

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS COMMITTEE

March 21, 2002
3:35 p.m.

MEMBERS PRESENT

Senator Gene Therriault, Chair
Senator Ben Stevens
Senator Bettye Davis

MEMBERS ABSENT

Senator Randy Phillips, Vice Chair
Senator Rick Halford

COMMITTEE CALENDAR

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

MOVED HJR 35 am OUT OF COMMITTEE

SENATE BILL NO. 306

"An Act establishing the Prescription Drug Assistance Task Force;
and providing for an effective date."

MOVED CSSB 306 (STA) OUT OF COMMITTEE

SENATE JOINT RESOLUTION NO. 13

Proposing amendments to the Constitution of the State of Alaska
relating to inflation-proofing the permanent fund.

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

HJR 35 - No previous action to record.

SB 306 - No previous action to record.

SJR 13 - See State Affairs minutes dated 4/26/01 and
2/22/02

WITNESS REGISTER

Representative Jeannette James
Alaska State Capitol, Room 214
Juneau, AK 99801-1182

POSITION STATEMENT: Sponsor of HJR 35

Heath Hilyard
Alaska State Capitol, Room 214
Juneau, AK 99801-1182

POSITION STATEMENT: Presented HJR 35

Senator Bettye Davis
Alaska State Capitol, Room 504
Juneau, AK 99801-1182

POSITION STATEMENT: Sponsor of SB 306

Richard Benavides
Alaska State Capitol, Room 504
Juneau, AK 99801-1182

POSITION STATEMENT: Explained SB 306

Steve Ashman
Department of Administration
Director of Senior Services
3601 C Street Suite 310
Anchorage, AK 99503

POSITION STATEMENT: Testified on SB 306

Gene Dau
AARP member
P.O. Box 20995
Juneau, AK 99801

POSITION STATEMENT: Testified on SB 306

John Furuness
NARFE member
1285 Fritz Cove Road
Juneau, AK 99801

POSITION STATEMENT: Testified on SB 306

Marie Darlin
AARP member
No address provided

POSITION STATEMENT: Testified on SB 306

Nancy Weller
Division of Medical Assistance
Department of Health &
Social Services
PO Box 110601
Juneau, AK 99801-0601

POSITION STATEMENT: Testified on SB 306

Joe Balash
Staff to State Affairs Committee

Alaska State Capitol, Room 121
Juneau, AK 99801-1182
POSITION STATEMENT: Introduced SJR 13

ACTION NARRATIVE

TAPE 02-16, SIDE A

CHAIRMAN GENE THERRIAULT called the Senate State Affairs Committee meeting to order at 3:35 p.m. Present were Senators Davis, Stevens and Chairman Therriault. Senators Halford and Phillips were out of town.

#HJR 35

HJR 35-REPEAL ESTATE TAX

HEATH HILYARD, staff for Representative Jeannette James, introduced HJR 35 and read the following into the record:

This resolution is similar in wording and intent to HJR 34 introduced by Rep. Coghill in the first session of the twenty first Alaska Legislature. The major reason we've chosen to revisit this issue is that in 2001, President Bush signed into law a tax relief act that included a temporary repeal of the Death tax and that repeal sunsets in 2010.

To address some of the technical elements of the new provisions I have included with my sponsor statement a timeline, prepared by Deloitte & Touche LLP, which demonstrates the graduated decline in tax rates and the increasing exemption levels as a result of the 2001 law. Alaska currently has its own Estate tax (AS 43.31) and our rate, and thus the revenue generated, is driven by the federal law. According to Brett Fried, a tax economist with the Alaska Dept. of Revenue, regardless of whether or not the federal repeal becomes permanent, the temporary repeal will cause Alaska's revenue stream from this tax will dry up by FY06.

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.

In a statement of support from NFIB Alaska for HJR 35, the NFIB states, "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." Further, an article appearing in Farm Bureau News published by the American Farm Bureau Federation states "many farmers and ranchers feel compelled to spend money for estate planning, an expense that is drain on ongoing farm operations." In addition to the NFIB, efforts to permanently repeal this tax enjoy broad support from the National Black Chamber of Commerce, the National Association of Women Business Owners and the National Congress of American Indians among others.

As indicated in the sponsor statement, not only does the death tax disproportionately tax several specific demographic groups, it also does not justify its own existence from a fiscal perspective costing more to collect than the revenue it generates.

Finally, I will leave with a quote from President Bush in a speech given this week to the Women's entrepreneurship summit, "We must make the repeal of the death tax permanent. I call upon Congress to do this immediately."

CHAIRMAN THERRIAULT asked whether the phone call that was scheduled for the following day from Speaker Hastert was in regard to the national effort to permanently repeal the estate tax.

REPRESENTATIVE JEANNETTE JAMES, resolution sponsor, replied it was for that purpose and she had already had one teleconference meeting with the U.S House on the issue.

CHAIRMAN THERRIAULT stated that his office received a notice that contained a copy of a suggested resolution for the Legislature to consider. He asked whether HJR 35 contained the suggested language.

MR. HILYARD replied that legislative legal had that basic

document when they drafted the resolution.

CHAIRMAN THERRIAULT noted there was a zero fiscal note. There were no further questions or additional testimony.

CHAIRMAN THERRIAULT disclosed his wife is an attorney with a master degree in tax issues.

REPRESENTATIVE JAMES announced she changed the name of the resolution to "Repeal Estate Tax" from "Repeal Death Tax."

CHAIRMAN THERRIAULT said he appreciated the change.

There was no prepared CS and no proposed amendments.

He asked for the will of the committee.

Senator Davis made a motion to move HJR 35 am and zero fiscal note from committee with individual recommendations.

There being no objection, HJR 35 am moved from committee.

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#SB 306

SB 306-PRESCRIPTION DRUG ASSISTANCE TASK FORCE

SENATOR BETTYE DAVIS, bill sponsor, stated that she has spent a lot of time reviewing prescription drug issues. She is currently serving on the Committee on Aging for the Council of State Governments and recently attended a conference on prescription drugs. Representative Joe Hayes is the sponsor of the same bill on the House side and asked that she mirror his bill in the Senate. She hopes that this legislation will help to find ways to aid senior citizens in the purchase of prescription drugs.

RICHARD BENAVIDES, aide to Senator Davis, explained that while Congress has been debating proposals to add a prescription drug benefit to Medicare, many states are taking steps to protect their more vulnerable residents from rising out of pocket costs and declining insurance coverage for prescription drugs. According to the National Conference of State Legislatures, over 40 states have considered legislation to help seniors and the disabled address these issues. SB 306 only involves Alaska's growing senior population. American Association of Retired People (AARP) statistics report that the annual growth rate for Medicaid spending on medications in Alaska rose 23.4 percent between 1996

and 1998. They also reported that about 11,000 seniors have no prescription drug coverage whatsoever.

Between October 31, 1999 and October 31, 2000, over 5,500 Alaskans aged 65 and above who were eligible for the state's Medicaid program, received 263,000 prescriptions at a cost to the state of over \$10 million. SB 306 would create a method to look at ways to provide meaningful relief to seniors without creating large new expenditure programs.

STEVE ASHMAN, Director of the Division of Senior Services, testified via teleconference that the Department of Administration would be charged with putting together the task force called for in the legislation. Currently they don't have accurate information on the number of seniors in need of prescription drug relief but there are certainly a number of anecdotal cases. It is a significant problem and one of the goals of the legislation is to investigate the options that are available as well as other states' practices.

He looks forward to working with the sponsor and will help in any way possible.

GENE DAU, AARP member testified in support of SB 306. He noted AARP Alaska sent a letter in support as well. Washington state doctors are now able to fax prescriptions directly to pharmacists in Canada who will mail the medicine to you in the U.S. He asked why this wouldn't be possible in the state of Alaska.

CHAIRMAN THERRIAULT commented he didn't know that you couldn't do that here.

SENATOR DAVIS stated that would be an option the task force could look into.

SENATOR STEVENS asked if the method of payment was a credit card or similar and not a credit against a U.S. based program.

MR. DAU replied payment was cash.

3:50 p.m.

JOHN FURUNESS, National Association of Retired Federal Employees (NARFE), testified in support of SB 306. Prescription drugs need to be made more affordable.

MARIE DARLIN, AARP member, testified in support of SB 306. She is the coordinator for the Capital City Task Force and although they

are following many bills this session, this is of particular concern. The AARP letter of support is in the bill file.

CHAIRMAN THERRIAULT asked Ms. Darlin whether she had a comment on the makeup of the task force.

MS. DARLIN said she was pleased with the composition of the task force.

CHAIRMAN THERRIAULT asked whether the Department of Social Services had any concern about the makeup of the proposed task force.

NANCY WILLER, a representative from the Division of Medical Assistance, said they had no concerns with its makeup. They understand that most of the federal proposals that are in the President's budget use Medicaid as a funding source for providing prescription drug coverage to additional senior populations. They would be available to provide assistance to the task force.

CHAIRMAN THERRIAULT asked Mr. Benavides about the meaning on page 2, lines 4-6.

MR. BENAVIDES said the wording came from the drafters and legal terminology isn't always easy for the layperson to understand.

SENATOR DAVIS explained the meaning is that we would have to adopt other state's strategies to fit Alaska. She said she supports the statement but was receptive to more artful wording.

CHAIRMAN THERRIAULT moved conceptual amendment number one to replace page 2, lines 4-6 with something similar to the following: "In considering the adoption of a strategy to help senior citizens cope with the cost of prescription drugs, the State of Alaska should review what has been done in other states."

SENATOR DAVIS said she could support the change.

CHAIRMAN THERRIAULT said he would work with Senator Davis and the drafters rather than holding the bill and presenting a proposed CS at the next meeting.

There was no objection to the conceptual amendment.

He asked Mr. Benavides to explain the fiscal note.

MR. BENAVIDES said the second page of the fiscal note explained

this would cover the cost of three meetings if travel, lodging, per diem and telephonic costs were incurred. Mr. Ashman was the author of the note and could answer specific questions.

CHAIRMAN THERRIAULT said he didn't have any particular questions and the bill had a referral to the Finance Committee where fiscal questions would be addressed.

There were no further amendments.

He asked for the will of the committee.

SENATOR STEVENS made a motion to move CSSB 306 (STA) and attached fiscal note from committee with individual recommendations.

There being no objection, CSSB 306 (STA) moved from committee.
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#SJR 13

SJR 13-CONST. AM: PERMANENT FUND

CHAIRMAN THERRIAULT said he would like to discuss some of the information they received from the Permanent Fund Trustees regarding the tax problems that might be triggered if anything was done to guarantee any part of the dividend in the Alaska State Constitution. He asked Mr. Balash to distribute copies of the legal opinions the trustees have gotten from Morrison & Foerster LLP over the years. He understood the trustee's concern and desire to let the Legislature know that if anything is done regarding ensuring any kind of dividend, there is a potential tax problem. His reading of the legal opinions leads him to believe it is not an absolute.

Mr. Balash conducted research based on discussions from the legal memos and developed a grid sheet comparing funds from other states. He also prepared a paper that discusses the Integral Part Theory, which is a legal theory that protects state activities from taxation.

MR. BALASH, staff to Senate State Affairs Committee, established the report given to the trustees was conducted by a tax firm in Washington D.C. The letter was addressed to the Attorney General's office because that office is statutorily the legal counsel to the Permanent Fund Corporation. They discussed a variety of ways the Permanent Fund can claim an exemption from federal taxation. Primarily they focus on the Integral Part Theory; the underlying doctrine is that Congress can tax the

income of states if they expressly say so, but they have never chosen to do so. Additionally, an entity that is an integral part of the state is not subject to taxation unless Congress specifically subjects it to taxation. This has been a successful defense against taxation with the IRS in a number of instances. Primarily they look at three points.

1. First they look at the type of entity. Is it a public corporation, a state agency or a type of fund within the treasury or even apart from the treasury?
2. Second they look at state creation, control and domination of the entity. Did the state create the fund and does the state maintain strict control over or domination of the entity?
3. Third they look at both the source and destination of the funds. Where did the money come from that is in the fund and what is the destination of the proceeds or assets?

There is no single determinant factor; rather the IRS looks at all three factors and sometimes there has been negotiation of what features the state needed to have to create the different disaster insurance funds and insulate them from taxation and qualify for the Integral Part Theory.

Of particular concern is the third part of the test or the destination. In Alaska the primary destination has been the dividend. Whether or not that counts as a private benefit or the creation of a private benefit causes some concern because anytime the destination is a private benefit the IRS carefully scrutinizes that benefit.

MR. BALASH referred to the grid sheet found at the end of the minutes to discuss and compare funds from other states according to the Integral Part Theory

For example, the State of Michigan set up a prepaid tuition program where parents invested a set amount of money into a public corporation. That money was invested and returns were paid out to the beneficiaries that were designated by the original investors. The state argued it was an integral part of the state while the IRS held that it was an investment scheme in which the investors were using the cloak of the state's tax-exempt status to hide their gains. Of particular concern to the IRS was that individuals invested their personal money, earned a return and then got a benefit.

CHAIRMAN THERRIAULT pointed out that it was largely due to the IRS rejection that Congress took specific action to approve such

funds.

MR. BALASH concurred and added that when the IRS rejected the supposition that they were an integral part of the state, Michigan filed a tax return, asked for a refund and sued when they didn't get it. Although they lost in the first round of litigation, the Sixth Circuit Court of Appeals ruled in their favor. The court ruled it was serving a public purpose; it was used in the State of Michigan and was an integral part of the state. The IRS disregarded the court and simply stopped issuing private letter rulings on the subject. Other states wanted to get similar benefits for their residents, which led to the lobbying effort and subsequent passage of the specific exemption in the IRS code.

SENATOR STEVENS asked if it wasn't a specific exemption for just Michigan.

CHAIRMAN THERRIAULT stressed it was for that type of activity.

MR. BALASH added that Alaska began a similar program at the University of Alaska.

CHAIRMAN THERRIAULT confirmed it is private individuals investing their money and those private individuals specifically receive the benefit.

He asked Mr. Balash to discuss the hurricane and disaster funds.

MR. BALASH explained that Florida, Hawaii, and California are all states where natural disasters are not uncommon or unexpected. Florida and Hawaii have hurricanes and California has earthquakes. Those states have established entities from which individuals or insurance companies purchase premiums. The premium revenues are invested to earn a return and if a disaster strikes, reimbursement is made for the amount of the policy. If you purchased a premium, you would receive a benefit but you wouldn't if you hadn't purchased a premium. Just as in the Michigan case, individuals or individual companies invest their money and are using the state's tax-exempt status to receive a benefit. Those states negotiated with the IRS to ensure the funds wouldn't be rejected. The IRS wanted the states to contribute some public money into the funds so they wouldn't be viewed as just an investment scheme.

It is clear that the source and destination is key to the IRS determination. As stated in the Alaska Constitution, the

Permanent Fund belongs to the state. It does not belong to any individuals, corporation, or agency, but a corporation manages it. The managing corporation always refers to the assets of the fund and the returns of the fund in its annual reports and news releases in order to clearly make the distinction that the fund belongs to the state and not the corporation. The corporation board is comprised of state officials and individuals that were appointed by the executive and the employees of the corporation are state employees.

It is easy to demonstrate that the state has controlling domination of the fund because the Legislature statutorily restricts how the corporation can invest the fund. For example they are currently able to invest no more than 55 percent in equities. Also, the Legislative Budget and Audit Committee has oversight of the fund and the corporation.

The source and destination is different for the Alaska Permanent Fund than the other examples. The source of the fund comes from state royalties, some settlements and approximately 2.7 billion general fund dollars that were deposited in the early 1980's. For the last 20 years, Alaska has paid out a benefit to private individuals in the state so there is clearly a private benefit from the payment. However, the individuals receiving the benefit never put any of their own money in the fund and never used the fund as a tax shield. Thus, the source and destination question of the Alaska Permanent Fund has not been posed to the IRS.

CHAIRMAN THERRIault stated that according to the Integral Part Theory, it is clear to him that the Permanent Fund is an integral part of the State of Alaska. Compared to the disaster funds discussed, Alaska has a much stronger case than the others due to the structure and source of the fund. The payout is not necessarily to individuals because they are not able to control or demand it, which gives Alaska a good basis to argue that the fund earnings should not be taxed unless Congress specifically authorizes it. Although Congress has that power, they must explicitly say that is what they want to do and they have not done so.

The question now is whether guaranteeing some level of dividend is enough for the IRS to say there is no public purpose. Currently some parts of the operating budget are funded with the earnings, which does point to a state purpose. Also, if all of the earnings aren't used for a state dividend they certainly are available for the Legislature to use, which is a state purpose. Under the proposed percent of market value methodology, it says that if a draw is made it must be limited to five percent. That

draw is permissive, it is not dictated that a draw must be made. The state could elect not to make a draw and that money would remain available to the Legislature or to the citizens if they elected to change the Constitution and put that money toward a public purpose.

Although the Legislature and the trustees have been counseled that guaranteeing any kind of dividend would result in a negative tax ruling, he's not so sure. His reading of the legal opinion as well as examining some of the cases discussed gives him confidence that the state would prevail.

CHAIRMAN THERRIAULT stated that the percent of market value proposal from the Permanent Fund Corporation has been in the committee for some time. He wanted to have the discussion so that members would be apprised of his interpretation and give them the opportunity to study the information and come to their own conclusion. With this done, the committee could consider taking final action on SJR 13 in the next several weeks.

CHAIRMAN THERRIAULT held SJR 13 in committee.

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There being no further business to come before the committee, Chairman Therriault adjourned the meeting at 3:20 p.m.

#SHR 13

	Alaska Permanent Fund	Michigan Education Trust	Florida Hurricane Catastrophe Fund	Hawaii Hurricane Relief Fund	California Earthquake Authority
Corporate Status	State Fund; managed by a public corporation	Public Corporation	State Fund	Public Corporation	State Agency
Ownership of Assets	State	Investors	Reverts to the state upon termination	Reverts to the state upon dissolution	Transferred to the state upon termination

Control and Domination		Investments dictated by law; LB&A Committee has oversight	Independent of the State; decisions could not be overridden by any agency		Initial plan of operations subject to legislative review	Initial plan of operations approved by the legislature; amendments approved by the insurance commissioner
	Board Make-up	state officials and public members confirmed by the legislature		state officials	state official and public members confirmed by the senate	state officials
	Employees	state employees		Fund employees and contract advisors	Administered by a state agency	Employees subject to state civil servant requirements
Source and Destination						
	Source	State royalties and settlements	Participants	Insurers/Participants ; some nonparticipant funds	Participants + additional state funds (mortgage recording fee)	Equivalent of state premium tax collections; some seed money; sale of fund premiums
	Destination	Currently, a matter of legislative grace	private beneficiaries	revenues earmarked for the fund	insurers and the insured	insurers and the insured
IRS ruling		none requested	rejected	exempt	exempt	exempt

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