

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS COMMITTEE

May 9, 2002
4:25 p.m.

MEMBERS PRESENT

Senator Gene Therriault, Chair
Senator Randy Phillips, Vice Chair
Senator Ben Stevens
Senator Bettye Davis

MEMBERS ABSENT

Senator Rick Halford

COMMITTEE CALENDAR

HOUSE BILL NO. 285

"An Act adding a second verse to the official Alaska state song."
MOVED HB 285 OUT OF COMMITTEE

CS FOR HOUSE BILL NO. 212(L&C)

"An Act requiring a subcontractor to obtain workers' compensation insurance covering the subcontractor and the subcontractor's employees and establishing responsibility of a contractor for obtaining workers' compensation coverage for the subcontractor and the subcontractor's employees if the subcontractor fails to obtain workers' compensation coverage; and providing for an effective date."

MOVED SCS CSHB 212 (STA) OUT OF COMMITTEE

2d CS FOR HOUSE BILL NO. 303(RLS)

"An Act relating to taxation of individual income; and providing for an effective date."

MOVED 2d CSHB 303(RLS) OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

HB 285 - See State Affairs minutes dated 5/4/02.

HB 212 - See Labor and Commerce minutes dated 4/25/01, 3/28/02 and State Affairs minutes dated 5/2/02.

HB 303- No previous action to record.

WITNESS REGISTER

Ms. Denny Weathers

P.O. Box 1791

Cordova, AK 99574

POSITION STATEMENT: Testified in opposition to HB 303.

Representative John Davies

Alaska State Capitol

Juneau, AK 99801-1182

POSITION STATEMENT: Introduced HB 303.

Ms. Mary Griswold

Homer, AK

POSITION STATEMENT: Testified in support of HB 303.

Mr. Kevin Ritchie

Alaska Municipal League

217 2nd St. #200

Juneau, AK 99801

POSITION STATEMENT: Testified in support of HB 303.

Mr. Carl Rose

Association of Alaska School Boards

316 W. 11th St.

Juneau, AK 99801-1510

POSITION STATEMENT: Testified in support of HB 303.

Mr. Larry Persily

Deputy Commissioner

Department of Revenue

PO Box 110400

Juneau, AK 99811-0400

POSITION STATEMENT: Testified in support of HB 303.

ACTION NARRATIVE

TAPE 02-30, SIDE A

4:25 p.m.

CHAIRMAN GENE THERRIAULT called the Senate State Affairs Committee meeting to order at 4:25 p.m. Present were Senators Phillips, Stevens, Davis, and Chairman Therriault.

The first order of business before the committee was HB 285.

#HB 285

HB 285-SECOND VERSE OF ALASKA'S STATE SONG

CHAIRMAN THERRIAULT said there was a public hearing on HB 285 on Saturday. He did not have a prepared CS.

SENATOR DAVIS moved HB 285 out of committee with attached zero fiscal note and individual recommendations.

There being no objection, HB 285 moved out of committee with attached fiscal note and individual recommendations.

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The next order of business before the committee was HB 212.

#HB 212

HB 212-WORKERS' COMP:CONTRACTORS & SUBCONTRACTOR

CHAIRMAN THERRIAULT said there had been a public hearing on HB 212. He said there was a prepared CS.

SENATOR PHILLIPS moved the P version of HB 212 for purposes of discussion.

There being no objection, the P version of HB 212 was adopted as the working document.

SENATOR PHILLIPS moved SCS CSHB 212 (STA) out of committee with attached zero fiscal note and individual recommendations.

There being no objection, SCS CSHB 212 moved out of committee with attached fiscal note and individual recommendations.

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The final order of business before the committee was HB 303.

#HB 303

HB 303-INDIVIDUAL INCOME TAX

CHAIRMAN THERRIAULT asked Denny Weathers in Cordova to give her testimony on HB 303.

MS. DENNY WEATHERS said the Constitution of the United States of America recognized two classes of taxes. The first was the direct tax authorized in art. 1, § 2, cl. 3 of the U.S. Constitution, "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers." She said the U.S. Constitution in art. 1, § 9, cl. 4 says, "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or enumeration herein before directed to be taken."

MS. WEATHERS said the second recognized tax was an indirect tax authorized in art. 1, § 8, cl. 1 of the U.S. Constitution:

The Congress shall have the Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

She said the State of Alaska recognized direct and indirect taxes as well as franchise taxes. She defined franchise taxes as annual taxes on the privilege of doing business in the state or taxes on the franchise of corporations. She said direct, indirect and franchise taxes were constitutional taxes but she did not think the proposed state individual income tax was constitutional.

She said the Alaskan government seemed to want to reward the unproductive and penalize the productive. She said politicians were writing laws designed to confiscate the profit of the working people's labor and use those confiscated dollars to buy the votes of the unproductive. She said this was wrong and the people were starting to realize it.

She asked the committee to remember our American political heritage. She said tax protesters formed the Declaration of Independence and the United States Constitution. She said the first four presidents of the United States were tax protestors who were criminals under the laws of England. She said the reasons for the Revolutionary War were listed in the Declaration of Independence, one of which was, "FOR imposing Taxes on us without our Consent." She asked if it was time for another revolution. She urged the legislature not to impose an unconstitutional state individual income tax.

She also wished to give the following testimony for her husband, Eric John Weathers, an Alaskan resident for over 48 years who lived on Hawkins Island. He wanted to know if the Legislature had forgotten to read Sec. 3 of the Alaska Statehood Act, which said, "The constitution of the State of Alaska shall always be republican in form and shall not be repugnant to the Constitution of the United States and the principles of the Declaration of Independence." *Black's Law Dictionary* defined republican as, "A government of the people," and repugnancy as "An inconsistency, opposition, or contrariety." He said Webster's defined repugnant as contradictory or incompatible.

MS. WEATHERS said her husband said one of the grievances listed in the Declaration of Independence was, "FOR imposing Taxes on us

without our Consent." He did not remember giving the Legislature his consent to tax him. He did not remember any vote on a state income or sales tax. He asked to be provided with the date of the vote, the outcome and a copy of his signature showing his consent.

Amendment X of the United States Constitution said, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." He said the Legislature was trying to usurp the people's power. He said the Preamble to the Constitution of the State of Alaska said, "We the people of Alaska," not we the government of Alaska. He said the people were not supposed to work for the government, the government was supposed to work for the people. He wanted the Legislature to look at Representative Vic Kohring's 10-point Save Alaska plan and get back to the basics.

CHAIRMAN THERRIAULT asked if there were any questions for Ms. Weathers. There were none. He said Representative John Davies, sponsor of HB 303, had joined the meeting and asked him to present the bill.

4:35 p.m.

REPRESENTATIVE JOHN DAVIES said the Alaska Fair Tax was a compromise reached in trying to pass a tax bill through the House of Representatives and hopefully it would be able to pass through the Senate. He said the first tax that was discussed was a flat income tax of 2.6% based on federal taxable income, which was rejected. He said the next tax that was discussed was a sales tax, which had a lot of individual support within the House but opposition from municipalities. He said the problem with the income tax seemed to be the sticker shock for the upper income levels. He thought if a lot of representatives were comfortable with a sales tax, they must have been comfortable with the distribution of costs at different income levels.

He said the Alaska Fair Tax was designed to mimic the effect a sales tax would have on people at different income levels. He said it was regressive at the upper income levels but slightly progressive at the lower income levels. He said the distribution of percentages had an unusual hump and was a little bit lower at the lower income levels, peaked at the \$50,000 to \$60,000 range and dropped off at the higher levels. He said the terms progressive and regressive referred to percentages. He said people in the lower income levels would pay about \$50, people in the middle income levels would pay about \$1,000 and people in the upper income levels would pay about \$5,000. He said people would

pay more as income increased but the rate at which they paid would decrease.

REPRESENTATIVE DAVIES said there was a lot of discussion on what constituted fair. He said flat taxes, progressive taxes and regressive taxes each had advocates saying they were fair. He said there was no perfect tax that everyone would agree on. He said the only significant advantage HB 303 had was that it received 24 votes in the House.

CHAIRMAN THERRIAULT said a graph showing the distribution of rates was in the bill packets.

REPRESENTATIVE DAVIES said from the peak to the right mimicked the distribution of the original HB 303 when it was a sales tax.

CHAIRMAN THERRIAULT asked what was in the packet Representative Davies had given him.

REPRESENTATIVE DAVIES said it was an amendment containing clean-up language suggested by the Department of Law and the Department of Revenue (DOR) based on questions and comments that had come up since the bill passed out of the House. He supported the amendment. He said the most substantial change would be in the second to last section dealing with the ability of non-residents to establish trusts to be managed in the state. The amendment clarified that trust income would not be taxed if a person were not a resident.

CHAIRMAN THERRIAULT asked if that was specifically designed to protect that business for the state.

REPRESENTATIVE DAVIES said it was and it had always been his intention to do so but it somehow got left out of the previous version of HB 303.

CHAIRMAN THERRIAULT asked if there were any further questions for Representative Davies. There were none. He asked Ms. Mary Griswold in Homer to give her testimony.

MS. MARY GRISWOLD said her highest priority for the legislative session was a sound fiscal plan to bridge the budget gap. She encouraged support for the fiscal package passed by the House. She said HB 303 was a reasonable compromise between a sales tax and a more conventional income tax, both of which had strong proponents and opponents and neither of which could pass on their own. She said she appreciated the government services we relied on and did not want to see them slashed. She encouraged

government efficiencies but recognized the need to raise more money. She said a combination of taxes and the use of Permanent Fund earnings would spread the burden. She asked for a 5% of market value payout for the Permanent Fund, broad-based taxes and the use of Permanent Fund earnings to solve the budget dilemma.

SENATOR PHILLIPS asked if she was willing to take a reduction in her Permanent Fund Dividend to fund government.

MS. GRISWOLD said she was.

CHAIRMAN THERRIAULT asked if there were any further questions for Ms. Griswold. There were none.

MR. KEVIN RITCHIE, Alaska Municipal League (AML), said a solid long-range fiscal plan had been a top priority of AML for five years. He thanked the House for working with communities around the state. He said sales tax was a revenue source that had been used by communities since statehood. He said the community sales tax was particularly important in Alaska because many small communities didn't have the option of property taxes. AML worked with the State to determine that about 50 mils of property tax would be needed to replace Bethel's 5% sales tax because of ownership patterns. He said some people would pay 50 mils and the federal government, which would be the property owner in many cases, would pay virtually nothing. He said having both a community sales tax and a statewide sales tax would be a significant burden on a community like Bethel because they wouldn't be able to move to a different form of taxation.

CHAIRMAN THERRIAULT said he was steady in his opposition to a statewide sales tax because he wanted that option preserved for local governments. He wished local governments would act like local governments and provide local services since they had a tool to raise revenue.

MR. RITCHIE believed 98 municipalities had a sales tax. He said AML would be happy to work with the State to see who could best provide services. He said that was a negotiation they would be happy to encourage municipalities to get involved in.

CHAIRMAN THERRIAULT asked if there were any questions for Mr. Ritchie. There were none.

MR. CARL ROSE, Executive Director of the Association of Alaska School Boards (AASB), said AASB's top priority was to support a fiscal plan. He said the ability of the State to move successfully into the future on a sound fiscal note was important

to all of us. He felt the State was facing a dilemma if we failed to make the transition. He said he could afford to be wrong but the State couldn't afford to be wrong if this step wasn't taken. He said by the time the "for sale" signs started going up in 1984 and 1985 it was too late and the state was already headed into a recession. He asked what the repercussions would be if action wasn't taken. He said the State was flirting with a major collision and would have to scramble to pick up the pieces to put the economy back together again. He said Alaska was still a young state and didn't have the necessary infrastructure in place. He thought much of that was being jeopardized if there was no fiscal plan. AASB supported HB 303 and any other legislation to improve on the plan from the House or address the future.

CHAIRMAN THERRIAULT asked if there were any questions for Mr. Rose. There were none.

He said HB 303 levied taxes at different rates depending upon the balance in the Constitutional Budget Reserve (CBR). He asked why the Fiscal Policy Caucus seemed to be so intent on protecting the CBR. He said a dollar in any savings account would earn interest and a rate of return until that dollar was spent. The one difference he could think of was that a three-quarters vote was required to spend money from the CBR. He said that was not what the Legislature intended but how the courts had interpreted it. He felt the three-quarters vote had been used to drive spending up. He asked if there was any other reason why the CBR was so sacred.

REPRESENTATIVE DAVIES said the desire to protect the CBR had nothing to do with the three-quarter vote. He wasn't going to argue about whether the budget had been spent up or who was responsible for it. He said if the committee wanted to amend HB 303 to make it conditional upon getting rid of the three-quarters vote, he would support that. He said he was on the record for three years supporting the repeal of the three-quarters vote. He felt it gave a perverted reflection of the process rather than perverted the process.

He said the CBR was the only savings account the State had that functioned as a shock absorber if oil prices fluctuated. He noted that oil was the State's major revenue source and was a very volatile source. He said that was why the Fiscal Policy Caucus was concerned with maintaining the CBR at \$1 to \$3 billion. He said the Fiscal Policy Caucus looked at the impact the various plans before them would have on the CBR five or six years into the future as a test.

REPRESENTATIVE DAVIES said if the CBR were maintained at the current level, it would continue to create about \$100 million in revenue. That was \$100 million that wouldn't need to be collected in taxes, taken from the permanent fund or cut from the budget.

CHAIRMAN THERRIAULT wished getting rid of the three-quarters vote on the CBR could be done statutorily.

REPRESENTATIVE DAVIES said that couldn't be done but if the committee wanted to do a constitutional amendment he would support it.

SENATOR STEVENS asked about lines 1-6 on page 7 of HB 303 describing a part-year or non-resident individual. He said that seemed hard to enforce.

REPRESENTATIVE DAVIES said that section described the apportionment of income in the state versus outside of the state for part-year residents. He said state income would be divided by total income and that would be the proportion of total income the State would tax.

SENATOR STEVENS asked what the mechanism of enforcement would be. He said he didn't see payroll withholding for regular employers, only the State.

REPRESENTATIVE DAVIES said payroll withholding was in Sec. 10 on page 10. He said HB 303 also provided for penalties for things such as fraud.

SENATOR STEVENS asked if the language on page 2, lines 14-18 of the amendment regarding the inclusion of a child's income was clean-up language.

REPRESENTATIVE DAVIES said that language clarified how the State would deal with a child's income. He said if the parent included the child's income for federal tax purposes, that income would also be included for state tax purposes.

SENATOR STEVENS said he was concerned about that section. He said if a family in the \$30,000 to \$40,000 income range included their child's income, that child would be paying more taxes on their income than a child from a family that was in the upper income levels.

REPRESENTATIVE DAVIES said there was the option not to include

the income. He said the child from the upper income family would not be paying less. They would be paying a lower percentage. He said their total tax bill would be significantly more. He didn't have strong feelings about that section and if the committee wanted to change it, he wouldn't oppose that change.

SENATOR STEVENS said he put his children's Permanent Fund Dividends into savings accounts and paid federal taxes for the children. He paid \$287 for his oldest child. According to the tax table in the packet, he would have to pay \$55 in state taxes, which was about 27% of the child's federal tax liability.

REPRESENTATIVE DAVIES said it wouldn't be that much.

SENATOR STEVENS said the figure on the table was about what her income was. He said that the majority of people making under \$10,000 per year were children, high school students or older people working part time. He said people that make under \$10,000 would be paying a higher percentage of their federal tax liability than a person making over \$100,000. He said this was an inverted slope.

REPRESENTATIVE DAVIES said it was true that if a person made a lot of money their rate would be fairly low. He said that comes from the regressive nature of a sales tax and would also be true if a broad-based sales tax were collected. He said the state tax wouldn't be quite as much as Senator Stevens thought. It would be about 1.35% of whatever the dividend was. He said the \$55 figure assumed \$4,000 income. He said the state tax liability of the child would be about \$20.

CHAIRMAN THERRIAULT asked Representative Davies if he had any comment on the fiscal note.

5:00 p.m.

REPRESENTATIVE DAVIES said he was relying on DOR to present an accurate number. He said the fiscal note was about \$8 or \$9 million, but he had the sense that actual operating costs would probably be less. He said there were two ways the cost could be mitigated. He said Representative Norman Rokeberg presented an amendment on the floor to allow people to use their Permanent Fund Dividend application to pay or withhold their state tax, reducing the amount of paperwork and allowing the existing bureaucracy to handle that part of it. The amendment was withdrawn because of other complications but the idea was sound.

REPRESENTATIVE DAVIES said when federal taxes were filed

electronically there was the option to pay state taxes as well. He said 17% of federal taxpayers filed electronically and that number was increasing rapidly. He said in the next three or four years approximately 50% of taxpayers would pay electronically. He said the State could use that to reduce costs significantly.

SENATOR STEVENS asked him to explain Sec. 5 on page 8 of HB 303.

REPRESENTATIVE DAVIES believed it was clean-up language having to do with amended returns after a dispute.

SENATOR STEVENS asked if he knew how many people in the state used itemized deductions on their federal taxes.

REPRESENTATIVE DAVIES said he did not know. He believed DOR used figures from 1998.

MR. LARRY PERSILY, Commissioner of DOR, said about 25% used itemized deductions.

SENATOR STEVENS asked if a state income tax would only be deductible if itemized deductions were used.

REPRESENTATIVE DAVIES said that was correct. He said the state income tax would reduce taxable income.

SENATOR STEVENS asked Mr. Persily to give a brief synopsis on state income tax deducted from federal tax liability.

MR. PERSILY said state income taxes were deductible if and only if a person itemized. He said if a person didn't own a home they probably wouldn't itemize because they wouldn't have enough itemized deductions without mortgage interest and would be better off taking the standard deduction. He said if a person took the standard deduction they wouldn't be able to deduct state income tax on top of that. He said if a person had an adjusted gross income of \$60,000 after mortgage interest, charitable donations and state income tax had been deducted they would look on the tax table to figure out how much was owed to the federal government. He said if the state income tax was \$1,000 and they were in the 25% federal tax bracket, they would get back \$250 of the state taxes from being in a lower federal tax bracket. Thus, the federal government would be helping to subsidize or lessen the burden of Alaskans who itemized.

CHAIRMAN THERRIAULT wanted to clarify that it didn't apply if the taxpayer owned a home; it applied if there was money owed on the home. He said many Alaskans built their own homes out of pocket

and would not have that deduction.

MR. PERSILY said that was correct.

SENATOR PHILLIPS said he was the only legislator who had been around long enough to have voted to repeal the state income tax. He said when the state income tax was repealed there were about 77 positions to collect \$750 million. He said the fiscal note for HB 303 accounted for 54 positions to collect \$250 million in taxes, a third of the money that 77 positions had collected.

MR. PERSILY said the income tax that was abolished in 1979 never collected more than about \$200 million at its high point during pipeline construction. He said if the tax tables from 1979 were applied to today's income, about \$750 million would be collected. In terms of the dollar of the day, the amount collected in the past was about the same as the amount that would be collected as a result of HB 303. He said it would cost the same to collect \$250 million as it would to collect \$300 to \$600 million. He said the factors determining cost were things such as the number of returns and the amount of enforcement. He said DOR would certainly be more efficient than they were in 1979 and take advantage of electronic filing, electronic funds transfers and other technological advances. He said start-up costs would be substantial, especially for the purchase of software. He said after the start-up period, DOR hoped operating costs would be about \$6 million.

5:10 p.m.

SENATOR PHILLIPS asked if the Administration supported HB 303.

MR. PERSILY said the Administration felt that HB 303 was probably the best kind of broad-based tax that could move at that point.

SENATOR PHILLIPS asked if the Administration had considered taking \$370 out of everybody's Permanent Fund Dividend to fund the \$250 million.

MR. PERSILY said the Administration also supported using the Permanent Fund earnings.

SENATOR PHILLIPS said he was asking about the dividends themselves and not earnings.

MR. PERSILY said he was limited in how he could speak.

SENATOR PHILLIPS said he understood that.

MR. PERSILY said the Administration favored using Permanent Fund earnings but could not say how much that would affect the dividends.

SENATOR PHILLIPS said his calculations indicated that \$370 from each dividend would equal about \$250 million. He said that would treat everybody equally.

MR. PERSILY said substantial funds would be taken from the Permanent Fund earnings whether or not a broad-based income tax was passed.

CHAIRMAN THERRIAULT asked if there was anybody else who wished to testify on HB 303. There was nobody.

He said the amendment was received after the hearing on HB 303 had started and he preferred not to take any action on it. He said if there were the votes to move HB 303 out of committee, the amendment would be included in the packet that would be sent to the Senate Finance Committee. He said the committee had been asked to move the bill on to the Finance Committee. He didn't think anybody could read too much into the committee's action to move the bill and even if the bill moved out it could have a negative committee report. He said he did not have a prepared CS. He asked for a motion to move HB 303 out of committee.

SENATOR DAVIS moved 2d CSHB 303(RLS) out of committee with attached fiscal note and individual recommendations.

SENATOR STEVENS objected for comment.

SENATOR PHILLIPS said this was the last thing he wanted to do. He said HB 303 would hit the middle class the hardest and 20% of the people would be shouldering 80% of the burden. He didn't like that and he despised this tax the most. He said the State gave away \$1,2 billion with the Permanent Fund Dividend.

TAPE 02-30, SIDE B

5:15 p.m.

SENATOR PHILLIPS said the budget shortfall was about \$700 to \$800 million. He said HB 303 would make the middle class take up that slack. He said that didn't make sense to him and he would not support the bill. He would vote to get it out of committee and then he would vote no and have his say on the floor. He hoped that all 20 senators would vote against it. He said this

proposal was not the first step that should be taken, it should be the last step taken.

CHAIRMAN THERRIAULT shared a lot of the same concerns. He said if HB 303 passed in this form, there would probably be a citizen's petition and it would be repealed.

He asked if there was any objection to the motion.

There being no objection 2d CSHB 303(RLS) moved out of committee with attached fiscal note and individual recommendations.

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ADJOURNMENT

There being no further business before the committee, the Senate State Affairs Committee meeting was adjourned at 5:20 p.m.