative from the Department of Revenue to respond.

MR. LARRY PERSILY, Deputy Commissioner of the Department of Revenue (DOR), stated:

I am not aware [that] any of the sales tax discussions this session have centered on wholesale. To us, all of - the way we read the legislation, all the sales tax bills before the legislature would deal with retail sales. The excise tax is different and that is on a specific item, such as alcohol excise or tobacco excise or motor fuel excise. We would not read this tax cap as applying to that but I guess certainly someone could make the argument it would but we read those as an excise tax, not as a general sales tax.

SENATOR DONLEY asked if that excise tax is actually on sales to retailers. He thought that Senator Cowdery was getting at what some might call a wholesale tax.

SENATOR COWDERY said it should be identified in the resolution.

SENATOR DONLEY said, "We're talking about retail here."

MR. PERSILY said the excise motor fuel, alcohol and tobacco taxes are all collected at the wholesale distributor level.

SENATOR DONLEY said his point was that 5 percent is below the 8 cents per gallon collected on the motor fuel tax. He said his concern is messing up the existing tax rates on excise taxes so the resolution needs to be clear that it pertains to a retail tax limitation.

CHAIRMAN TAYLOR asked Mr. Persily to respond to Senator Cowdery's question about the rate of the former income tax levied in the state.

MR. PERSILY said the former income tax was not assessed on federal adjusted gross income, it was assessed on taxable income and it varied from 3.5 to 14.5 percent. If one converted that income to adjusted gross income, the 14.5 percent of taxable income would exceed 5 percent of one's adjusted gross income. He pointed out that none of the proposals before the legislature this year come close to 5 percent of adjusted gross income. They range from 1 percent to 3.5 percent.

CHAIRMAN TAYLOR said he thought Alaskans paid a percentage of their federal tax amount.

MR. PERSILY said it was changed so that when it was finally abolished in 1979 it was a sliding scale percentage of one's taxable income.

CHAIRMAN TAYLOR thought he paid 17 percent of the amount he paid to the federal government.

MR. PERSILY said he does not know what it was prior to tax the time it was abolished, but if it was 17 percent of one's liability, that would convert to less than 5 percent of one's adjusted gross income.

SENATOR DONLEY asked if DOR could provide a short summary of the meaning of "federal adjusted gross income." He said he is wondering what kinds of income are excluded from that as that should be an important policy consideration if the legislature is going to adopt it as a standard. He noted he has some concerns because he does not know if race horses are considered an exclusion.

MR. PERSILY replied:

Adjusted gross income pretty much is all income. Federal taxable income, as the Senator explained, would incorporate those deductions, exemptions credits allowed under federal law so you end up with your total income after deductions, exemptions, and that's what you pay federal tax on or, if the state tax were assessed on federal taxable income, that would be what you pay your state tax on. The third proposal out there, as the Chairman explained, is a straight percentage of your federal tax bill - the three different tax bases you could use.

CHAIRMAN TAYLOR said Senator Cowdery's next question was what will it cost to administer this system. He said that would depend upon which mechanism is chosen will become much more burdensome to administer if a totally different state tax form is used and one is taxed on all of their orange groves and race horses as opposed to merely paying a flat percentage of one's federal tax.

MR. PERSILY said certainly the complexity of any personal income tax in Alaska would be reflected in the fiscal note. Even simple accommodations for people who work in another state will have to be calculated. None of the proposals advancing in the legislature assess the tax on federal tax liability. The proposals either use adjusted gross income or federal taxable income. DOR's best estimate to administer an income tax for either one will cost about \$6 million. He said that even if it is simplified as much as possible, there are 420,000 to 440,000 taxpayers to deal with.

SENATOR COWDERY asked if the tax should be based on income derived only in Alaska.

MR. PERSILY said it would so that if a person had two jobs, one in Alaska and one in California, the state would only collect on the portion earned in Alaska.

SENATOR DONLEY asked how that will work if the other state has no income tax. He said he thought if the other state does not have an income tax, the home state gets that revenue.

MR. PERSILY said he is not sure about that. He knows that issue has come up in places that have municipal taxes so that, for example, someone may work in Manhattan but live in a suburb, and will have to pay the municipal tax in Manhattan. He was not sure whether the State of Alaska could tax all income if some income is earned in Washington and the person lives in Washington.

SENATOR DONLEY said he believes Oregon residents who work in Alaska pay Oregon taxes on the income earned in Alaska.

CHAIRMAN TAYLOR affirmed that is true and said it is also true of retirees living in California and Oregon even though their income was earned in Alaska.

SENATOR THERRIAULT asked if DOR has calculated how a statewide sales tax might impact the financial feasibility of a gas pipeline. He asked how having 5 percent of any transaction might tip the economics.

MR. PERSILY said DOR would recommend that if the legislature adopted any kind of a sales tax bill, that natural gas, similar to oil moving through the pipeline should be exempted, as would construction material. DOR sees a sales tax as a retail tax, not a tax on goods used in the manufacture of something that will be taxed later. Therefore, DOR would recommend exempting the gas moving through a pipeline, construction material used in the construction of a line and the construction of office buildings.

SENATOR THERRIAULT said he wasn't thinking so much of the product going through the line as the construction of the line. He asked how a piece of steel and cutting time that he sells at his welding shop and charge sales tax on that will be used in the construction of the gas line will be figured into the construction cost of the line.

MR. PERSILY said that is a policy call for the legislature. He said DOR's recommendation, looking at large construction projects and knowing what effect a sales tax would have on a multi-billion dollar project, is that the legislature make some accommodation.

CHAIRMAN TAYLOR noted that homeowners in Alaska face that problem everyday if they live in communities that impose a sales tax. Wrangell residents pay 7.5 percent so if one buys \$75,000 worth of construction materials to build a house at the local store, the tax would be quite high. The city council got around that problem by requiring sales tax to be paid on the first \$1,000 of products for a single project.

MR. PERSILY said in Juneau, when one gets a building permit, all purchases for that project under the building permit are exempt from sales tax. That provides an incentive to get a permit and follow the building code because no matter what one pays for the permit, they'll come out far ahead on savings on sales tax.

CHAIRMAN TAYLOR said it is wise to consider that problem because the regressive aspects of a sales tax make it one of the most offensive taxes in existence.

SENATOR DONLEY moved to insert the word "retail" after the word "a" on page 1, line 12, so that it reads, "(b) The rate of a

retail sales tax levied..." [Amendment 1]

CHAIRMAN TAYLOR announced that with no objection, Amendment 1 was adopted.

SENATOR DONLEY noted the intent of this resolution is to put a limit on the percent of tax and not to deal with the details of particular tax proposals.

CHAIRMAN TAYLOR agreed but said it is important to get an answer to what constitutes "federal adjusted gross income."

MR. PERSILY repeated it refers to total income.

SENATOR DONLEY wanted to know why it is referred to as adjusted.

MR. PERSILY said he hasn't figured that one out. He said the tax people said there are a few minor adjustments that do not apply to most people. He then offered to get that information for members.

SENATOR COWDERY said he hopes the sponsor's intent is to apply it only to income derived in Alaska.

SENATOR DONLEY agreed that is an issue, as well as how the instate/out-of-state income question would integrate with the constitutional provision.

SENATOR AUSTERMAN said that he and Representative Crawford intended this to apply to an Alaska state income tax based on Alaska income. He suggested placing the word "Alaska" on line 7 for the purpose of clarification. He repeated that he and Representative Crawford intended that it apply to Alaskan income and that they are not after income earned in other states. He pointed out that would happen automatically anyway because the federal law reads that way.

SENATOR COWDERY expressed concern that because the word "federal" is included, one could derive income from almost every other state and still be subject to federal adjusted gross income.

CHAIRMAN TAYLOR asked Senator Austerman to select the manner by which the state will do this and require that the rate of an individual income tax levied by the state not exceed five percent of federal income tax.

SENATOR DONLEY said he does not agree with that approach because that will be back to the bottom line tax. He said his biggest

concern with the resolution is that the state will be at the whim of Congress to simply pass a new federal law that redefines what "adjusted gross income." He doesn't believe that Alaska's constitution should be tied to something that can be changed by a simple act of Congress. He noted the problem gets worse if it is tied to the bottom line of one's federal tax liability because then all of the deductibles and the gigantic 1,000-page tax code will be incorporated into Alaska's constitution. That will raise a lot of public policy calls and he does not support the federal tax code. He said he would prefer to go to an inclusive definition and set a lower taxation rate to avoid having to deal with other states' special provisions in the tax code. He maintained that his public policy goal is to minimize the impact of the federal process on any potential revenue for the state.

CHAIRMAN TAYLOR said he mentioned it because he believes the former state income tax, when it was figured at 3.5 to 14.5 percent of what one paid the feds, was simple to administer and calculate. He said he believes the maximum amount the state charged was approximately the same amount of maximum credit that an Alaskan taxpayer could get as a deduction against the federal tax obligation so that if one owed \$1,000 in taxes to the federal government and would have to pay \$145 to the State of Alaska, the \$145 was taken as a credit against either the income upon which the federal tax was figured or as a credit against the tax obligation owed to the federal government.

SENATOR AUSTERMAN said he does not recall how the credit was applied.

CHAIRMAN TAYLOR clarified that he meant that if one didn't have the state tax, you would have paid that much more to the federal government anyhow.

MR. PERSILY explained that state income tax is deductible from federal income. No state has the authority to tax a credit against federal tax liability so if one earns \$30,000 and paid \$1,000 in state income tax, the \$1,000 could be taken as a deduction against taxable income, just like one could for medical expenses or home mortgage interest. He pointed out that CSSJR 33(JUD) says the state income tax may not exceed 5 percent of federal adjusted gross income or, if levied on any basis other than federal adjusted gross income, it may not exceed the equivalent of 5 percent of adjusted gross income, so there is no need to define whether it is adjusted gross income or based on something else; that can be done in an income tax bill.

CHAIRMAN TAYLOR said his only concern is that the federal rate is

30-something percent, so the state will add another five percent on and taxpayers could pay 39 percent for taxes.

MR. PERSILY clarified that the federal tax rate is after deductions so it differs from the 5 percent before any deductions. He suggested that most people who are in the 34 percent tax bracket have a lot of write-offs.

CHAIRMAN TAYLOR said his concern is that the person paying in the high tax bracket today is paying that on a net amount, after deductions. CSSJR 33(JUD) hardly provides a limit if it is a flat 5 percent on gross income with no deductions allowed. He noted it could be a much higher percentage than what the taxpayer pays at 34 percent with deductions. He said he knows of a lot of businesses that do not earn 5 percent net, yet the state could tax them at that rate.

SENATOR AUSTERMAN noted the resolution does not include corporations.

CHAIRMAN TAYLOR acknowledged that it applies to individuals but maintained that corporations will still pay at 7 percent.

MR. PERSILY informed members that the corporate rate varies from zero to 9.4 percent of net.

CHAIRMAN TAYLOR noted that is based on net after allowable deductions. The definition in CSSJR 33(JUD) does not provide for any deductions.

MR. PERSILY said that is correct but it doesn't say the personal income tax has to be based on adjusted gross income. He noted:

You could have taxable income or federal tax liability but then you would convert it just for the sake of this amendment to make sure it doesn't exceed the equivalent of 5 percent on gross. We don't see where this constitutional amendment would dictate which form of calculating your tax you use.

SENATOR AUSTERMAN agreed that CSSJR 33(JUD) just sets a limit.

CHAIRMAN TAYLOR said he could easily see where a person might easily pay a small amount of federal taxes because of allowable deductions but pay a huge amount of state taxes and the limit would provide no relief whatsoever.

SENATOR COWDERY said he too has concerns about using federal adjusted gross income.

SENATOR AUSTERMAN said he assumes the bill will not move out of committee today and can get more definitive answers for Senator Cowdery. He noted on the question of the taxation of the piece of steel that Senator Therriault talked about, he believes that would be determined by the make up of the tax package and would not be affected by CSSJR 33(JUD). He pointed out that, regarding local taxes, every community is different and in Kodiak no purchase over \$25 is taxed. He said drafting a statewide sales tax will require a lot of discussion. He repeated that those details will come to play at a later time and that this resolution merely provides a ceiling.

CHAIRMAN TAYLOR said he applauds what Senator Austerman is trying to do but he finds it difficult to understand whether that limitation will be meaningful without proper definition.

SENATOR AUSTERMAN agreed and said that since this is the first hearing, he will get answers to members' questions.

SENATOR ELLIS asked when it might be rescheduled.

CHAIRMAN TAYLOR estimated in one week.

#

#SJR 37

SJR 37-CONST AM: HIRING FREEZE

SENATOR PETE KELLY, sponsor of SJR 37, said the measure will give the legislature the authority to require the governor to institute a hiring freeze if the legislature determines one is necessary. Without that constitutional authority, the legislature is unable to because of the separation of powers doctrine; SJR 37 provides that authority. Currently the new budget contains 858 new employees, according to the Division of Legislative Finance. The Administration has argued that number and revised it downward to 500 plus, but either number represents a large number of new employees being added to the budget when the state is facing a gap between revenues and expenditures. He said he is not trying to place blame, as legislators may be responsible for some of those employees; it is the nature of doing business and trying to keep up with federal programs. The purpose of SJR 37 is to provide a tool so that the nature of business can be structurally changed and the people's branch of government can have more impact into the size and scope of the budgets that have been offered in recent years. Should this constitutional amendment pass, it will have no impact on this Administration but will give future legislators a tool to reduce state budgets if they find themselves with an Administration that is unwilling to take proactive steps to do so.

SENATOR KELLY informed members that in prior testimony on another resolution that encourages the governor to institute a hiring freeze, he has been asked how much this resolution will save and to justify it. He said the fact is he does not know how much it will save but hiring freezes are one of those self-evident truths in businesses. He believes those who are against a hiring freeze should justify their opinions of why this tool shouldn't be offered.

SENATOR COWDERY asked if a [joint] resolution needs a simple majority vote to pass.

SENATOR KELLY said that does and noted that the purpose behind that is that the legislature is the policy maker yet, because of the strict separation of powers rules in Alaska, the legislature is sometimes not able to implement policy when it comes to budgetary issues. It should be the will of the legislature to do so without having to go through the bill process, which is why he introduced this measure as a resolution. He does not want the measure to be vetoed or to go through a fight on the floor.

CHAIRMAN TAYLOR said he learned while watching a television show that 46 states are facing deficit budgets. He said he has been shocked to see the numbers the Alaska legislature is looking at today and the lack of any attention to any type of reductions or prioritizations by departments.

TAPE 02-9, SIDE B

CHAIRMAN TAYLOR said he finds it hard to believe the other 45 governors are crazy because they are trying to reduce their budgets. Several states have imposed both hiring freezes and restrictions on travel. He recalled that Governor Sheffield actually impounded funds and was chastised for it, but that was his attempt to do everything he could during a deficit the state faced in 1986. He maintained that he will be shocked if the legislature will ever have to impose a hiring freeze in the future. He then asked Senator Kelly if he is aware of any other state that doesn't use this type of a tool.

SENATOR KELLY said he does not know who does or doesn't, but he included in members' packets a copy of Governor Locke's recent memo that imposes a hiring freeze. He agreed with Senator Taylor that governors all over the United States have gone into "high gear" to deal with deficit problems. He said Alaska is more fortunate in that it does have some money in the bank and a smaller government so it has the ability to get its hands around the problem but it can't if it won't institute something as simple as a hiring freeze, which does no damage to current employees.

CHAIRMAN TAYLOR said Washington State is only facing a \$1.6 billion deficit in a much larger budget.

SENATOR KELLY said Washington's total budget is \$23 billion.

CHAIRMAN TAYLOR noted Alaska is facing a 43 or 46 percent deficit.

SENATOR ELLIS asked if Senator Kelly's measure applies only to general funds and whether he found anyway to go after positions funded by other sources, such as fees or airport funds. He then

SENATOR KELLY'S response was inaudible.

SENATOR ELLIS said that many government positions are funded with a combination of funds. He asked if all positions that are funded with any general funds will be covered under this freeze.

SENATOR KELLY said he would imagine those details will be defined in statute by a future legislature, which would then institute a freeze by resolution when need be. SJR 37 merely gives the authority, it does not provide the specifics.

SENATOR ELLIS asked if Senator Kelly's point is that the details can be dealt with later and worked out in statute.

SENATOR KELLY said before a statute would be of any value at all, the Constitution will have to be amended.

CHAIRMAN TAYLOR felt that Senator Ellis raised a good point as the words "general fund" are not in the resolution and said he found the answer to be fascinating. He asked, "Has the subterfuge of the words 'other funds' now carried with it enough authority that if your position was funded by 'other funds' that that somehow isn't general funds?" He said that attaching that kind of definition worries him.

SENATOR KELLY said that is possible and acknowledged that he did not understand Senator Ellis's question at first. He explained that SJR 37 merely provides the legislature with authority at a later date, it does not specify which funds.

SENATOR COWDERY moved SJR 37 to its next committee of referral with individual recommendations.

SENATOR ELLIS objected.

CHAIRMAN TAYLOR announced the motion carried with Senators Cowdery, Therriault and Taylor voting in favor, and Senator Ellis opposed.

#

#SJR 38

SJR 38-CONST AM: PRIORITY OF EXPENDITURES

SENATOR PETE KELLY, sponsor of SJR 38, informed members they previously heard from Representative Dyson about a prioritized budget. He is of the opinion that a prioritized budget falls into the same category as a hiring freeze; in other words nothing in the Constitution can force the governor to do either. SJR 38 would allow the legislature to require a prioritized budget. He noted Representative Dyson's bill places the details in statute.

There being no further testimony or questions, SENATOR COWDERY moved SJR 38 to its next committee of referral with individual recommendations and asked for unanimous consent.

CHAIRMAN TAYLOR announced that with no objection, SJR 38 will move to Senate Finance.

#

There being no further business to come before the committee, CHAIRMAN TAYLOR adjourned the meeting at 2:35 p.m.