

HOUSE FINANCE COMMITTEE
March 18, 2004
1:44 P.M.

TAPE HFC 04 - 61, Side A
TAPE HFC 04 - 61, Side B

CALL TO ORDER

Co-Chair Williams called the House Finance Committee meeting to order at 1:44 P.M.

MEMBERS PRESENT

Representative John Harris, Co-Chair
Representative Bill Williams, Co-Chair
Representative Kevin Meyer, Vice-Chair
Representative Mike Chenault
Representative Eric Croft
Representative Hugh Fate
Representative Richard Foster
Representative Mike Hawker
Representative Reggie Joule
Representative Carl Moses
Representative Bill Stoltze

MEMBERS ABSENT

None

ALSO PRESENT

Representative Peggy Wilson; Bob Bartholomew, Chief Operating Officer, Alaska Permanent Fund Corporation, Department of Revenue

PRESENT VIA TELECONFERENCE

Dan Dickinson, Director, Division of Oil and Gas Audit, Department of Revenue, Anchorage; Michael Williams, Tax Division, Department of Revenue, Anchorage

SUMMARY

HB 236 An Act imposing a tax on employment; and providing for an effective date.

HB 236 was HEARD and HELD in Committee for further consideration.

HB 298 An Act relating to the distribution of appropriations from the Alaska permanent fund

under art. IX, sec. 15(b), Constitution of the State of Alaska, and making conforming amendments; and providing for an effective date.

HB 298 was HEARD and HELD in Committee for further consideration.

#HB298

HOUSE BILL NO. 298

An Act relating to the distribution of appropriations from the Alaska permanent fund under art. IX, sec. 15(b), Constitution of the State of Alaska, and making conforming amendments; and providing for an effective date.

REPRESENTATIVE MIKE HAWKER provided an overview of the legislation. He stated that HB 298 would be effective only if a Percent of Market Value (POMV) constitutional amendment is approved by the voters during the 2004 general election. HB 298 provides conforming language to existing statute to accommodate changing the constitutional requirement that all income of the Permanent Fund be deposited into the general fund to the more limiting appropriation mechanism of "up to 5%" of market value in the proposed POMV constitutional amendment. It would also recognize the merger of the Earnings Reserve Fund into the Permanent Fund.

Representative Hawker added that HB 298 provides the annual appropriation from the Permanent Fund under the POMV management structure, to be divided equally between paying individual dividends and public services.

Representative Hawker described each section:

- **Section 1:** Amends the basis for the Alaska jury list to people applying for a Permanent Fund Dividend. Former language referenced applicants for a "distribution of Alaska income."
- **Section 2:** Changes the duties of the Legislative Budget and Audit Committee (LBA) from making annual recommendations for investment policy for the "income" of the Permanent Fund to making annual recommendations for investment policy for the Permanent Fund. The change would be consistent with the merger of the Earnings Reserve (income) Account into the Permanent Fund and with the general oversight responsibilities of LBA for the Permanent Fund operations.
- **Section 3(a):** Provides that no appropriation "shall" be made from the Permanent Fund in excess of the average 10-year real rate of return. If the fund does not make a 5% real return over 10 years,

the amount available for appropriation would be reduced to the real return. The provision provides a statutory framework for implementing the "up to 5%" provision in the proposed POMV constitutional amendment.

- **Section 3(b):** Provides that annual appropriations from the Permanent Fund be divided equally between paying individual dividends and public services.
- **Section 3(c):** Defines the index to be used in determining the Rate of Inflation.
- **Section 4:** The proposed POMV constitutional amendment allows appropriations based on the "market value" of that fund. The section provides a statutory mandate that "market value" be determined in accordance with generally accepted accounting principals.

Representative Croft questioned the value flexibility and if it was realized or unrealized. Representative Hawker explained that under the generally accepted accounting principals, the value of business investments of the Permanent Fund Corporation would be measured on a market principal. The unrealized earnings and losses would be used for determination of the value of the fund.

Representative Croft agreed that would be easy with the stocks and bonds but more difficult with the small real estate investments. Representative Hawker suggested that it would be determined in a case-by-case base.

BOB BARTHOLOMEW, CHIEF OPERATING OFFICER, ALASKA PERMANENT FUND CORPORATION, DEPARTMENT OF REVENUE, explained that the determination of value under the generally accepted accounting principals for stocks and bonds that are publicly traded in the market have a daily pricing. Under the accounting principals, they are determined daily for the value. For the real estate properties direct investments for buildings, the generally accepted accounting principals require that the value be recorded at the cost. They are not marked up and most of the income from real estate comes from the rental income. That is recorded on an on-going basis. If buildings loose value, for accounting purposes that is recorded.

Representative Croft asked if it was only marked down, not up. Mr. Bartholomew replied that was correct.

Representative Croft thought, "Games could be played with what fair market value is". He asked other areas that might be problematic. Mr. Bartholomew advised that at this time, the Permanent Fund is not invested in anything other than stocks, bonds and real estate. The Board has made two decisions during the last two meetings to allocate

approximately 3% of the value of the fund into alternative investments. The two possible categories are:

- Private equities investing in start-up businesses; and/or
- Buying businesses already in place.

A manager would be hired to do this work and they would be responsible for providing a quarterly evaluation. There are generally accepted accounting principals and rules that are followed in evaluations.

Representative Hawker added that the Permanent Fund is subject to an annual outside audit that provides a benchmark and standardized disclosure procedures, providing assurance that the determination of fair value would be objective and consistent and not manipulated by the management of the fund.

Mr. Bartholomew continued:

- **Section 5:** Eliminates the current statutory provision that any unexpended operating budget of the Permanent Fund Corporation be included in the determination of "income" of the fund for the calculation of income available for distribution. The determination of income available for distribution will no longer be required under the proposed POMV constitutional amendment, which bases the amount that can be distributed on market value. Accordingly, the provision would no longer be relevant.

Representative Croft asked if that amount would come out of the legislative 5%. Mr. Bartholomew explained that the current constitutional amendment would limit all appropriations out of the Permanent Fund to 5%, hence the operating and the investment management costs would come from that 5%. That would make a portion be placed for the cost of management, approximately \$45-\$50 million dollars per year.

Representative Hawker continued:

- **Section 6:** The Permanent Fund Corporation manages the investment portfolio of the Mental Health Trust Authority. Current statute provides that the income from those funds be determined "in the same manner the corporation determines the net income of the Alaska Permanent Fund." The Mental Health Trust Authority previously adopted a POMV style management. The section provides a statutory mandate that the net income of the Mental Health

Trust fund be determined in accordance with generally accepted accounting principals. That is the same language adopted for the Permanent Fund in Section 4.

- **Section 7:** The section changes language in the existing Permanent Fund Dividend payment statutes to language that conforms to the proposed POMV methodology. The change has no substantive consequence on the current dividend payment statutes.
- **Section 8:** The section changes language in the disclosures required on the payment stub for the Permanent Fund Dividends to language that conforms to the proposed POMV methodology. The change has no substantive consequence on the disclosures required.
- **Section 9:** Repeals statute that would be superceded by operation of the proposed POMV constitutional amendment. AS 37.13.140 defines income and net income of the Permanent Fund for purposes of making distributions. Under the proposed POMV constitutional amendment, distributions are based on market value, not on income. AS 37.13.145 defines the disposition of income of the Permanent Fund including inflation proofing and transfers it to the dividend account. Inflation proofing is inherent in the proposed POMV constitutional amendment. Section 3 of HB 298 provides for transfers to the dividend account.
- **Section 10:** Provides that Sections 3, 4 and 6-9 of this Act, take effect only if a POMV amendment is approved by the voters during the 2004 general election and then takes effect.
- **Section 11:** Provides that subject to Section 10, the effective date of the Act would be January 1st, 2005.
- **Section 12:** Provides that subject to Sections 1, 2, and 5, it will take effective immediately.

Co-Chair Williams inquired about Section 12. Representative Hawker noted that he personally did not support that section, suggesting that it "clouded" the issue. Mr. Bartholomew added that the three changes would have little effect on the Permanent Fund.

Vice Chair Meyer questioned how the Ways and Means Committee determined the 50/50 split. He assumed that it was the

correct split but wondered how it had been determined. He noted that the Conference had recommended a 60/40 split and that the Permanent Fund Corporation had written a letter indicating that to keep the dividend at the same level as it currently is, a 70/30 split should be used.

Representative Hawker advised that the 50/50 split had been an "intuitive agreement". It was a judgment decision and would be a "fair" division of the proceeds. Justification is highlighted in the graph handout contained in member's packets indicating, given the approximate five year balance of \$26 billion dollars, 5% of that would make available for public spending, \$1.3 billion dollars. If that amount was divided into equal components, half to the whole of the State and half to the general fund for State purposes. A \$650 million dollar amount would continue to be able to pay a dividend check in excess of \$1000 dollars a year and continue to grow.

Vice Chair Meyer commented, based on that chart, the State would be receiving \$650 million dollars, an amount more than needed at present time. He inquired if in that case, would then more go toward dividends.

Representative Hawker advised that the Legislature retains the complete authority of appropriation. Dividends could either be increased or they could deal with the deferred capital needs or apply funds to the \$6 billion dollar debt owed to the Capital Budget Reserve (CBR) fund. The Legislature is entrusted with the management of public funds and would be responsible to determine what would be the most appropriate manner to utilize the remaining funds.

Vice Chair Meyer acknowledged that the proposed idea is a great plan. He thought that as the fund grows, the 5% would increase, as would the State's needs. He added sometime, the State needs to consider inflation proofing education. If a spending cap was in place, the formula could work well.

Mr. Bartholomew interjected that from the Board of Trustee's perspective, addressing the use of earnings would be outside of their policy responsibility. The Board has not taken a position on how the money should be used but instead attempts to determine what can be available. There is no recommendation for the amounts; however, there is information on historical and future payments under various allocation earnings.

Mr. Bartholomew noted that the Permanent Fund had prepared several different analysis. He suggested that the information be looked at from a couple different perspectives, as there is a lot of volatility and that creates weakness in the current system. He pointed out how much of the 5% has historically been allocated to dividends.

There have been years when the entire 5% could have been needed. If the formula goes back to 1990, computing the actual dividend payments as a percentage of the fund and then moving forward to 2015 provides a 25-year window. That amount of time can encompass the "good and bad times" in the market. A medium case return is predicted for the future and looks more like a 70/30 split. By starting next year and looking forward at the next 10-year period, as presented at the Conference of Alaskans, that amount would result in a 60/40 split. The difference is that in the next three years, there is a large downward dip in what is being paid into the dividend because of the 5-year average and the bear market experienced.

Representative Stoltze asked if it was intended to pass the enabling legislation prior to the passage of the resolution. Co-Chair Williams responded that it was his intent to hear all the bills that relate to the POMV and move them to the House Rules Committee.

Representative Stoltze mentioned the applications and their effective dates and if it would require a 2/3 vote of both bodies. He wondered what would happen if one piece passed and the other did not. If that happened, when would the effective dates take place? Co-Chair Harris admitted those were good points.

Co-Chair Harris stated that under the proposed bill, there would be a 50/50 split. He asked Mr. Bartholomew, which part of the 50% would the fees for the Permanent Fund come from. Mr. Bartholomew understood that if the direction was to allocate 50% of the available amount to the dividend fund, then the Legislature goes to the operating budget, making the decision of where the fee is taken from. He commented that he had never been involved in those discussions.

Co-Chair Harris assumed that it would come out of the 50% appropriated to the general fund. Mr. Bartholomew clarified that if the Legislature was giving 50% to the dividend, they would then be taking all the operating costs out of the other half. Co-Chair Harris acknowledged that made sense.

Co-Chair Harris voiced his appreciation for the hard work done by Representative Hawker and the Ways and Means Committee. He added that the concept of taking no more than 5% from a "pot of money" and insuring that nothing is taken from the corpus of the fund, then the Legislature taking money from it would be prohibited. He pointed out that some legislators believe that the main body of the fund should not be depleted by the Legislature. He voiced concerns with the 50/50 split because he did not think it would be "sellable". He supported the 60/40 split with 60% for the dividend and 40% to be used for work in general government.

Co-Chair Harris elaborated that he would be more comfortable with the 40% being used for public education rather than the general fund. Public education is a huge growing cost for Alaska. He believed that it would be the most "accepted" funding vehicle to come before the State, pointing out that over 90% of Alaskans support greater public education funding. Even at the \$650 million dollars, that amount could not cover this year's \$1 billion general fund dollar cost for public education. He reiterated that he would support amendments "leaning toward" public education.

Representative Fate referenced Section 8, which would place eligibility for dividends into the Constitution. Representative Hawker pointed out that is already statutory language.

Co-Chair Harris clarified that language would only conform legislation to the amendment of the constitution. Representative Hawker noted that he had not read any language that would become constitutional. The point is that there are some statutes under the conditional effect language currently drafted, Sections 1, 2 & 5, would take effect immediately upon being signed by the Governor and all the rest would be conditional. Representative Fate noted that he had misunderstood the reference.

Representative Croft referenced Section 3(b) and asked if the 5% would be deposited into the general fund. Mr. Bartholomew looked at the constitutional amendment as proposed, noting that it does not direct a deposit to the general fund but instead directs that appropriation to be limited to 5%. The underlining appropriation bill would determine where money goes.

Representative Croft observed that as a constitutional matter, it would be sitting in the permanent fund and the Legislature would give constitutional authority to appropriate up to 5% out of it. Mr. Bartholomew agreed that was correct.

Representative Croft asked if the constitution mentioned the Earnings Reserve Account or if that account in the Permanent Fund was really just a general fund account in the same area. Mr. Bartholomew explained that currently, the Earnings Reserve was by statute defined as an account within the Permanent Fund, according to the statutory definition from 1982.

Representative Croft asked the legal effect in Section 3(b). He asked if the statute would have any effect of the Legislature's ability to appropriate from them. Mr. Bartholomew understood that all the Constitution was doing was limiting the total draw to 5% and then the statute would

define where it goes. There would be an interpretation of Lines 14-18, regarding the legal requirements. He recommended Legislative Legal confirm that query.

Representative Croft maintained that the language "50% may be appropriated" was odd legal language. He asked the legal affect of Sections 3(b)(1&2), as he did not see any limits appropriating authority in that language without using words such as "must, may or more than". He requested that someone address that concern. Co-Chair Harris acknowledged the language was "permissive" as voiced by Representative Croft.

Representative Croft offered to check with Tam Cook at Legislative Legal Services regarding the concerns.

Co-Chair Harris explained that a lot of what the Legislature is allowed to do through statute would be determined by what the constitutional provisions indicate. The legislation would technically do away with the Earnings Reserve Account. There would be a single account and then no more than 5% of that could be used in any one year. If the earnings were less than 5%, they could not be used to maintain the value of the single corpus. Statutorily, of that amount, it would be determined how much could be used for dividends. That language could be in the constitution.

Co-Chair Williams noted that HB 298 would be HELD in Committee for further consideration.

#HB236

HOUSE BILL NO. 236

An Act imposing a tax on employment; and providing for an effective date.

REPRESENTATIVE MIKE HAWKER commented that the legislation would impose an education tax on wages and net earnings from self-employment in Alaska. HB 236 provides that the tax collected would be separately accounted for and may be appropriated for education. The tax imposed may not exceed \$100 per calendar year.

- **Section 1:** Provides a short title: Alaska Education Tax Act.
- **Section 2:** Adds the education tax to the list of taxes that are prior, paramount and superior to all other leans upon the real and personal property of the person liable for the tax.

TAPE HFC 04 - 61, Side B

Representative Hawker continued:

- **Section 3:**
- 43.45.011: Imposes a tax, not to exceed a combined total of \$100 a calendar year on wages and net earnings from self-employment in excess of \$600. The tax is imposed at a rate of 0% on the first \$600 of earnings, 10% on the next \$1,000 of earnings and 0% on all other earnings. Section 3 also provides that the tax is imposed only in calendar years following a June 30th fiscal year end when the cash balance in the Constitutional Budget Reserve Fund (CBR) is less than \$1.0 billion dollars. The tax would be suspended in a subsequent calendar year following a June 30th fiscal year end when the cash balance in the CBR was greater than \$2.5 billion dollars.
- 43.45.021: Provides that the education tax is to be collected from wages by employers in accordance with regulations adopted by the Department of Revenue.
- 43.45.026: Provides that the Department may require security deposits from employers who have been delinquent in remitting the education tax.
- 43.45.031: Provides that self-employed individuals remit their education tax in accordance with regulations adopted by the Department of Revenue.
- 43.45.041: Provides for refunds of overpayment of the education tax.
- 43.45.051: Requires that a person required to report a payment to a self-employed individual to the federal government, report the same information to the Department of Revenue.
- 43.45.061: Provides that the tax collected be accounted for separately and may be used for education.
- 43.45.099: Defines critical terms by reference to the Internal Revenue Code (26 U.S.C.)

Representative Hawker highlighted the sectional analysis:

- **Section 4:** Allows the Department of Revenue to develop regulations to implement the Act before the effective date of the Act.
- **Section 5:** Allows Section 4 of the Act to take effect immediately.
- **Section 6:** Allows the other sections of the Act to take effect January 1st, 2005, although the education tax would not actually be imposed until the CBR trigger point was reached.

REPRESENTATIVE PEGGY WILSON commented that Alaska has many resources and that the most precious resource is our children. A head tax for education is important.

In response to Co-Chair Williams, Representative Wilson thought that the caller option would be a good idea, as it would allow the people of the State to keep the Legislature in a position of reporting what is spent in regard to what is paid. It provides the necessary "pressure" for when times are economically difficult statewide.

Co-Chair Williams inquired how the Ways and Means Committee had determined the statewide testimony issues regarding revenue taxes.

Representative Wilson replied that the Ways and Means Committee, which helped in making the determination for the education tax calculation, had heard a lot of statewide testimony. Representative Hawker added that the idea of a school tax was voiced throughout the State during the summer and he was impressed that the school tax had been consistently supported. He added that many Alaskan residents are hesitant to support the Percent of Market Value plan without initiating taxes first.

Co-Chair Williams questioned how much would be generated from receipt of the tax. Representative Wilson anticipated approximately \$43 million dollars collected and the cost to administer the tax will be about \$1.4 million dollars.

Vice Chair Meyer addressed the fiscal note, pointing out that the initial capital cost would be about \$683 thousand dollars and that the Department would need to hire about 10 people to administer the program. He commented that was a "lot of expense" to administer this program. Vice Chair Meyer suggested that an income tax "could get to the same place and generate the same amount". Representative Wilson acknowledged that she would be willing to "switch". Vice Chair Meyer reiterated concerns with the high administrative costs for the program.

Vice Chair Meyer asked about a "double tax" for those that live outside of Alaska who come to work in State. Representative Hawker pointed out that the initial fiscal note had been overviewed on with the Department of Revenue. When the bill is in place, it will cost the State approximately \$1 million dollars a year to administer and collect almost \$46 million dollars a year. It is not intended to be a complete income tax but rather a small component to deal with the fiscal concern. He argued that a \$1 million dollar cost to administer a program that would generate \$46 million dollars would be a fair exchange. He added that placing a surcharge on the out-of-state workers remains an issue.

Vice Chair Meyer commented the idea would be more "sellable" if out-of-state workers could be taxed more. He asked about the \$685 thousand dollar fiscal note.

Vice Chair Meyer asked how the legislation would deal with the person working for multiple employers. Representative Hawker responded that the provisions in the bill address that first and if the person overpays during the course of a year, the State would refund that at the end of the year. There is a provision that an employer "shall" withhold money from an employee, unless the employee can provide written documentation that they had previously paid the tax. If there were sequential employers throughout the year, it would be easy to take their pay stubs in and show that the amount had been paid. The responsibility rests on the employee.

Representative Croft asked where the language was located that indicates the tax will go to education. Representative Hawker replied it is on Page 5, Line 18, the disposition of tax proceeds.

Representative Croft responded that it shall be deposited into the general fund and that the Legislature "may" appropriate for education. He questioned if the amount could be appropriated for anything else. Representative Hawker advised that the State constitution prohibits the absolute dedication of funds. It is a "best interest determination" that the money be set-aside for specific purposes. It becomes a statement of legislative intent that the funds are designated for that purpose, by creating separate accounting of those funds.

Representative Stoltze inquired if Representative Wilson favored the trigger mechanism. Representative Wilson said she did. Representative Stoltze noted his concern with "triggers", commenting that the money should go directly to the education cause.

Co-Chair Williams advised that amendments to the bill would be taken at the next meeting.

Vice Chair Meyer voiced appreciation to the sponsors for bringing the education concept forward.

HB 236 was HELD in Committee for further consideration.
#

ADJOURNMENT

The meeting was adjourned at 2:56 P.M.