

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

May 8, 2003

7:08 a.m.

MEMBERS PRESENT

Representative Mike Hawker, Co-Chair
Representative Jim Whitaker, Co-Chair
Representative Cheryll Heinze
Representative Vic Kohring
Representative Bruce Weyhrauch
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Norman Rokeberg

OTHER LEGISLATORS PRESENT

Representative Dan Ogg
Representative Paul Seaton
Representative Sharon Cissna
Representative Les Gara

COMMITTEE CALENDAR

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."

- HEARD AND HELD

HOUSE BILL NO. 293

"An Act levying and collecting a state sales and use tax; and providing for an effective date."

- HEARD AND HELD

PREVIOUS ACTION

BILL: HB 298

SHORT TITLE: DISTRIBUTIONS OF APPROPS FROM PERM FUND

SPONSOR(S): WAYS & MEANS

Jrn-Date	Jrn-Page		Action
05/05/03	1318	(H)	READ THE FIRST TIME - REFERRALS
05/05/03	1318	(H)	W&M, FIN
05/05/03	1318	(H)	REFERRED TO WAYS & MEANS
05/06/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519
05/06/03		(H)	Heard & Held MINUTE(W&M)
05/08/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519

BILL: HB 293

SHORT TITLE: STATE SALES AND USE TAX

SPONSOR(S): WAYS & MEANS

Jrn-Date	Jrn-Page		Action
04/30/03	1202	(H)	READ THE FIRST TIME - REFERRALS
04/30/03	1202	(H)	W&M, FIN
05/01/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519
05/01/03		(H)	Heard & Held -- Teleconference -- MINUTE(W&M)
05/06/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519
05/06/03		(H)	Heard & Held MINUTE(W&M)
05/07/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519
05/07/03		(H)	Heard & Held -- Recessed to a call of the chair -- MINUTE(W&M)
05/08/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519

WITNESS REGISTER

ROBERT BARTHOLOMEW, Chief Operating Officer
Alaska Permanent Fund Corporation
Department of Revenue
Juneau, Alaska
POSITION STATEMENT: Testified on HB 298.

LARRY PERSILY, Deputy Commissioner
Office of the Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Testified on HB 298 and HB 293.

RON LORENSEN, Attorney
Simpson, Tillinghast, Sorensen, and Longenbaugh
Juneau, Alaska

POSITION STATEMENT: Testified as outside counsel to the Alaska
Permanent Fund Corporation on HB 298.

TAMARA COOK, Director
Legislative Legal and Research Services
Legislative Affairs Agency
Juneau, Alaska

POSITION STATEMENT: Testified on HB 298.

ROBYNN WILSON, Revenue Auditor
Tax Division
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Answered questions on HB 293.

ACTION NARRATIVE

TAPE 03-24, SIDE A

Number 0001

CO-CHAIR JIM WHITAKER called the House Special Committee on Ways and Means meeting to order at 7:08 a.m. Representatives Hawker, Whitaker, Heinze, Kohring, Weyhrauch, Wilson, and Moses were present at the call to order. Representative Gruenberg arrived as the meeting was in progress. Representatives Ogg, Seaton, Cissna, and Gara were also present.

HB 298-DISTRIBUTIONS OF APPROPS FROM PERM FUND

Number 0132

CO-CHAIR WHITAKER announced that the first order of business would be 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."

CO-CHAIR HAWKER moved to adopt committee substitute (CS) for HB 298, Version 23-LS1075\D, as the working document. There being no objection, Version D was before the committee.

Number 0254

ROBERT BARTHOLOMEW, Chief Operating Officer, Alaska Permanent Fund Corporation, Department of Revenue, testified on HB 298. Mr. Bartholomew told the committee in reviewing the original version of HB 298 there were several changes that affected statutes that cover the Alaska Permanent Fund Corporation and the distribution of funds out of the permanent fund. The changes in the CS begin in Section 3, page 3. He explained that there were two concerns that need to be addressed.

Number 0353

CO-CHAIR WHITAKER interrupted Mr. Bartholomew and asked him to give the committee a brief explanation of the purpose of HB 298 before delving into the changes incorporated in the CS.

Number 0404

MR. BARTHOLOMEW explained that the committee has already passed out HJR 26, which is a constitutional amendment that changes how the [Alaska Permanent Fund Corporation] determines how much [money] should be available from the permanent fund and how to accomplish inflation-proofing [the fund]. Mr. Bartholomew pointed out that some of the provisions in the constitutional amendment affect the existing statutes that cover prior methods that were used for the permanent fund. The legislation amends the statutes to ensure that [the statutes] will work in accordance with the payout of market value [POMV] concept. The statutes have been reviewed to see what needed to be updated, he said. He told the members that the sections he will speak to [in the CS] are those that specifically address how money is appropriated out of the permanent fund. He said he is not familiar with [all] the changes that were made in Sections 1 and 2.

REPRESENTATIVE WEYHRAUCH asked if there is a sectional analysis on this bill.

CO-CHAIR WHITAKER replied that there is not.

Number 0558

MR. BARTHOLOMEW explained that in Section 1 there is a language change in which the reference to the "distribution of Alaska permanent fund income" to [the permanent fund dividend].

MR. BARTHOLOMEW went on to say that Section 2 has the same change where the word "income" is removed and the word "appropriations" is added. These changes to both Sections 1 and 2 make the statutes work with the constitutional amendment that has been proposed [in HJR 26]. Mr. Bartholomew pointed out to the committee that the effective date of HB 298 is tied to the successful passage of the constitutional amendment by the public.

CO-CHAIR WHITAKER summarized that Sections 1 and 2 are really housekeeping changes.

Number 0716

LARRY PERSILY, Deputy Commissioner, Office of the Commissioner, Department of Revenue, testified on HB 298. He told the committee that Section 1 really only deals with language related to jury duty lists, and assures that it conforms with the new definition of paying the permanent fund dividend based on the new law. Section 2 deals with the new definition of permanent fund appropriations as it applies to the authority of the Legislative Budget and Audit Committee. He commented that both Sections 1 and 2 are merely technical measures.

CO-CHAIR WHITAKER noted for the record that Representative Gruenberg had joined the committee.

Number 0801

REPRESENTATIVE GRUENBERG pointed out that he does not believe the changes to Sections 1 and 2 need to be conditional on the passage of the constitutional amendment since they are only housekeeping changes.

CO-CHAIR HAWKER asked whether these are housekeeping matters as a result of the passage of HJR 26, or would these changes be necessary anyway.

Number 0844

REPRESENTATIVE GRUENBERG replied that he believes these changes are still appropriate [whether HJR 26 passes or not].

Furthermore, the language is more understandable to the average Alaskan and the jury clerk.

Number 0906

MR. BARTHOLOMEW explained that Section 3 is a new section added to describe how appropriations are made from the permanent fund. He pointed out to the committee that later in the bill the existing provisions are repealed. Section 3 will be the language that the legislature would look at in describing appropriations from the fund. Mr. Bartholomew told the members that as written in the bill, no more than 60 percent of the total amount available under the 5 percent spending limit would go to the general fund and not more than 40 percent of the total amount available for appropriation would go to the dividend fund.

Number 1000

CO-CHAIR WHITAKER commented that this is the meat of bill.

MR. BARTHOLOMEW pointed out that the difference between the original bill and the CS is the [clarifying language] that this legislation is about an individual specific fiscal year and that it is not necessary to spend the entire amount, but that not more than 60 percent [for general fund appropriation] and [not more than 40 percent for dividends] will be spent. He summarized that the appropriations could be anything from zero up to those amounts.

MR. BARTHOLOMEW told the members that Section 4 is a new section being added at the request of the permanent fund's [legal] counsel. This language clarifies what method the permanent fund is going to use in determining that year-end market value. He added that there has been discussion about how it is determined and this language would clarify that the permanent fund will be computed by market value in accordance with generally accepted accounting principles (GAAP) after the costs to manage the fund have been taken out. He reiterated his comments by saying that the year-end market value is determined after the cost of managing the fund is taken out and before any of the distributions covered in Section 3 occur. Clarifying all of this is the purpose of Section 4, he added.

Number 1118

CO-CHAIR HAWKER asked if Section 4 would result in using a mark to market valuation.

Number 1135

MR. BARTHOLOMEW responded that is correct. He explained that the current requirement of using generally accepted accounting principles means that at the end of each month, when financial statements are done, all investments of the permanent fund are recorded at their market value. So the mark to market [value] includes all those investments as the market goes up and down. These changes are tracked, reported, and recorded at their market value on June 30.

Number 1213

REPRESENTATIVE SEATON asked if it would be better to state that all expenses that are incurred by the [permanent] fund are deducted from the fund before the market value is determined. He said he would not want to see this legislation challenged or in a position in which it is necessary to [continually] explain it.

MR. BARTHOLOMEW agreed with Representative Seaton that is a good point. He referred to Section 5 which outlines how this process works and pointed out that the cost to manage the fund and the operating budget for the Alaska Permanent Fund Corporation comes out of revenue that is generated [by investments]. In other words, it comes off the top. He explained that is what is being maintained in Section 5 of HB 298. Mr. Bartholomew told the members that when this law was written many years ago it was done so that if there is no net income, and for example, like last year when the fund incurred a net loss, there would still be funds to pay the expenses of managing the fund. The costs [of running the fund] are coming out of revenue, he said.

MR. BARTHOLOMEW went on to say that Section 4 requires that at the end of a year a determination is made as to the net value in accordance with GAAP, which includes several key concepts such as marking all investments to market and deducting the cost to manage and run the [permanent] fund. That is how the value is determined. Mr. Bartholomew summarized that Sections 4 and 5 read together specifies that the intent is for the cost of managing and investing the fund to come out of revenues, and not out of the 5 percent that is based on value. He agreed with Co-Chair Whitaker that these sections of the bill maintain the status quo.

Number 1525

MR. PERSILY clarified that the money that Mr. Bartholomew is talking about to manage the fund is subject to appropriation as approved by the legislature every year. It is not a matter of the Alaska Permanent Fund Corporation just taking the funds as it wants; it is part of the budget appropriation process.

Number 1546

REPRESENTATIVE GRUENBERG told the committee that he has seen private corporation change the bottom line due to changes in accounting principles. When this happens it can really change the earnings for that particular year. He said he knows that companies always notify stockholders when that happens, and since he is not an accountant he accepts that is the way corporations do business. Representative Gruenberg recalled Mr. Bartholomew's testimony in other meetings where he referred to the way managers of the fund can manipulate earnings which would have a considerable impact on the earnings of the fund and the dividend for that year. He noted that this is the first time he has seen the use of the term GAAP in any state statute, and asked if there is any statute that generally requires the use of the term GAAP.

Number 1731

MR. BARTHOLOMEW responded that for the last 20 years the Alaska Permanent Fund Corporation has been required by statute to follow GAAP with one exception. That exception was to ignore unrealized gains and losses which is called the mark to market, he said. He explained that the permanent fund has not been required to follow GAAP for purposes of determining how much money can be taken out of the permanent fund and how much to pay for dividends, and that is the exception. Mr. Bartholomew said theoretically how much revenue is recorded could be changed by deciding to buy or not sell certain investments. There is also a financial accounting statement in accordance with GAAP with no exceptions. He reiterated that the permanent fund does two separate sets of accounting records, one for GAAP and one that is required by statute with the one exception to GAAP, and then the dividend is calculated. He told the members that this bill actually simplifies and takes away the ability to theoretically delay or accelerate the taking of gains to affect the formulas. Mr. Bartholomew emphasized that this has not happened except for investment or policy reasons that were discussed.

Number 1909

REPRESENTATIVE GRUENBERG turned to AS 37.13.140, which is being repealed in Section 11, page 6, line 15. That statute was the partial implementation of the GAAP for the purposes of determining net income only. Representative Gruenberg said he applauds [the implementation of GAAP]. He asked Mr. Persily if any state statute is in place that requires the use of GAAP.

MR. PERSILY replied that he is not familiar with any, but he said he does know that the performance measures which are in statute for the Department of Revenue makes reference to that [in missions and measures].

Number 2023

CO-CHAIR HAWKER informed the committee that GAAP is a term of art by accounting bodies of the United States. There are international accounting principles in which government entities are subject to Governmental Accounting Standards Board (GASB). He explained that enterprise operations operating as public corporations can adopt either business principles or government principles. In the Alaska permanent fund's case it is viewed as an operation that is much better served by GAAP rather than by GASB. He noted that both of these are interactive standards which support the conclusion that the permanent fund is more properly under the auspices of business accounting principles. He pointed out that in order for state financial statements to be certified it must conform to GASB principles. He summarized his comments by saying that in most cases GASB adopts GAAP, and the Financial Accounting Standards Board (FASB) is the basis for GAAP.

Number 2304

RON LORENSEN, Attorney, Simpson, Tillinghast, Sorensen, and Longenbaugh, testified as outside counsel to the Alaska Permanent Fund Corporation on HB 298. He clarified that the Alaska Permanent Fund Corporation operates under GASB principles, not under business principles. The reference to GAAP is the generic reference to those principles which are applicable to the fund and those principles are actually GASB, rather than FASB. In response to Representative Gruenberg's question that the committee should not even be discussing GAAP, he replied that GAAP actually refers to both GASB and FASB; it depends on which kind of an entity a corporation is. He

reiterated that the lower case [GAAP] generally accepted accounting principles is a generic reference to those accepted accounting principles which are applicable, and emphasized that those which are applicable to the Alaska Permanent Fund Corporation are the GASB principles. Using GAAP in a generic sense is a correct reference, he said.

Number 2453

CO-CHAIR WHITAKER point out that the question is whether unrealized losses and gains are accounted for on June 30.

MR. BARTHOLOMEW replied that is correct. He said that the main change that is being made is that the current language, which directs the Alaska Permanent Fund Corporation to exclude those unrealized gains and losses when a determination of income available for appropriation, will go away and the fund will comply with generally accepted accounting principles that cover accounting for investments that Co-Chair Hawker referred to as mark to market. That is the industry standard and what the fund will be moving to, he said.

CO-CHAIR WHITAKER asked Mr. Bartholomew to put this change in perspective, since this is not just a question of semantics and nomenclature; it is a significant policy change.

Number 2554

MR. BARTHOLOMEW replied that in looking at the permanent fund as June 30 approaches, accounting records are kept according to statute, excluding unrealized gains and losses. The earnings reserve of the permanent fund is in two pieces. There is the realized earnings reserve, which currently has \$1.2 billion and that is where the bond interest, stock dividend, and rental incomes from real estate [are held]. This is a cash flow account and is called the realized earnings reserve [account] based on realized income.

MR. BARTHOLOMEW explained that there is a second earning reserve [account], and according to statute when the fund is determining what is available, it excludes the unrealized gains and losses. Those funds are kept in a separate account because the financial statements require that the funds be recorded. That account is for volatility, it has varied from a positive \$4 to \$5 billion of unrealized gains to over \$1 billion in losses, which occurred twice this year. That account does have a lot of volatility, but it is important because it shows what is going on with the

value of investments, he said. The permanent fund currently accounts for them separately and there is confusion between the statutes saying to ignore them and GAAP saying the fund is required to record them so the value of investments is known. Mr. Bartholomew explained that this bill would say it is important to recognize both; do not separately account for them. There is one fund and the value of that fund includes the cash flow received and the gain or loss in investments. When the Alaska Permanent Fund Corporation determines the value of fund on June 30 for determining what is available, it will be the true value of the fund, including unrealized gains and losses. He emphasized that is an important change.

MR. BARTHOLOMEW, in response to Co-Chair Whitaker, explained that mark to market is accounting nomenclature.

Number 2818

MR. LORENSEN commented that it is important to be clear that the permanent fund presently marks to market the value of the fund under GASB principles. The change is that it will no longer be a determination of income. That varies from GASB principles; by deleting [AS 37.13.140 in Section 11 on page 6, line 15 in the bill] there will no longer be a separate statutory earnings reserve account determination which calls for applying GAAP while taking out the unrealized portion. Income in the future will be determined according to GAAP OR GASB and the market value will be determined according to GASB. There will not be a change in the way market value is determined. This [language] clarifies, for the purposes of a constitutional amendment, that is the way it is to be determined.

Number 2915

REPRESENTATIVE GRUENBERG noted that this is extremely important because it is the basis for the calculation of the dividend. He asked if these changes could be implemented without a constitutional amendment.

MR. BARTHOLOMEW responded that changes in accounting could be done in statute, as it is currently defined. How the determination of what's available from the permanent fund for appropriation is done in statute, he noted. This legislation would amend existing statutes. Both of these are statutory issues, he said. He told the members the change is due to the constitutional amendment which would implement a spending limit based on value.

TAMARA COOK, Director, Legislative Legal and Research Services, Legislative Affairs Agency, responded to Representative Gruenberg's question by saying that she is not nearly as certain that the Alaska Permanent Fund Corporation can statutorily achieve the distribution that is set out in the work draft that is being considered. She said her uncertainty is based on the existing language in the constitution. She read [portions of] Section 15 of the Alaska Constitution which says:

The principle can be used only for income producing investments designated by law as eligible. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

MS. COOK told the committee that is all that is in the existing provision of the constitution with respect to uses that can be made of the permanent fund other than investment. She said she does not see how an unrealized gain can be deposited into the general fund. Consequently, an unrealized gain cannot be the kind of income to which this constitutional provision is referring and thus an unrealized loss cannot be the type of income to which the constitution is referring. The constitution is talking about funds that can be physically deposited in the general fund, and if the legislature were silent, that is what would happen, she commented.

Number 3334

REPRESENTATIVE GRUENBERG commented that it seems to him that this is not a discussion about deposits to the general fund rather it's really about the basis of the calculation of dividend. He asked if that requires a deposit to the general fund.

MS. COOK replied that it does not. However, the reason the existing statute enables the state to have an earnings reserve account is because the sentence [in the constitution] goes on to say, "unless otherwise provided by law this income will be deposited in the general fund." [The legislature] has provided a law that the income will be deposited into the earnings reserve account of the permanent fund. If no law were in place, these funds would go into the general fund. Ms. Cook explained that in order for the court to agree that the word income in this context includes market value analysis, the court must agree that an unrealized gain or loss would automatically flow into the general fund. Ms. Cook noted that she is not an

accountant, but neither are the justices of the supreme court. She explained that the justices tend to look at the language in the same way a common person would. Ms. Cook said that those who have witnessed fluctuations in retirement accounts well know there is no income until the income is realized. She pointed out that unrealized gains are just not there when moving money from one pot to other. Once income is moved into the general fund there is the implication that it is immediately available for expenditure. How can the legislature immediately expend unrealized income in the general fund, she asked. The present constitution, at the very least, creates a question as to whether it would be possible to go to a market value approach in the use of money from the permanent fund.

Number 3602

REPRESENTATIVE GRUENBERG asked if Mr. Lorensen agrees with Ms. Cook.

MR. LORENSEN responded that he does agree with Ms. Cook. He said the issue that Ms. Cook just described is the subject of an attorney general's opinion that is being written. Until the opinion is issued, he said he does not know what the real answer is. However, he told the members his own view is similar to that of Ms. Cook. He said he does not believe a market value based distribution can be implemented under the current form of the constitution.

Number 3648

REPRESENTATIVE GRUENBERG commented that this is important because there may be a requirement to have a constitutional amendment and a conditional effective date. The other way of approaching this issue is with a standard or no effective date, which would mean it would be 90 days after the governor signs the bill. Representative Gruenberg offered that one way to approach this is to provide two effective dates.

MR. LORENSEN remarked that he does not believe [this can be done without amending the constitution.]

Number 3818

MR. BARTHOLOMEW said he believes that HB 298 was written on the premise that HJR 26 would pass and then HB 298 would be effective and if it did not pass, then it would not be effective. He explained that when changing to the market value

approach, instead of an income-based approach for determining what is available from the permanent fund, the 5 percent spending limit that the board of trustees is proposing is a very essential part of the protection. When there is a high stock market, as was the case in 1998 and 1999, the permanent fund could go up by billions of dollars; under market value that amount of money over principle is available. Mr. Bartholomew added that in the past there has been \$5-6 billion available for appropriation. The fund's [managers] believe that the fund cannot be invested in long-term assets, such as stocks and real estate, if there is a risk that large amounts of money could be appropriated. That is the driving force for the need for stability and predictability with regard to what's going to come out of the fund, he said. The 5 percent spending limit is very important when changing what comes out of the fund. Mr. Bartholomew summarized his comments by saying he would be very hesitant to support anything in HB 298 without understanding that this all came from the concept of being partnered with the constitutional amendment [HJR 26]. He emphasized that everything being considered needs to be tied to the successful passage of the constitutional amendment.

Number 4026

CO-CHAIR WHITAKER pointed out that the manner in which the value of the fund is determined, the mark to market, is part of the discussion and is a significant change. This legislation is saying that at a certain point in time this is the value of the fund. This approach is different than the option and policy of not recognizing the swing in the market, or unrealized gains and losses. He asked if this would be considered a big policy shift.

MR. BARTHOLOMEW responded that it is a change, but he hesitated to say it is a big shift because it is really a timing difference. He commented that over time, realized and unrealized [income] will equal, but those timeframes can be very long.

CO-CHAIR WHITAKER asked if he is correct in assuming that by passing HJR 26 and HB 298 the legislature would preclude a [scenario in which there aren't adequate funds to pay a dividend].

Number 4351

MR. BARTHOLOMEW replied that is correct. The intent of HJR 26 and HB 298 would be to ensure an annual distribution each year. Currently there is the risk that the distribution formula could lead to a zero distribution from the permanent fund dividend, he said.

CO-CHAIR WHITAKER stated that this is a significant policy change.

Number 4431

REPRESENTATIVE WEYHRAUCH turned attention to an opinion prepared by Legislative Legal and Research Services that indicated that there were certain IRS implications if the permanent fund were to be structured as a guaranteed dividend and thus the fund could be subject to taxation. He asked if she would comment on this point.

Number 4507

MS. COOK replied that she believes Representative Weyhrauch is referring to the concern expressed by the trustees of the Alaska Permanent Fund Corporation. The tax-exempt status of the permanent fund is determined by it being viewed as a governmental fund that is of a public nature. The test that the IRS uses tends to look at whether it is a private versus a governmental benefit. Currently, the permanent fund has been used to pay dividends to individuals in Alaska, but that is been the result of a decision that the legislature makes when it appropriates money each year. It does satisfy a public purpose. Ms. Cook went on to say the question is whether the legislature has eroded the governmental nature of that fund if a constitutional provision were setup so that a private right is created in the fund. She reiterated that she is not a tax attorney and does not know how intense the danger is regarding whether the IRS would determine that all or a portion of the income of the fund is subject to taxation. Ms. Cook said the heart of the problem is at what point does the legislature change the nature of a public fund so radically that there is a risk that the fund will lose its tax-exempt status because of the private benefit associated with the fund.

TAPE 03-24, SIDE B

MR. BARTHOLOMEW agreed that's the issue.

Number 4527

REPRESENTATIVE WEYHRAUCH asked for a copy of Ms. Cook's opinion on this matter. He said he would like to meet with her and the administration to review the analysis of Section 3(2) to see if it "invades" the IRS concern.

Number 4432

REPRESENTATIVE HEINZE asked if some visual tools could be developed to help legislators explain this [concept] to the public.

CO-CHAIR WHITAKER assured Representative Heinze that information would be made available.

Number 4302

MR. BARTHOLOMEW turned attention to Section 6 of the CS. The Permanent Fund Corporation handles investments for several other funds, including the Alaska Mental Health Trust Fund (AMHTF) and the Alaska Science and Technology Fund (ASTF). This section brings in sync how the permanent fund would do the accounting for the investments of the Alaska Mental Health Trust Fund. Mr. Bartholomew explained that there needs to be a discussion with the managers and board of AMHTF in order to ensure they understand the proposal made in Section 6. That discussion has not yet taken place, he said.

MR. BARTHOLOMEW explained that Section 7 covers the Alaska Science and Technology Fund which has been the subject of a lot of discussion in the legislature this year. Section 7 would change the statutes such that ASTF would be accounted for in a way that is similar to the permanent fund. Section 8 addresses the Alaska International Trade and Business Fund.

CO-CHAIR WHITAKER noted that these funds are of concern because the permanent fund manages these three funds.

Number 4041

MR. PERSILY commented that Section 9 is a technical [change related to the change] in Sections 1 and 2. Section 9 deals with paying the dividend each year so instead of defining income of the permanent fund, it is defining money appropriated from the permanent fund. The same change is found in Section 10 where there is technical change from "income" to "amount."

These changes conform the sections with the new method and language.

Number 3955

CO-CHAIR WHITAKER inquired as to the reason for repealing Section 11.

MR. BARTHOLOMEW responded that in Section 11 AS 37.13.140 and .145 are being repealed because they are replaced by Sections 3 and 4 in the existing bill. The third statutory noted, AS 37.13.300(c), is a technical amendment complying with the [Alaska Mental Health Trust]. He said Section 12 covers the conditional effect.

Number 3847

CO-CHAIR WHITAKER said that the CS proposes that 60 percent of the amount of money available be appropriated to and for purposes of government.

REPRESENTATIVE WILSON recalled that according to the graphs shown to the members, it was determined that this would be the best way to approach this issue in the long run and keep the fund as stable as possible. She told the members she does not have the graphs in front of her, and asked if someone would summarize the three options that were highlighted.

Number 3705

CO-CHAIR WHITAKER provided the members with a copy of the graphs. He explained that by looking at the graphs from a purely governmental fiscal perspective the preferential option is [60 percent for governmental purposes and 40 percent for dividends]. The 50-50 [percent option] has less stability. The 40-60 [percent] option with 40 percent for governmental purposes and 60 percent for dividend distribution leads the state on a short course to continued deficient spending with no constitutional budget reserve. This is a policy and economic call, he stated.

Number 3500

REPRESENTATIVE GARA inquired as to Ms. Cook's legal opinion regarding the use of a severability clause in the constitution that would be triggered if a tax consequence were to come about. For instance, if the dividend is constitutionally protected and

that causes a tax implication then the severability clause could ensure the state avoids the problem that way.

MS. COOK explained that severability clauses work in statute. However, this kind of clause would not be a severability provision, rather it would be an alternative constitutional provision that would take effect only if certain conditions are met. Ms. Cook said she does not see why there could not be any number of alternative provisions that are triggered, given that each one in itself would be an amendment to the constitution.

Number 3300

REPRESENTATIVE GARA posed a hypothetical situation in which an amendment to the constitution on the dividend were put in place and caused a tax implication. If amending the constitution in this way meant this would be a problem for the IRS, would a provision in the constitution allowing for a three-quarters vote of the legislature, as is provided in other sections of the constitution, solve the IRS' concern.

MS. COOK responded that it might. She said she does not know how the IRS would respond; they are a mysterious force. There may be enough legislative discretion because the legislature can only appropriate money for a public purpose. Ms. Cook pointed out that the Alaska Supreme Court has already acknowledged that the permanent fund dividend appears to serve a public purpose. Maybe the IRS would agree, she commented.

Number 3116

REPRESENTATIVE GARA told the members that he does not understand why the public purpose versus private purpose issue raises questions [with the IRS]. He asked if that issue is discussed in her [opinion].

MS. COOK said she has not discussed that issue because she does not understand it and thus she strongly urged the legislature to obtain an independent view from a tax attorney. She noted that there have been states that have set up funds that the IRS determined created enough of a private benefit to have taxed them. She summarized her comments by saying there is the theoretical potential to be a problem.

Number 2958

REPRESENTATIVE OGG commented that the [Constitutional Budget Reserve Fund] CBRF End-of-Year Balance chart reflects that the two proposals on one end or the other buys the state about 3 years. He asked if it is possible to have more flexibility in Section 3 so that the legislature could decide in any given climate which option of 60 percent to select; either 60 percent to the general fund [or 60 percent to the dividend]. He asked if that flexibility is desirable.

CO-CHAIR WHITAKER commented that Representative Ogg raises a good point. He asked if the legislature has the consensus to do that and determine the dividend on a yearly basis.

REPRESENTATIVE OGG reiterated his question as to the advisability of putting that kind of flexibility in the bill.

REPRESENTATIVE WILSON commented that this premise would raise a big fight every year. It would also extend the time spent on this issue.

Number 2654

CO-CHAIR WHITAKER agreed with Representative Wilson. This bill will allow the legislature to go to the voters and define the split, rather than saying every year the legislature will decide. There may be a "trust me" factor [connected to that flexibility].

REPRESENTATIVE OGG offered that inserting language up to 60 percent allows the legislature [to look at the fiscal climate] and decide what percent to appropriate for dividends and the general fund.

CO-CHAIR WHITAKER said Representative Ogg's suggestion sounds like he would like to run government like a business. In a business environment one could look at the fiscal situation, say it's a difficult time, and since the books can't be balanced, not give a dividend. That would be purely a business decision, he commented.

REPRESENTATIVE WILSON said if the public realizes what that [change] would do, she said she believes they would want more of a guarantee that [a dividend] would be there rather than have that option [come and go] from year to year.

Number 2349

CO-CHAIR WHITAKER asked the members to give some thought to this subject. He said he hopes to move the bill from committee at the next meeting.

[HB 298 was held over.]

Number 2321

The House Special Committee on Ways and Means meeting was recessed at 8:15 a.m. to a call of chair.

TAPE 03-25, SIDE A

Number 0040

The meeting reconvened 5:05 p.m. Members present were Representatives Hawker, Whitaker, Rokeberg, Weyhrauch, Wilson, Gruenberg, and Moses. Representatives Heinze and Kohring arrived as the meeting was in progress. Representatives Ogg and Seaton were also present.

HB 293-STATE SALES AND USE TAX

CO-CHAIR WHITAKER announced that the next order of business would be HOUSE BILL NO. 293, "An Act levying and collecting a state sales and use tax; and providing for an effective date."

MR. PERSILY explained that originally HB 293 was a state sales and use tax. The version before the committee now includes an increase of \$.12 per gallon in highway motor fuel tax that had been proposed by the governor at the beginning of the session. There are no changes in aviation gas, jet fuel, marine fuel, or off-road motor fuel, he added.

Number 0223

CO-CHAIR HAWKER moved to adopt CS for HB 293, Version CSHB 293 bil.doc, dated 5/8/03, as the working document. There being no objection, Version CSHB 293 bil.doc, dated 5/8/03, was before the committee.

Number 0225

MR. PERSILY explained that Section 1 of the bill is the enforcement provision for motor vehicles that might be purchased out of state. What this says is if an individual wishes to register his/her vehicle in Alaska, it will be necessary to show proof that the sales and use tax has been paid. Section 2

rewrites a significant portion of Title 29, it is rewritten to eliminate the municipal authority to enforce, collect, and administer sales and use taxes, he said. Under this version the Department of Revenue would be responsible for administration, enforcement, and collection of the sales and use tax. The exemptions would be set by the legislature in statute and would be applied to the rate rules municipalities want collected. The [tax] rate for municipalities would still be up to them, but the exemptions, rules, and enforcement would be handled by the state.

MR. PERSILY went on to say Section 7 deals with the motor fuel tax increase which would go from 8 cents a gallon to 20 cents a gallon. He reiterated that this increase would not include aviation gas, jet fuel, marine fuel, or off-road motor fuel.

Number 0409

REPRESENTATIVE WEYHRAUCH asked about Sections, 3, 4, 5, and 6.

MR. PERSILY responded that those sections are the rewrites of Title 29. He explained that this legislation sets a combined cap of state and municipal sales tax of 8 percent. Section 3 covers a phase-in [sales tax]. This legislation specifies that when the tax goes into effect on January 1, 2004, whatever [tax] the municipality has in place at that time will remain in place. Therefore, if there is not sufficient room between the 8 percent cap and what the municipalities have [on the books], the state would collect less [in state sales taxes]. For example, if a city gets a 6 percent tax as of January 1, 2004, the state would collect 8 percent in that community, the city would receive its full 6 percent, and the state would receive 2 percent. Mr. Persily noted that this bill has a seasonal sales tax feature to it because there is a 2 percent sales tax from October 1 through March 31 and 4 percent sales tax from April 1 to September 30. He explained that he is providing an overview of the bill rather than going section by section.

Number 0617

MR. PERSILY turned attention to Section 9, page 9, line 21, where it spells out the state's portion of the tax under the seasonal tax. Section 3, page 4, describes how the sales tax is shared with municipalities.

REPRESENTATIVE WEYHRAUCH commented that this would mean if an individual purchased a car in the summer he/she would pay more tax than if it was purchased in the winter.

MR. PERSILY responded that would depend on where the individual lives. For example, Petersburg has a 6 percent tax and because there is an 8 percent cap, those residents would pay 8 percent. However, if the buyer lives in Anchorage, there would be a 2 percent tax in the fall [and winter] and 4 percent tax in the spring and summer because Anchorage [don not already have a municipal sales tax].

REPRESENTATIVE WILSON asked if a Petersburg resident could buy a vehicle in Anchorage, pay the sales tax there because it is lower. She asked if the sales tax would only be charged where the vehicle was purchased, provided the purchase took place in state.

Number 0745

ROBYNN WILSON, Revenue Auditor, Tax Division, Department of Revenue, answered questions on HB 293. In response to Representative Wilson's question, she replied that it would depend on whether that municipality had a use tax. She pointed out that many localities do not have a use tax. For example, if a car was purchased in Anchorage and taken to another city if that city had a use tax, there would be some rate adjustments. If the city where the purchaser lived did not have a use tax, then he/she would just pay the tax where it was purchased.

Number 0809

REPRESENTATIVE WILSON concluded then that if she purchases a car in state, and returns home with it, she would not have to pay a tax where she lives.

MS. WILSON replied that if the town where she lives does not have a use tax, that would be correct. If the town does have a use tax then there may be an additional fee. In further response to Representative Wilson, Ms. Wilson clarified that she would not pay the state tax again, but there may be a municipal portion that may be adjusted if the city [in which she lives] has a use tax.

Number 0933

MR. PERSILY provided the following example. If an individual buys a vehicle in a community that has a 2 percent tax and brings it back to his/her community where there is a 5 percent use tax. In this case, the individual would owe the community the 3 percent difference.

CO-CHAIR WHITAKER pointed out that is no different than [the current policy]. He explained his comment by saying that if she were to purchase a vehicle in Anchorage today and return to her community with the vehicle, she would have to pay her community's use tax.

REPRESENTATIVE WILSON responded that she did not do that [when she purchased a vehicle].

MR. PERSILY pointed out that without the connection to the vehicle registration, enforcement is very difficult. Therefore, this legislation includes a provision that specifies that in order to register a vehicle there must be proof of sales tax payment. The aforementioned would ensure that individuals do not buy cars in the Lower 48 in order to avoid sales tax.

Number 1036

MR. PERSILY told the committee that in Section 3 the department was directed by the co-chairs to craft a way to phase-in a point at which the state gets its full 2 percent and 4 percent, and the communities get their 2 percent and 4 percent. This would allow time for communities to adjust their sales tax to stay within the 8 percent cap. On January 1, 2004, any municipal sales tax that is in effect will be collected by the full amount by the state. On January 1, 2008, the maximum municipal sales tax would be 6 percent. In response to Representative Gruenberg, Mr. Persily specified that the aforementioned language is in Section 3 on page 4, line 22.

Number 1141

CO-CHAIR WHITAKER announced that Mr. Persily will be working through the bill section by section, but if he comes to a point in the bill where it is necessary to look at another section to fully understand it, then he will move to that section. The committee is looking at Section 3, page 4, lines 21-26, he said.

CO-CHAIR WHITAKER noted for the record that Representative Seaton had joined the committee.

Number 1220

MR. PERSILY told the members that municipalities with a sales tax will continue to receive the full amount of the municipal tax for four years, through January 1, 2008. After January 1, 2008, state statute would specify that the maximum municipal sales and use tax would be 6 percent. Therefore, a community with a 7 percent sales tax would see a decrease in tax revenues by 1 percent. On Jan 10, 2010, the maximum municipal sales tax rate would go to 5 percent during the summer, because during the winter the state is only taking 2 percent so there is still 6 percent available for municipalities. However, during the summer of 2010 the maximum municipal rate would go to 5 percent. During the summer of 2012 the maximum municipal sales tax would be 4 percent, and the tax could still be 6 percent the rest of the year. The intent of this [phased-in approach] is to give municipalities time to adjust to a state-mandated lower rate and also allow municipalities to see how the state exemptions and state administered sales tax [impact revenues]. Mr. Persily noted that if this bill were to pass, many communities may find they could collect the same revenue with a lower tax rate.

Number 1348

CO-CHAIR WHITAKER asked Mr. Persily to comment on what affect the period between January 1, 2004, and January 1, 2008, would have on municipalities.

MR. PERSILY responded that during that time period the state would collect whatever sales tax rate is on the books and the cities would receive the full collections off of that rate. He agreed with Co-Chair Whitaker's statement that there is a 4-year adjustment period and then a four-year set-down period.

Number 1431

REPRESENTATIVE SEATON asked for clarification that the percentage goes up to 4 percent in the summer because the state anticipates that there will be higher revenues then. However, he interpreted that to mean that when there are higher revenues, the municipalities will collect less taxes.

MR. PERSILY clarified that what the state is saying in this legislation is that a seasonal feature is important to pass more of the burden on to nonresident visitors. Those cities that have sales taxes at 5-7 percent will have to reduce their rate to stay within the 8 percent cap for the eventual 4 percent

state collection. Mr. Persily noted that because of fewer state exemptions these cities may not see a loss of revenue. It would be necessary, once the state code is adopted, to compare it with the municipal code item by item in order to see how it would affect local collections.

Number 1542

REPRESENTATIVE SEATON surmised that legislators will not know what affect this required seasonal reduction in sales tax will have on municipalities until the entire process is complete.

MR. PERSILY responded that each of the municipalities' finance officers could look at the bill, compare it to its existing code, and probably reach a good estimate with regard to how this bill would affect municipal collection.

Number 1621

REPRESENTATIVE OGG said in the summer Kodiak has a lot of people buying groceries for the fishing season. Kodiak's current sales tax is 6 percent, [with this bill it] would be up to 8 percent. Therefore, he surmised that the tendency would be for people to purchase supplies in Anchorage where the sales tax would only be 4 percent. He asked if Mr. Persily believes that kind of impact will be felt [by communities such as Kodiak].

MR. PERSILY acknowledged that imposing a higher sales tax on communities that already have one, means there is a risk of affecting the local economy. He stated that he could not speculate on the impact, although it is something the committee will want to consider. Mr. Persily commented that human nature being what it is there will be some people who will go out of their way to save a little money. Adding to the sales tax is going to increase the cost of purchasing goods. He said he could not provide any estimates between communities, but common sense says that it would affect some spending decisions.

Number 1815

REPRESENTATIVE OGG commented that most of the testimony heard on this bill has come from areas outside the metropolitan areas of Fairbanks or Anchorage and many of these communities already have high sales taxes. He said it would be good to know what impact this bill will have on small communities. He questioned whether this will cause commerce to flow out of smaller communities to [larger urban] areas.

MR. PERSILY replied that the department does not have the ability to create a model to predict the impact of a higher sales tax and the effect it will have on shopping habits. Although there may be economists somewhere in the country that could do that, he said he does not know of anyone who could do a credible model.

Number 1930

REPRESENTATIVE OGG said he believes there is a delicate balance and if it is altered, then things start to shift. He said he wants to know what that potential shift will be before moving into it.

CO-CHAIR WHITAKER reiterated that if the legislature does not do something, the consequences are dire. He added that it will be necessary to make adjustments to the bill in this body as well as the other body. This bill allows for a time period of adjustment.

CO-CHAIR WHITAKER noted for the record that Representatives Heinze and Kohring had joined the meeting.

Number 2108

REPRESENTATIVE SEATON asked Mr. Persily if he understands this correctly. In communities that have, for example, a 6 percent sales taxes in place, the tax would be capped at 8 percent. The same 8 percent will be charged, but based on whether it is winter or summer will determine what [percentage] goes to the city and what [percentage] goes to the state.

MR. PERSILY responded that is correct.

Number 2149

REPRESENTATIVE WILSON offered a hypothetical example in which the sales tax is 6 percent in Kodiak. In such a situation, what would the City of Kodiak collect in 2004, she asked.

MR. PERSILY replied that on January 1, 2004, the state would collect a total of 8 percent with 6 percent going to Kodiak and 2 percent to the state. Under this bill, in Kodiak's case there would be a 5 percent limit January 1, 2010. During the summer months the state would continue to collect 8 percent of which 5 percent would go to Kodiak and 3 percent to the state. In the

winter months, the state would continue to collect 8 percent of which 2 percent would go to the state and 6 percent to Kodiak. On January 1, 2012, the final year of the phase-in, when the municipal limit is 4 percent in the summer months, the state would collect 8 percent, keep 4 percent, and give Kodiak 4 percent. In the winter the state would give Kodiak 6 percent and keep 2 percent.

Number 2319

REPRESENTATIVE WILSON asked if she understands this correctly. In Kodiak's case the state will collect 8 percent, and give back 6 percent until the year 2010 at which time the state will continue to collect 8 percent, but only return 5 percent to Kodiak.

MR. PERSILY responded that Kodiak will get 5 percent in the summer months, and 6 percent in the winter months when the state's rate drops. Mr. Persily turned to Section 5, page 5, which covers the same phase-in language for cities. It has the same effect, one for boroughs, and one for cities.

Number 2417

REPRESENTATIVE GRUENBERG asked about unified municipalities.

MR. PERSILY responded that he is not sure whether unified municipalities fall under boroughs or cities.

Number 2440

REPRESENTATIVE SEATON related that the community of Homer has a 3.5 percent [sales tax] while the borough has a 2 percent [sales tax], and therefore the total sales tax is 5.5 percent. Which entity loses money, he asked.

MR. PERSILY responded that since both the borough and city fall under the [8 percent cap], the state would lose out on collections while the city and borough would receive the full amount.

Number 2559

MR. PERSILY pointed out that Sections 6-8 deal with motor fuel tax change.

REPRESENTATIVE GRUENBERG noted that Sections 6 and 7 refer to 20 cents per gallon and Section 8 refers to 18 cents per gallon. He asked why there is a difference in [the motor fuel] tax.

MS. WILSON replied that Section 8 addresses the fuel used on highways. Currently, an individual would pay [a tax of] 8 cents a gallon on fuel. If the fuel is used off-road, that individual would be entitled to a 6-cent refund, which means 2 cents would be paid. This bill does not change taxation of net fuel used off-road, so an individual would pay 20 cents for that gallon of fuel and then be refunded 18 cents. This section is a refund provision which maintains the status quo under which 2 cents per gallon is paid for off-road use.

Number 2746

REPRESENTATIVE GRUENBERG commented that there is an increase of 12 cents per gallon.

MS. WILSON replied that is correct. The fuel used on the highway is increased by 12 cents per gallon. To keep status quo on the off-road highway use, the refund is increased which keeps the fuel tax at 2 cents per gallon.

REPRESENTATIVE WEYHRAUCH commented that many people pull their boats or RVs to the gas station, and fill-up both tanks at same time. He said he is pretty sure that most people do not apply for a refund even though these are off-road vehicles.

Number 2853

MS. WILSON told the members that a boat is considered "marine use" and is in a separate section, so it is not consider off-road for state purposes. She agreed that it is true that refunds are available for off-road vehicles by submitting a form and receipt for purchase of the fuel to the state.

Number 2905

REPRESENTATIVE OGG asked if this section delineates that the state will be the collector of sales tax.

MR. PERSILY, in response to Representative Ogg, said that the state would administer, collect, enforce, audit, and send the checks to the communities where the state has collected on behalf of that community.

Number 2940

REPRESENTATIVE OGG suggested that there may be [some economic advantage] by using tax collection systems that cities already have in place and suggested some flexibility be written into the legislation. Cities may be better at tax collection due to the fact that they know the people and the system is already in place. He reiterated that he believes it would be beneficial to allow the state to use the existing municipal tax structure to collect the sales tax.

MR. PERSILY pointed out that this bill would bring Alaska into compliance with the Streamlined Sales Tax Project, which is a nationwide effort. This compliance would allow the state to obtain sales tax from the Internet purchases, mail orders, and catalog sales if Congress changes the law. This will be worth a lot in future. One of the requirements of [compliance] is that the state be the administrator of the sales tax. The idea is that businesses would send one check to the state rather than to many different local jurisdictions. Although this would not stop the state from working on contract or some other agreement with local municipalities to assist in enforcement work, in order to comply with the Streamlined Sales Tax Project the state must be the central administration point.

Number 3143

REPRESENTATIVE OGG replied that is exactly his point; if the state is the central administration point why not give the state the option of allowing a city to be agent. The city as the agent would not mean that sovereignty of collecting the tax would pass to the municipality, but it could allow for tax collection locally. If this would save money and collect more taxes, he said he believes it would be a viable option.

MS. WILSON explained that this is an effort to maintain simplicity for businesses, particularly for businesses that have commerce in multiple locations. The goal is for that business to write one check. For instance, a company could contact the state and ask for the sales tax rate for a particular zip code. This would enable businesses to rely on the state to advise them when there is a change in the rate. Ms. Wilson said that to the extent that arrangement is not threatened, a contract arrangement would not be a problem. The overall goal is to keep it simple for businesses and not to have, for example, 10 audit teams coming in to audit a business for 10 different localities. Only the state would do the audit; however, there would be

nothing to prevent the state from contracting with a city to perform an audit.

Number 3410

REPRESENTATIVE GRUENBERG referred to Section 7, page 7, and asked why the legislature would increase the tax on motor vehicle fuel when there is no increase on aviation gas, watercraft fuel, and aviation jet fuel.

MR. PERSILY responded that was a decision made by the administration. He pointed out that in Alaska's case the motor fuel tax rate is the lowest in the nation and has not increased in over 30 years. Mr. Persily commented that those facts entered greatly into the decision.

Number 3450

REPRESENTATIVE GRUENBERG asked how aviation gas, watercraft fuel, and aviation jet fuel rates compare with the rates in other states.

MR. PERSILY commented that he could get that information. He said the collections on aviation gas, watercraft fuel, and aviation jet fuel is not very significant. If this is an effort to look for more revenues to pay for public services, there is a lot more gas that goes into cars, pickup trucks, and SUVs. Currently, there are exemptions written into state statutes for the cargo business out of Anchorage airport, he added.

Number 3545

REPRESENTATIVE GRUENBERG questioned [why] this exemption [for cargo] is in state statute and is letting huge planes go through Alaska and not raising taxes at all.

MR. PERSILY responded that the decision [to provide these exemptions] was made by the legislature some years ago as an incentive to help build the international cargo business in Alaska.

Number 3621

REPRESENTATIVE ROKEBERG commented that it is a very complex issue, and not merely an incentive [to the international cargo business].

CO-CHAIR WHITAKER pointed out that this is not such a complex issue that an answer to Representative Gruenberg's question cannot be obtained. He told Representative Gruenberg that an answer to his question would be provided.

Number 3652

MR. PERSILY explained that in Section 9, page 9, Chapter 44, is the sales and use tax language and most of the language deals with the mechanics of collecting and administering the tax. Page 9, line 21, covers the state portion of the tax, 2 percent in the winter and 4 percent in the summer, and explains that the amount is decreased based on what the city or borough tax may be. Mr. Persily pointed to one provision on page 10, line 22, which requires that the sales and use tax must be stated separately on the sales so the purchaser knows the amount of the tax and the amount of the goods. On page 11, line 3; he explained that "Nexus" means to the full extent under federal law and the U.S. Constitution. Therefore, if an entity has a nexus or any connection with the State of Alaska, a sales and use tax can be collected.

Number 3829

REPRESENTATIVE GRUENBERG offered a technical amendment, on page 11, line 5, insert the word "a" before the words "nexus with the State of Alaska". There being no objection, the technical amendment was adopted.

REPRESENTATIVE WILSON asked for an example of someone with a nexus with the State of Alaska.

MS. WILSON posed an example in which a catalog company buys products. If the aforementioned company has no presence or connection in the state of Alaska, [the consumer] would be responsible for the use tax. If, however, that catalog company had an office or some a physical presence in the state, then that catalog company would have to collect the tax.

Number 3927

REPRESENTATIVE GRUENBERG pointed out that the language on page 10, lines 27-28, AS 43.44.040(c), impinges on free speech in a commercial context and the ability to contract. He asked why the state has such an overriding interest in imposing such a prohibition.

MS. WILSON replied that she is not an attorney; however, she related that most states have this provision. The goal of the provision is to ensure that all businesses are on a level playing field, so that there is not one retailer advertising that it will absorb the tax.

REPRESENTATIVE GRUENBERG asked if anyone has checked to see if this provision [is allowable under the constitution].

Number 4028

CO-CHAIR WHITAKER replied that he would guess that it has not been checked. He told Representative Gruenberg that he is making notes of questions that need to be answered and a written opinion will be obtained from Legislative Legal and Research Services.

Number 4044

MR. PERSILY referred to page 11, line 7, which deals with exempt sales. This legislation includes a requirement for certificates. If, for example, an individual is purchasing something that is exempt from sales tax, an exemption certificate would be presented to the business so the business has some assurance that it is a nontaxable item. The department shall provide these exemption certificates.

REPRESENTATIVE HEINZE commented that she feels very frustrated that she did not have time to read the bill. The review of the bill is going so fast, she said, that she does not fully understand what the committee is doing.

Number 4214

MR. PERSILY referred to page 12, line 6, which deals with exemptions. Line 6 explains that any sales to or by government agencies, whether federal, state, or municipal, would be exempt from sales tax. Subsection (b) on page [12] makes it clear that utilities are not exempt from the sales and use tax, he said.

MS. WILSON pointed out that page 12, lines 11-12, clarifies that that although government entities are exempt, that exemption does not include utilities that might be provided by a city or governmental entity.

Number 4411

MR. PERSILY further clarified that if there is a municipally operated utility that sells services to residents or businesses, those services are subject to a sales tax as opposed to the government, for example, selling land, which would be exempt. In response to Representative Wilson, Mr. Persily pointed out that the City of Wrangell provides utilities and charges a sales tax on those utilities. That practice would continue under this legislation, he said. Mr. Persily explained that although subsection (a) on page 12, line 6, specifies that government sales are exempt from sales tax, that exemption does not apply to utility services provided by government.

Number 4506

MR. PERSILY addressed page 12, line 13, regarding sales to or by 501(c)(3) corporations. That language specifies that sales to or by the IRS are exempt from the tax. Mr. Persily clarified that this is about charitable organizations. Although there are other IRS tax-exempt organizations, a 501(c)(3) is the IRS' designation for charitable organizations.

Number 4604

REPRESENTATIVE GRUENBERG directed attention to page 12, line 9, where it refers to federally recognized tribes and asked if that would include all Native organizations.

MS. WILSON responded that there is a list of federally recognized tribes.

MR. PERSILY added that the federally recognized list does not include regional Native corporations.

TAPE 03-25, SIDE B

Number 4648

REPRESENTATIVE WEYHRAUCH agreed that the federally recognized tribe list does not include regional corporations.

Number 4631

MR. PERSILY reviewed exemptions from the sales tax starting on page 12, line 17, which provides that purchases made under the food stamp program or WIC program are exempt; line 23 provides that wages, salaries, and commissions are exempt; line 27 provides that insurance premiums are exempt; line 31 provides

that dividends and interest are exempt; and page 13, line 5 provides that garage sales or isolated or occasional sales, and fundraising by nonprofit groups that may not be a 501(c)(3) are also exempt.

Number 4500

REPRESENTATIVE SEATON asked why proceeds from the sales of stocks, bonds, or securities are exempt.

MR. PERSILY said there would be very tough administrative problems with [taxing stocks, bonds, or securities]. For example, would the sales tax be on gross proceeds of the sale or just on the profit. Furthermore, if an individual lost money on the sale, would the state want to send back some sales tax on the amount the individual lost.

Number 4417

MS. WILSON replied that traditionally sales tax has been applied to tangible personal property. This legislation is a broader bill and direction was given to exempt those items.

REPRESENTATIVE GRUENBERG commented that he can see why the state might not want to tax a citizen who sold stock. He asked if that would also apply to the purchase of the stock.

MR. PERSILY restated Representative Gruenberg's question by using the example of an individual who buys stock from Merrill Lynch. Does Merrill Lynch charge that individual sales tax on the purchase of the stock, he asked.

MS. WILSON replied that the bill taxes sales of tangible personal property and services; stock is intangible so it falls outside the prevue of this bill.

Number 4255

REPRESENTATIVE GRUENBERG asked if he is correct in saying that a copy write or a patent purchase is not taxable.

MS. WILSON responded that is correct.

Number 4228

MR. PERSILY explained that normally a sales and use tax deals with tangible personal property; those items Representative

Gruenberg mentioned are intangible. He added that he is not aware of a constitutional prohibition against a sales and use tax on an intangible item, but it would put Alaska at the leading edge in finding things on which to assess a sales tax.

REPRESENTATIVE SEATON asked if fishing permits would be nontaxable.

MS. WILSON replied that is correct; it is an intangible asset.

MR. PERSILY referred to page 13, line 13, which deals with household effects brought into Alaska and noted that these items would not be taxed.

Number 4136

REPRESENTATIVE MOSES inquired as to whether the tax would apply to construction camps where there are bunkhouses and mess halls.

MS. WILSON responded that real property is not being taxed. However, there is no exemption provided for meals, services, and lodging. If these meals and services are being sold there is no exemption, and therefore, they would be taxable.

MR. PERSILY posed an example in which an individual contracted with a company to provide meal services to his/her work crew at a construction or fish site. The amount of money under that contract would be subject to taxation under this legislation.

REPRESENTATIVE MOSES commented that [in many cases] it is in lieu of wages.

MR. PERSILY replied that an argument could be made that a portion of all purchases goes to wages of someone who provided the service or someone who built the product. This is much like a sales tax that would have to be paid to an accountant to do a tax return, or to a mechanic who fixes your car, or to a company that provides meal services at the work site; they are services and would be taxed.

Number 3940

MS. WILSON commented that in this situation, the business is in effect the consumer of the service. Although the benefit is passed on to the employees, the business is the consumer of the meal service.

REPRESENTATIVE MOSES stated that he needs more clarity on this. On the North Slope [these companies] should be taxed. [There are employees] eating in mess halls or being provided lodging and not being charged. He stated he believes it is essential [that it be subject to sales and use tax].

MR. PERSILY posed an example in which an individual is operating a business on the North Slope and contracts with someone to provide meal service to the company's workers. That individual would have to pay sales tax on that service that was purchased. If the business is providing meals and lodging to the workers at no charge, as Representative Moses mentioned, there is no taxable transaction there. There is no tax charged to those workers because they did not purchase services or goods.

Number 3800

REPRESENTATIVE OGG asked about the exemption for occasional sales. He asked about the language that refers to "other than a vehicle" and asked how that applies to a rowboat or sailboat. Would such items be taxed, he asked.

MS. WILSON agreed that there needs to be some clarification in reference to the term "vehicle." The intent of this section is to not tax garage sales, for example; however, if an individual sells a car every five years that should be taxable. Ms. Wilson reiterated that the language could use some clarification either through statute or regulation.

Number 3643

CO-CHAIR WHITAKER agreed with Ms. Wilson that there is need for clarification; however, he said he would be concerned if that clarification were to be done through regulations because this is quite a substantial issue.

Number 3635

MR. PERSILY referred to page 13, line 18, where there is a cap on motor vehicles, watercrafts, aircrafts, and mobile homes, regardless of the purchase price of those items. A sales tax would be charged up to the first \$5,000 of the price. For example, if there were an 8 percent sales tax and an individual bought a \$30,000 car, sales tax would only be charged on the first \$5,000.

REPRESENTATIVE WILSON asked if the sales tax would be collected when [the buyer] changes the registration.

MR. PERSILY said that is correct.

[HB 293 was held over.]

ADJOURNMENT

Number 2321

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 6:00 p.m.