

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS**

February 27, 2004  
7:00 a.m.

**MEMBERS PRESENT**

Representative Mike Hawker, Chair  
Representative Bruce Weyhrauch, Vice Chair  
Representative Vic Kohring  
Representative Dan Ogg  
Representative Norman Rokeberg  
Representative Ralph Samuels  
Representative Peggy Wilson  
Representative Max Gruenberg  
Representative Carl Moses

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

HOUSE BILL NO. 470  
"An Act relating to the taxation of income."

- HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 470

SHORT TITLE: INCOME TAX ON INDIVIDUALS & FIDUCIARIES

SPONSOR(S): REPRESENTATIVE(S) MOSES

02/16/04	(H)	READ THE FIRST TIME - REFERRALS
02/16/04	(H)	W&M, FIN
02/27/04	(H)	W&M AT 7:00 AM HOUSE FINANCE 519

**WITNESS REGISTER**

TIM BENINTENDI, Staff  
to Representative Carl Moses  
Alaska State Legislature  
Juneau, Alaska

POSITION STATEMENT: Presented HB 470 on behalf of  
Representative Moses, sponsor of the bill.

DAN DICKINSON, Director  
Tax Division  
Department of Revenue (DOR)  
Anchorage, Alaska

POSITION STATEMENT: Explained aspects of HB 470 and answered questions.

MIKE WILLIAMS, Revenue Auditor  
Tax Division  
Department of Revenue  
Anchorage, Alaska

POSITION STATEMENT: Testified during the discussion of HB 470.

### **ACTION NARRATIVE**

#### **TAPE 04-9, SIDE A**

Number 0001

**CHAIR MIKE HAWKER** called the House Special Committee on Ways and Means meeting to order at 7:00 a.m. Representatives Hawker, Samuels, Kohring, Weyhrauch, Wilson, Moses, and Ogg were present at the call to order. Representatives Rokeberg and Gruenberg arrived as the meeting was in progress.

#### HB 470-INCOME TAX ON INDIVIDUALS & FIDUCIARIES

Number 0056

CHAIR HAWKER announced that the first order of business would be HOUSE BILL NO. 470, "An Act relating to the taxation of income."

CHAIR HAWKER spoke about the history of the bill since 1989, and stated that the purpose of the meeting was to look at specific ideas and investigate implications, complexities, and fiscal consequences of personal income taxes. He said Representative Moses, sponsor of HB 470, brings the bill forward at an appropriate time. He reviewed the three goals of the [House Special Committee on Ways and Means]: finding ways to manage the cost of government, making government more efficient, and raising revenues, with the ultimate goal of matching revenues and expenses.

Number 0640

TIM BENINTENDI, Staff to Representative Carl Moses, Alaska State Legislature, sponsor of HB 470, began by highlighting historical features of income tax history in Alaska, as follows:

Net income tax was established, actually, in 1949 as part of a major tax policy overhaul during territorial days. It was levied on residents, non-residents, fiduciaries, and corporations operating in Alaska. The tax rate was simply 10 percent of a taxpayer's federal tax liability and that applied to all income levels. Tax administration and collection were simple, and employers withheld 10 percent of what was being withheld, already, for an individual's federal withholding. The personal income tax successfully withstood a constitutional challenge in 1950. The court considered the tax reasonable since it was structured according to one's ability to pay. Between 1949 and 1961 the tax rate gradually went from 10 percent to 16 percent.

MR. BENINTENDI continued to say:

In 1975, Alaska modified its tax structure by introducing graduated tax rates on various levels of income, bringing in that progressivity, I guess. And, the range, at that time, was from 3 percent to 14.5 percent. It also expanded the section of tax law dealing with non-resident taxable income. In FY77, the Alaska personal income tax raised its highest amount ever, which was \$210 million. Personal income tax was repealed in 1980, the same year that the legislature appropriated \$186 million to refund everyone's 1979 and 1980 income tax payments.

Number 0853

MR. BENINTENDI referred to a 1989 research piece [ALASKA'S PERSONAL INCOME TAX HISTORY] in the committee members' packets and explained that Table 2 shows all the state tax revenue, total personal income, and the percent of total personal income the tax in the years 1959 through 1980.

MR. BENINTENDI, in answer to the question about why an income tax is needed, said about half the population supports it. He continued to say:

Forty-three states elsewhere in the country have some variation on a personal income tax. Many Alaskans have paid income taxes in other states where they've lived prior to coming here. This bill derives tax from income sources within Alaska only. General support throughout our state is fairly consistent. We've spared you loading up your packet with support letters and a lot of cheerleading but, nonetheless, we have tried to approach a number of non-profits, individuals, and municipal entities who have supported this tax in the past, and they're currently either working on resolutions or getting support letters ginned-up. It's been a pretty short threshold since we heard we'd have the meeting, so that's in process. But, it's fair to say, there's some pretty legitimate support out there for income tax restoration.

Number 1025

MR. BENINTENDI continued to say:

In 1995 there was a bipartisan, long-range financial planning commission appointed, and they exhaustively went through a review of revenue measures for the State of Alaska. In that exercise they recommended the restoration of an income tax by the year 2002. More recently here, in the last couple of weeks, AARP has divulged poll results where they conclude that half of the citizens in Alaska over 18 support an income tax. This measure, our bill in particular, would shift part of the tax burden to non-resident workers and bring in about \$30 million a year from that group. And that is an estimate.

MR. BENINTENDI said there is sentiment in the state that out-of-state workers don't contribute to services. Under this bill those workers would not be able to take advantage of the property tax credit. He remarked that about one third of [income tax] revenue would come from out-of-state workers.

Number 1202

CHAIR HAWKER welcomed Representative Rokeberg to the meeting. He asked Mr. Benintendi if [HB 470] was crafted with the active involvement of professional tax counsel.

MR. BENINTENDI replied [it was drawn up] by bill drafters with input from legal counsel.

CHAIR HAWKER said, at this point, [the committee] is looking at the macro structure of the bill, but that the finer points would have to be dealt with later on. He pointed out that the legislature has established Alaska as a preeminent location for trusts, due to its tax policies. He wondered if that idea had been specifically considered in the bill.

Number 1342

MR. BENINTENDI responded that the sponsor has always felt fiduciaries, estates, and trust income should be "hooked in." He said several years ago, then-Representative Al Vezey put Alaska on the map in terms of being an attractive state for developing state planning, estates, and trusts, because it had no income tax. He said it was an issue that needed consideration. "Right now, our bill does propose to tax those entities," he said.

REPRESENTATIVE SAMUELS asked for clarification about one third of the money from state income tax coming from out-of-state workers.

MR. BENINTENDI replied it is fair to say about one third of the money would come from that source.

CHAIR HAWKER made a point of clarification by adding, "That is, from this bill as it is structured, which has a significant credit for persons owning real estate and paying personal property taxes in this state."

Number 1521

DICK DICKINSON, Director, Tax Division, Department of Revenue (DOR), responded to Mr. Benintendi's statement by saying if the total revenue from just the income tax portion is \$344 million, and out-of-state workers represent 10 percent of the payroll, after all the credits the total comes to about \$30 million. He asked Mike Williams to comment.

Number 1600

MIKE WILLIAMS, Revenue Auditor, Tax Division, Department of Revenue, Anchorage, Alaska, said Department of Labor (DOL), in their non-resident report, suggests that about \$900 million in

wages from Alaskan sources goes to non-residents, so \$30 million might be a little high, but in the ballpark.

CHAIR HAWKER asked if a mathematical average of non-residents earning \$900 million in wages turns out to be about \$15,000 per worker.

MR. WILLIAMS said he believes that is correct.

Number 1651

REPRESENTATIVE WEYHRAUCH agreed with Mr. Benintendi and the sponsor that there has been a lot of interest in this bill. It seems like a psychological hurdle has been overcome to begin to discuss an income tax as a fiscal tool, he said. At the Southeast Conference last summer, he said he discussed an income tax with a zero percent rate. He asked if one of the major philosophic purposes of the bill is to capture the income from out-of-state workers who take their incomes south without investment in the state.

MR. BENINTENDI replied that it is one of the sponsor's main objectives.

REPRESENTATIVE WEYHRAUCH asked if an out-of-state worker who invests in in-state property would be taxed.

MR. BENINTENDI explained that a number of out-of-state people own property, and the issue of the tax credit had constitutional problems in the early days. The first thought was to have the property tax credit applied just to Alaskan residents, and that was found to be unconstitutional. Eventually, the tax credit was for any [property] taxes paid in a municipality.

MR. DICKINSON added that under the definition from DOL, the person would have to have been a resident for two years and eligible for a [permanent fund dividend].

Number 2000

REPRESENTATIVE OGG asked if using the term "federal tax liability" is 10 percent of one's federal taxable income, or if it is 10 percent of the federal tax paid.

MR. BENINTENDI pointed out that in HB 470 the tax liability figure is used, which is simple and follows the federal tax structure.

REPRESENTATIVE OGG asked if it is the same as the original state income tax.

MR. BENINTENDI said it is a function of the federal tax liability.

Number 2140

CHAIR HAWKER asked about the DOR handout on the three typical bases for qualifying for state taxes.

MR. DICKINSON stated that there is a difference between tax liability and tax paid and he asked Mr. Williams to explain the difference.

CHAIR HAWKER pointed out that the members had a 2003 form 1040, and Schedules A & B in their packets.

Number 2232

MR. WILLIAMS referred to his memo of February 26, 2004, which contains a table on personal income tax rate comparison. It shows how much revenue Alaska might get under adjusted gross income (AGI), under federal taxable income, and under net federal tax liability. He explained that AGI is the equivalent of line 34 of the 2003 form 1040. Federal taxable income is the same as line 40; the gross income, plus the personal exemptions, and either the standard or itemized deduction. Itemized deductions are typically mortgage interest, property taxes, and charitable contributions. The net federal tax liability is line 54, after federal credits.

MR. WILLIAMS continued to explain that at 1 percent of AGI the state would generate about \$138 million. The equivalent rate applied using federal tax income would be 1.38 percent, and 7.0 percent using the net federal tax liability. He said he did not go past 10 percent [on the chart] because there comes a point when the rate can't calculate more than \$1 billion in tax, and, practically, this state couldn't sustain more than \$1 billion in tax, anyway. He emphasized that personal income tax alone would not fill the [fiscal] gap.

CHAIR HAWKER noted that Mr. Williams' point about income tax alone not filling the gap was written into the document [memo of February 26, 2004]. He asked about the range of the tax rates

which were based on net federal tax liability in the previous state income tax, abolished in 1981.

MR. WILLIAMS answered that the rates at the time of repeal were based on federal taxable income and ranged in from 3 percent to 14.5 percent, a graduated rate, with about a dozen income brackets. If that structure were still in place, it would generate about \$750 million, he said.

MR. WILLIAMS continued to explain [net] federal tax liability, noting that, currently, there is no other state that uses percent of federal tax liability as a tax base. There were three states until recently: North Dakota, Vermont, and Rhode Island. He said he believes the reason is that federal tax liability concedes a lot of policy and decision-making about the tax to members of Congress, and too much revenue was being lost due to changes in the IRS code. He said a study in the District of Columbia, where tax burdens at various income levels were analyzed, shows an effective rate of between 3-4 percent.

Number 2843

CHAIR HAWKER noted that in the members' packets is a chart that compares state individual income tax rates.

REPRESENTATIVE OGG asked if the old state tax is based on federal taxable income, and the proposed state tax is based on the net federal tax liability.

MR. WILLIAMS said that is correct.

REPRESENTATIVE ROKEBERG asked if line 40 is federal taxable income, in Mr. Williams' model.

MR. WILLIAMS said it is.

REPRESENTATIVE ROKEBERG asked about the net federal tax liability.

MR. WILLIAMS said the rates generated for net federal tax liability are based on current IRS tax data, using line 54 from the current federal return form.

Number 3000

REPRESENTATIVE ROKEBERG said, "Just so everybody understands, we've got three different potential federal tax bases for

benchmarks to work from." He said it is necessary to be very clear about which number is being talked about. He asked if the document of HB 470 scenarios [Department of Revenue Comparative Analysis HB 470] in the bill packet is based on AGI.

MR. WILLIAMS answered that the scenarios are strictly based on HB 470 structures which start with AGI and look at what an Alaskan's tax liability would be.

REPRESENTATIVE ROKEBERG asked if line 54 is being used for the deductions.

MR. WILLIAMS said that is correct. He explained [reading from the chart], "There's a point where you get to just above the Alaska Income Tax line. It says tax before credits or tax after credits, under the Federal Return Values." He said he is not clear if HB 470 was intended to be before or after credits, so he figured it out both ways.

REPRESENTATIVE ROKEBERG asked Mr. Williams if he is referring to calculations on line 40 and line 54.

MR. WILLIAMS apologized for not having a form 1040 in front of him, but said it is not line 40.

CHAIR HAWKER said it is line 43.

MR. WILLIAMS said, line 43, the federal income tax before credits. He said there are many [ways to calculate it].

REPRESENTATIVE ROKEBERG said that it is important to understand the base data.

Number 3421

REPRESENTATIVE WILSON asked if Alaska income tax before federal credits is line 43, and after credits is line 54.

MR. WILLIAMS said that is correct.

REPRESENTATIVE SAMUELS asked Mr. Benintendi if, before the property tax exemption, about \$340 million would be raised and that amount reduced to \$100 million.

MR. BENINTENDI said yes.

CHAIR HAWKER asked Mr. Benintendi to explain the tax calculations in HB 470.

Number 3549

MR. BENINTENDI explained the bill beginning with page 1, line 13. There would be three phase-in years to ease [the income tax] back into the system, he said. The \$20,000 figure, the federal tax liability, is the benchmark, and there is a scale of income earners of less than, and more than, \$20,000. He read from page 2, [lines 3-17], to explain the percentage of tax per year, based on income level.

CHAIR HAWKER asked if, for the rate differential throughout the phase-in, the bill maintains a 5 percent spread between those folks with federal income tax liability of less than \$20,000 and those with more than \$20,000. He noted that these were not marginal rates, but a complete shift of change of rate going back to dollar one of a person's income. If a person has less than \$20,000, their rate of tax would be 5 percent, but if they earn a penny more of income - \$20,000.01 - their rate of tax would be 10 percent, or \$2,000. So that penny of income has cost them \$1,000, he added.

MR. WILLIAMS said that is correct, as written now.

CHAIR HAWKER asked if that is the intent [of the bill].

MR. WILLIAMS indicated that it isn't and replied that the bill certainly could be worked on.

CHAIR HAWKER said that his point is that [the bill] has not been looked at in detail by tax attorneys yet, so there are unintended consequences of the structure, as it exists.

REPRESENTATIVE WILSON suggested the bill be graduated.

MR. DICKINSON explained that on federal taxes on the first \$20,000 a person could pay 5 percent, and then on the next dollar he or she would pay 10 percent. "But, when you earn that additional dollar, you don't immediately incur an additional \$1,000 in taxes. It becomes a marginal rate, not an average rate. You pay 10 percent on what is earned over \$20,000," he explained.

CHAIR HAWKER pointed out that the rates are dependant on the federal tax liability factor which is subject to change for

every single change of federal tax code. "We would be more subject to federal influence on this than if we went and taxed a basis for taxation, a revenue basis." He asked if the bill includes taxing permanent fund dividends.

MR. BENINTENDI replied, "Under this bill, dividends would be taxed."

REPRESENTATIVE OGG said it seems that the middle segment of tax payers, because they own property, have no net tax liability, so that the bill seems to be aimed at the very high and very low end of taxpayers. He asked if that is the intent of the bill.

MR. BENINTENDI responded that he couldn't break it down so distinctly, so he does not have an opinion.

Number 4230

REPRESENTATIVE OGG said it seems like the middle is being left out.

MR. BENINTENDI said that is good information because the intent of the sponsor is to soften the impact of the tax on working families and homeowners. He said there is room for adjustment because that is not the intent [of the bill].

REPRESENTATIVE ROKEBERG asked Mr. Dickinson what policy guidelines he needs in order for his department to create new models for the committee to work with.

MR. DICKINSON said one of his department's missions is to provide new models.

CHAIR HAWKER requested a new model that contains familiar input parameters and output formats.

MR. DICKINSON mentioned that he plans to put the information on the web, also.

Number 4634

REPRESENTATIVE WILSON she said the model assumes that the family has two children still at home.

**TAPE 04-9, SIDE B**

Number 4628

REPRESENTATIVE WILSON continued to say there are many families whose children are no longer in the home. She said she would like to see more of a break for those working families with children still at home.

CHAIR HAWKER noted that the sections of the bill are modifications to the existing Title 43. He asked Mr. Dickinson to explain Title 43 and how HB 470 fits into it.

MR. DICKINSON deferred to Mr. Williams for the answer.

MR. WILLIAMS asked if Representative Hawker is asking how the bill meshed in with the current income tax Act.

CHAIR HAWKER asked, "What is the Alaska Net Income Tax Act, currently?"

MR. WILLIAMS explained that Title 43, Chapter 20, the Alaska Net Income Tax Act, is the vehicle used for taxing corporations. The proposed bill would mesh the taxation of individuals in with the current statutes.

CHAIR HAWKER asked if it would be better to keep the two entities separate.

MR. WILLIAMS suggested, from an administrator's perspective, a separate chapter be created for individuals rather than marrying it with the corporate income tax.

REPRESENTATIVE WEYHRAUCH asked why line 13, on page 1, didn't say "for 2005" to make it simpler.

MR. DICKINSON replied that, typically, what is said is "for a taxable year beginning...."

Number 4113

REPRESENTATIVE WEYHRAUCH asked the sponsor why the 1980 version of the income tax was not introduced instead.

MR. BENINTENDI answered that he is not sure.

REPRESENTATIVE WEYHRAUCH asked if there was any consideration to having a "kick-out" if the Constitutional Budget Reserve (CBR) exceeded \$2 billion, or if revenues to the state through percent of market value (POMV), or huge gas or oil developments, managed to close the gap between expenses and revenues.

MR. BENINTENDI replied, "No, we consider this bill a work-in-progress or, certainly, a vehicle to be amended, and we did not get into that area at all. It's certainly possible."

Number 4038

REPRESENTATIVE MOSES said his main objective [for sponsoring the bill] is to try to get the non-residents to contribute for services provided. He said he hopes to reinstate [the income tax] to the way it originally was. The bill undoubtedly needs technical amendments, he added.

CHAIR HAWKER said in future sessions the details would be fleshed out.

REPRESENTATIVE WILSON stated that because Alaska has no state income tax, a lot of businesses are set up to pay the least amount of taxes. She suggested the bill consider this issue.

CHAIR HAWKER agreed with Representative Wilson.

MR. BENINTENDI pointed out the issue of whether or not to hook subchapter S corporations (S-corps), limited liability companies (LLCs), and sole proprietorships into this bill.

CHAIR HAWKER asked Mr. Benintendi to address on whom the bill assesses taxes.

MR. BENINTENDI replied, "It would be individual wage earners, estates, and trusts. As it is written, S-corps are not impacted."

CHAIR HAWKER asked Mr. Dickinson to discuss how personal income tax affects S-corps.

MR. DICKINSON explained that entities that are not real people can be taxed on two levels, as an entity or as a "pass-through." Pass-through means that the income earned is passed through to its owners. He said the problem with corporations is that they are taxed at both levels; double taxation of corporate profits. The IRS code, in order to fix the problem of double taxation which is allowed for subchapter C corporations (C-corps), set up a new category for smaller corporations called subchapter S corporations (S-corps). Whatever profits they earn get distributed back to the owners.

Number 3426

MR. DICKINSON gave examples of limited liabilities which are taxed at the entity level, and explained that the owners would pay themselves in wages, issue themselves a W2, and call themselves a wage earner. He said the bill should be clear whom it targets.

CHAIR HAWKER made the point that if [the legislature] passes an individual state income tax bill, then there would be a way to collect taxes on those earnings that are currently transferable and avoidable in the current corporate taxation structure.

MR. DICKINSON said that is correct, because now, if you can move the corporate income to an individual level, it is tax-free. He made the point that LLCs have the option of being treated at the entity level or at a pass-through level. Whatever election they choose on their federal return would be done at the state level. Every state does it differently, he said.

REPRESENTATIVE WILSON said the "fair thing" should be done. She asked what that might be.

MR. DICKINSON said, if you look at 50 states, you would find 50 ways of dealing with corporate taxes. He said there is no best solution, but experts say, "You should have the fewest distinctions, the broadest rates, and the most inclusive [policy]."

Number 3050

REPRESENTATIVE ROKEBERG, speaking from personal experience as a small business owner and participant in several LLCs, answered Representative Wilson's question. He said now LLCs are more typical than S-corps, which he termed antique. He pointed out that the important element in LLCs is that businesses get the corporate tax treatment under federal law of personal, single taxation, not federal taxation. Avoiding double taxation is fair, especially for small business entities, he added, and he suggested adopting the same philosophy reflected in the federal tax code as the appropriate way to go. He pointed out that net income is taxed in a C-corp. He said it might be worth examining the issue of large entities using the LLC model as an avoidance to paying taxes. That might be done by putting a floor on income. He said small businesses are the biggest job generator in the state, "the driver behind our economy in a lot

of ways." He repeated the idea that [Alaska] should follow the federal model.

Number 2800

CHAIR HAWKER said the same dialogue was looked at last year during the discussion of consumption-based taxes, in order to avoid double taxation.

REPRESENTATIVE WILSON asked if Representative Rokeberg is saying that because LLCs are taxed at the federal level, they should not be taxed again at the state level.

REPRESENTATIVE ROKEBERG defined double taxation as when the dividends or net profits of a business are taxed twice, once when issued as a dividend or a draw, and again on a personal income statement.

CHAIR HAWKER said that Representative Rokeberg is setting up the analysis of the bill in order to avoid double taxation.

MR. DICKINSON added that it would be double taxation by the federal government and then double taxation by the state. It does not mean once by the federal government, and then, once by the state. He said that, typically, a major corporation will pay federal tax and corporate income tax in all 50 states.

REPRESENTATIVE SAMUELS asked if boat owners are S-corps, and who would be targeted for the tax.

REPRESENTATIVE MOSES replied that the boat owner is paid for by the processing plant, given a 1099 for the fish delivered, and, in turn, pays his crew a share and gives them a 1099, which should credit back to his 1099. There is a trail that can be followed.

REPRESENTATIVE SAMUELS said he was wondering about the boat captain versus the boat owner. He offered a scenario whereby the boat owner leases his boat to a holding company based in Seattle and adjusts it so that the boat captain never makes a nickel. The lease payment goes to Seattle, [and no tax is collected]. He wanted to know the percentage of out-of-state workers in the various industries. He predicted it is mostly fishers, not oil workers.

Number 2227

CHAIR HAWKER said DOL had a recent analysis which would be made available to the committee and which would answer that question.

MR. DICKINSON recalled that the fishing industry is either the highest or the second highest [out-of-state business].

REPRESENTATIVE WEYHRAUCH said fishing is the second highest employer in the state and, so, is probably one of the highest out-of-state employers.

MR. WILLIAMS responded to Representative Samuel's question about boat owners by saying it is possible that when a boat owner leases to an Alaskan resident the form of business could be structured such that no corporate or income tax is paid. For example, if a Seattle boat owner sets up a LLC, S-corps, or a partnership in which it leases a boat to an Alaskan captain, because [Alaska] does not have a personal income tax or a corporate income tax on pass-through entities, it is possible for the Seattle boat owner to receive [profits] income tax free, from an Alaskan standpoint.

CHAIR HAWKER asked if there would be a tax consequence in the domicile of the corporation.

MR. WILLIAMS replied there would be.

REPRESENTATIVE SAMUELS followed up to say, "If I was going to [avoid taxes], I would find a state with no corporate income tax, set up a holding company based there, lease the boat back to myself, as an individual, and make sure that the payment was such that I never made a dime, no matter how much crab I caught. The money would flow to the state with no income tax, and I would get away with all the money."

MR. WILLIAMS pointed out that that is why Nevada Corporations are so popular.

Number 2000

REPRESENTATIVE GRUENBERG inquired if the Alaska tax law could be structured to tax cases, [such as Representative Samuels mentioned], so Nevada Corporations could not be used.

MR. DICKINSON replied that Alaska could certainly attempt to do so. He said there are ways to close some of the options mentioned by Mr. Williams. Defining small corporations would be part of the issue.

CHAIR HAWKER asked Mr. Benintendi to explain Section 10 of the bill.

REPRESENTATIVE OGG referred to Section 8, subsection (b), line 4, the words "and the credit may not exceed the actual tax paid to the other state or territory." He said this idea was omitted in subsection (c) and clarity may be needed.

MR. BENINTENDI said it is a point well taken, but he suspected it was because the bill is only impacting income sources within Alaska. He said he is open to making changes.

CHAIR HAWKER said the bill is a conceptual piece, at the moment, and had not undergone the scrutiny of tax counsel. He said there are many unclear issues. "For example, are there carryovers for unused credits?", he wondered.

REPRESENTATIVE OGG he said it looks like there is a potential open door there.

MR. BENINTENDI spoke about Section 10 of HB 493. He said the sponsor went with the lead of the bill drafters and attorneys on this section. He said it is up to the will of the committee to make changes.

CHAIR HAWKER suggested that tax counsel take a look at this section to make it consistent with current IRS reporting requirements. He pointed out that there is a provision for making a reporting that says "within 30 days after termination of employment" which is inconsistent with federal employment reporting. He asked Mr. Benintendi if he envisions making the withholding process familiar to folks, consistent with the idea of federal withholding reporting to the state on an annual basis, and the employer reporting to both the employee and the regulatory agency.

Number 1446

MR. BENINTENDI said yes, the model in the bill should be as familiar to the taxpayer as possible.

CHAIR HAWKER indicated that the bill will not move out of committee today.

REPRESENTATIVE ROKEBERG asked if the intention is to work on a committee substitute in the next few days.

CHAIR HAWKER answered that, at the moment, the plan is to look at HB 493, corporate tax issues, and oil price projections next Wednesday. The committee is planning to revisit HB 470 next Friday.

REPRESENTATIVE ROKEBERG suggested that a new committee substitute be circulated as soon as possible.

CHAIR HAWKER said the Department of Revenue would work with the sponsor to flesh out the bill. He wondered if a subcommittee should be formed.

REPRESENTATIVE WEYHRAUCH said he is planning to get the bill out to people in the tax industry and to see if the entities that Representative Samuels mentioned could be addressed.

CHAIR HAWKER said he'd like to get a more mature version of the bill and, using the professional community, take care of the more obvious issues.

REPRESENTATIVE ROKEBERG said the bill needs a lot of work and a lot of elements will be added to it.

REPRESENTATIVE OGG said he has heard interest in having a minimum amount paid under this bill, as well as a cap.

REPRESENTATIVE ROKEBERG suggested that a variety of revenue legislation should come before the committee to generate feedback about what policies need to be made.

CHAIR HAWKER said there are several [revenue] bills in committee such as the head tax concept, this bill, and corporate tax structures. He emphasized that there is "no one silver bullet", and additional revenues must be found. He said that even with the proposed B version budget, which includes major reductions in state spending, it would only be a year or so before other inflating aspects appear. "One revenue source just isn't an appropriate, wise, prudent, or, even, feasible solution," he added.

Number 0622

REPRESENTATIVE GRUENBERG requested that the committee consider looking at other vehicles such as [HB 236], HB 493, as well as HB 470, and any others.

CHAIR HAWKER pointed out that House Special Committee on Ways and Means, since it is a special committee, is precluded from introducing any more bills at this date.

REPRESENTATIVE GRUENBERG suggested that the committee might want to ask the Rules Committee to introduce new bills if they are needed.

REPRESENTATIVE WILSON mentioned that HB 321 does have a cap at both ends. She asked if bills could be merged.

REPRESENTATIVE ROKEBERG replied that there are a number of techniques that could be used. He said there are ways to introduce new bills if necessary, and there are a number of bills that had been introduced that the committee could work with or modified. He mentioned HB 298.

CHAIR HAWKER agreed that HB 298 is a linkage bill that would do a lot of the structural "heavy lifting" in building a fiscal policy.

REPRESENTATIVE KOHRING asked if the committee was at closing comments.

CHAIR HAWKER responded that the committee would continue until 9:00 a.m.

Number 0338

REPRESENTATIVE KOHRING said a major consideration of the income tax is its effect on the economy. He stated a concern that the income tax is a drain on the economy. He cautioned the committee not to focus solely on raising revenue for the state treasury. He said his primary goal is to help grow the state's economy, create jobs, and further industry, and he opined that an income tax would be a drag on that process. He suggested the best thing to do in the long run is to keep taxes to an absolute minimum to allow private individuals and small businesses to retain as much of their own money as possible so that most of it gets reinvested into the economy, which, in turn, expands the economy. "We, as a state, are going to benefit much more greatly from that than if we were to extract a large amount of that money out of the economy through taxes of this nature," he surmised.

Number 0159

REPRESENTATIVE SAMUELS said he agrees with Representative Kohring, and added:

We need to look at the economic impact of taxes, but we also need to look at the economic impact of the CBR going down to zero and what that would do to the bond rating. We need to look at the situation if the market drops and there are no earnings in the Permanent Fund, and the price of oil drops and there is no money. What do you do when you are forced to go in there and cut \$1.2 billion? We also need to look at the economic impact of that side of it, too. They are all bad choices, but the option of doing nothing is not very pleasant, either.

CHAIR HAWKER remarked that is why he chooses the term, "dilemma," for this situation.

REPRESENTATIVE GRUENBERG said in 1985 there were problems at least as difficult as the ones today. Each period of time has its own problems and it is up to the leadership to recognize the challenge and to find the solutions, he said.

**TAPE 04-10, SIDE A**

Number 0035

REPRESENTATIVE WEYHRAUCH said he was staff in 1982 in Senate Finance. Even then, there was a macro on everyone's computer that said, "in these times of declining state revenues." [Declining revenue] is always used to justify somebody's position. He said that Representative Kohring has a legitimate point, and he didn't want "the first words out of our mouths to be taxes", particularly when we are trying to attract private investment in the state. He said he goes back to the letter [from the Conference of Alaskans] requesting the legislature to look at options. He said he feels that [this bill] is a legitimate option to look at. He suggested that the sponsor address the question, "How is this bill going to affect me?" and have [DOR] produce a model to show various situations.

Number 0213

REPRESENTATIVE WILSON suggested an economist speak to the committee about the various [fiscal plan] scenarios in order of impact. She opined that an income tax is lower on the matrix than cutting government jobs and other things.

CHAIR HAWKER noted that DOR has included a preliminary discussion of economic consequences and the alternatives in their analysis that has been provided to the committee.

REPRESENTATIVE OGG related a story about Lou Williams, Jr., whose father was working at the time the state introduced the first income tax in 1948-9. The year before the income tax began, the state budget was around \$2 million over what they were taking in as revenues. He said the problem was that the state had the money, but it was tied up in accounts. The legislature was wrestling with a growing government after World War II and discussing how to make it work by using income taxes. He said the legislature, today, is doing the same and is in a similar situation; the state has accounts and it has money, but the access is restricted. He said the comparison is very similar, and [the issue] still has to be dealt with.

Number 0619

REPRESENTATIVE ROKEBERG concurred with Representative Wilson's request to ask an economist to speak to the committee about revenue issues and their impact on the economy. He suggested Dr. Goldsmith, recalling his presentation two years ago.

CHAIR HAWKER added that Dr. Goldsmith spoke to the committee last year, as well.

REPRESENTATIVE ROKEBERG said he appreciates Representative Kohring's admonition to be aware of the impacts [of taxation], and said he cannot agree with him more; however, he said he thinks it is important that the committee recognize the impacts of doing nothing. A "soft landing" economic model has been talked about for years, but he said [the economy] is so bad that people don't even use that term any more. He said, "We are heading for a cliff. There is not going to be a soft landing." He opined that this has been a foreseeable incident. "[The legislature] would not be performing their constitutional duty if they did not take up these issues and try to educate the public about where we are financially," he said. He emphasized that many do not understand that Alaska is three years away from a huge crisis. He compared today's times with 1986 when then-Governor Sheffield had to take draconian measures. He pointed out that even with huge cuts, the problem would remain if additional revenues are not generated. "It's time for a reexamination of our entire fiscal situation," he concluded.

Number 0942

CHAIR HAWKER stated that the committee was formed with clear objectives: managing costs, increasing efficiencies, and balancing revenues and expenditures. A year ago the highest priority was economic development, he said, adding:

We are a resources-development state, a state that wants to be pro-business. In this committee we've taken on the nuts and bolts of balancing our state budget, and our first priority was fiscal discipline. The first action of the committee was to hear, debate, and move forward, the constitutional spending limit bill. The second issue was the role the permanent fund earnings would take in future state fiscal planning, and the POMV was considered as a tool. Third, were issues of structuring the general revenue system.

CHAIR HAWKER continued:

Today, we're having a debate on income taxation. This isn't the first thing we leaped to. This is not something we made as our first priority. It is something, as our overall debate has continued ... We're coming to recognize there is no silver bullet to solve the state's fiscal situation. Budget cuts aren't going to get us there alone, use of the permanent fund earnings is not going to get us there alone, and any single change to the general revenue system is not going to get us there alone. We've got to look for a matrix of solutions.

CHAIR HAWKER said the committee is on the fifth point of a four-point plan; addressing future oil price volatility with some mechanism that provides [the state] with the security that the constitutional budget reserve is not depleted. He emphasized that the committee's process has been a thoughtful process. The fact that the committee is discussing an income tax does not mean that the committee endorses a particular bill, nor does it condemn a particular bill. The committee is conducting a debate to bring the facts and circumstances of the state before the people and before the members of the legislature so that the committee has the information to make the necessary intelligent decisions. He thanked the members of the committee for contributing to an extremely productive, important, and powerful dialogue that shows the people, despite the conference of mayors' no-confidence vote, that this committee is moving in the

right direction. "We are, in fact, making progress on these issues," he concluded.

Number 1348

CHAIR HAWKER said public testimony would be taken at a future date.

REPRESENTATIVE GRUENBERG indicated that the committee has not taken up a large number of bills, but has taken up a lot of weighty subjects. He suggested having more meetings for public testimony in order to move through the process.

CHAIR HAWKER replied that the committee should be prepared for an increased schedule as the issues mature.

REPRESENTATIVE ROKEBERG referred to the models [from DOR] in the bill packet and asked why the \$1.5 million, in the non-resident portion of the Year 2 projections, is different from the number discussed earlier.

Number 1720

MR. WILLIAMS responded that the models he uses capture all ways that [non-residents] are reported in Alaska, and there have been some difficulties in interpreting how you determine a non-resident. He said that DOL uses the strictest standards, meaning those who receive a Permanent Fund Dividend (PFD). He said he takes the difference between wages reported by Alaskan employers versus wages reported on income taxes filed from an Alaskan address and attributes that difference to non-residents. That creates a smaller non-resident number than what DOL suggests, he added.

REPRESENTATIVE ROKEBERG said the earlier number was \$30 million and now it is down to \$1.5 million.

Number 1835

MR. DICKINSON replied that [the calculation] starts with the total number of Alaskans who file a return. The difference that Mr. Williams is characterizing are dollars that showed up as being received by an Alaskan address, but not paid by an Alaskan employer. He said it is the reverse situation of people who are employed in Alaska for three months and then go back to their home states and file. He asked Mr. Williams if that is relevant.

MR. WILLIAMS said it is relevant.

REPRESENTATIVE ROKEBERG said, "Except, we're looking at a huge difference, here."

MR. WILLIAMS replied that part of the problem is that the data he has is aggregate. He said he doesn't know specifically, on a stratified basis, how much the non-residents earned, which causes difficulties in projection.

REPRESENTATIVE ROKEBERG said there seems to be a problem because the earlier testimony suggested \$30 million to \$34 million, which has been consistent over the years. But the model shows only \$1.5 million.

MR. WILLIAMS replied that part of the problem is that the tax base HB 470 uses is a percent of federal tax liability. A non-resident might only earn a portion of his or her income in Alaska, and the federal tax liability has to be apportioned even further. It has a diminishing effect on the non-resident revenue potential.

REPRESENTATIVE ROKEBERG suggested that the DOL model backwards to get \$30 million.

MR. DICKINSON stated that the starting number he uses is from DOL, which is roughly 10 percent of the total, "or \$900-something million, total." He said this model is using a much different definition of non-resident.

REPRESENTATIVE ROKEBERG said the model needs clarification. He asked where the numbers for the tax credit in the form of homeownership, personal property, and real property, come from.

Number 2255

MR. WILLIAMS replied that the credit for homeownership came from the Department of Community & Economic Development's publication called Alaska Taxable put together by Steve Van Sant. He said he took the total assessed value of residential real property in the various municipalities and applied its perspective mill rate to come up with a total potential credit base, then he used the United States Census Bureau's statistics which says there is 68 percent homeownership in Alaska, and attributed it back to the revenue that could come from Alaskans.

MR. DICKINSON said, although that may seem imprecise, the potential credit is much larger than the income tax base. A lot of the credit is not being used, he noted.

REPRESENTATIVE ROKEBERG asked about commercial valuations.

MR. DICKINSON said a distinction is made between residential and commercial [valuations].

REPRESENTATIVE ROKEBERG asked if the state assessor has figures for the real and personal property taxes throughout the municipalities and the state.

MR. WILLIAMS answered that the state assessor's publication does distinguish between residential and commercial, and he said he only uses the residential properties as a potential credit base. He mentioned that HB 470 has provisions for both real and tangible personal property paid to a municipality, so it is conceivable that an individual who has a business and is paying property tax on personal property could use that as a credit against tax in HB 470.

REPRESENTATIVE ROKEBERG asked if there is any other "like data" on personal property tax collections.

MR. WILLIAMS said [the other data] is not detailed.

REPRESENTATIVE ROKEBERG asked if fishing vessels qualify for personal property taxes in certain ports of the state.

MR. BENINTENDI said he does not know.

REPRESENTATIVE ROKEBERG said he is aware of a legal case making distinctions between residential and commercial property. Legally, it has been challenged in the courts so it is a difficult factor. He said it is an area that needs to be looked at. The personal property exemption may be going too far, as far as a tax credit build-up. He suggested that a future model should make a distinction between those numbers. He said he would like to see resolution on out-of-state income and get to the bottom of the argument as to how many that actually is.

Number 2800

CHAIR HAWKER mentioned that one of the target hearings is on non-resident taxation, nexus out-of-state taxation, constitutional ramifications, and creative concepts that might

be used to tax non-residents directly without imposing state taxes on residents.

REPRESENTATIVE ROKEBERG pointed out that DOR uses a high standard of resident definition that revolves around the PFD. Under state law, the establishment of residency is based more on intent and on other issues, rather than longevity. Therefore, there are fewer non-residents than meets the eye, he maintained, and he disputed the DOL numbers as being way too high.

REPRESENTATIVE MOSES said it appears that fishermen are not covered under the estimates of non-resident earnings because there is no payroll record. The pamphlet that DOL puts out specifically states that lodge owners, boat owners, and fishermen are not included.

CHAIR HAWKER replied that that is the "1099 area" he is talking about.

REPRESENTATIVE ROKEBERG said that Representative Moses is exactly right, and asked if there were any other statistics about offshore fisheries.

REPRESENTATIVE MOSES said even process workers are considered independent businessmen because they are paid on a share basis. He said there are hundreds and hundreds of those.

Number 3131

CHAIR HAWKER said that this is the nexus topic he would like to pursue. "How far does our nexus extend? How can we look at corralling the greatest source of wealth that is leaving this state as we develop our own revenue policies?" he asked.

REPRESENTATIVE GRUENBERG said this is part of an issue that other states have been very involved in. He mentioned that he has attended a session at the National Conference of State Legislatures on Internet sales.

Number 3232

CHAIR HAWKER noted that is another issue brought up in a discussion of consumption taxation. He made closing comments, thanking the members and guests for their participation.

[HB 470 was held over.]

## **ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:15 a.m.