

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**March 18, 2004**  
**1:47 PM**

**TAPES**

SFC-04 # 52, Side A  
SFC 04 # 52, Side B

**CALL TO ORDER**

Co-Chair Gary Wilken convened the meeting at approximately 1:47 PM.

**PRESENT**

Senator Lyda Green, Co-Chair  
Senator Gary Wilken, Co-Chair  
Senator Con Bunde, Vice Chair  
Senator Ben Stevens  
Senator Donny Olson  
Senator Lyman Hoffman  
Senator Fred Dyson

**Also Attending:** SENATOR JOHN COWDERY; SENATOR HOLLIS FRENCH;  
SENATOR RALPH SEEKINS; SENATOR BERT STEDMAN; SENATOR GARY STEVENS;  
SENATOR GENE THERRIAULT; SENATOR TOM WAGONER; REPRESENTATIVE MARY  
KAPSNER; JOE BALASH, Staff to Senator Therriault; BOB BARTHOLOMEW,  
Chief Financial Officer, Alaska Permanent Fund Corporation,  
Department of Revenue; PHELAN STRAUBE, Staff to Senator B. Stevens;

**Attending via Teleconference:** There were no teleconference  
participants.

**SUMMARY INFORMATION**

Presentation on POMV Proposal  
By Senator Therriault

SENATOR GENE THERRIAULT noted he offered a proposal in the form of  
a committee substitute working draft to SJR 18, 23-LS1007\I [copy  
on file.] He indicated this is because both his proposal and SJR 18  
relate to a Percent of Market Value (POMV) approach to managing the  
Alaska Permanent Fund. He recalled earlier discussions were held on  
a POMV method of management and he cited evidence that POMV is a  
good management formula.

Senator Therriault described that in transition to a true POMV system the concept of principal is removed. He noted this concept is problematic for some. He asserted that before Alaska voters would approve any changes to the Permanent Fund, they must have confidence in the proposal. He stated that the complexity of the POMV proposal presented by the Trustees of the Fund, presents "many hurdles" to win final approval from the general public. Although most legislators have gained an understanding of the POMV methodology, he surmised that public concerns must be addressed.

Senator Therriault explained the proposed committee substitute provides assurance that the principal of the Fund would be protected in the event of a series of "down" years of poor performance of the stock market. He noted the proposal would preserve the existing Constitutional language stipulating that the principal of the Fund could only be invested and not spent. He furthered that the committee substitute would establish a Constitutionally based earnings reserve sub-account into which all income of the Fund shall be deposited immediately upon receipt. Appropriations from the Permanent Fund would be limited to, and could only be made from, this sub-account, he stated. Therefore, he remarked the principal of the Fund would remain protected.

Senator Therriault relayed a claim that once the legislature begins spending from the Permanent Fund, it would "only be a matter of time before the entire Fund is gone." He suggested that a sub-account would provide assurance that the principal were protected and could not be spent. He qualified that the proposed committee substitute retains POMV-type language that would limit the amount that could be appropriated in any fiscal year to prevent the legislature from appropriating too much during years of high investment earnings. He gave as an example the current situation in which approximately \$5 million of realized and unrealized gains are contained in the earnings reserve account. He pointed out that the legislature would be completely within its power to appropriate this entire amount in one fiscal year. By contrast, he stated the proposed committee substitute would prevent such overspending and thereby protecting the value of the Fund. He explained the sub-account establishment that would then be managed as a POMV and payouts from that sub-account would be limited to five percent of the value of the total Fund.

Senator Therriault acknowledged concerns voiced that the dividend program would be threatened if any earnings from the Fund were utilized for any purpose other than the dividend program itself. He assured this proposal would provide Constitutional protection of the dividend.

Senator Therriault cautioned against amending the Alaska Constitution in a manner that removes flexibility for determining the amount of future dividend payouts. This proposal, he stated would retain flexibility if required in the future.

Senator Therriault spoke to the limitations of how funds could be withdrawn from the Permanent Fund and for what purpose: expenditures would be restricted to education and dividends. He commented that the public questions how funds would be spent if used for government services. He predicted this provision would allay those concerns.

Senator Therriault noted the various percentages of POMV available for appropriation proposed by different legislators. He recommended allowing each legislature to make this determination. He suggested if the voters approved this proposal, a second dividend could be offered in December 2004 that would represent the amount available for dividend payouts if this procedure had been in place earlier. He stressed this additional dividend would be a one-time occurrence during the current calendar year. He stated this additional dividend would demonstrate that dividends may not benefit from the peaks in Fund performance, but would also be insulated from the consequences of years of poor market performance or "valleys". He opined that most Alaskans understand the Fund performance is currently in a valley and is likely to remain for several years. He emphasized this would be a separate issue for consideration.

Senator Therriault noted the 30 days normally required to certify an election and detailed the timeframe in which this issue would be decided, as well as timeframe for the Department of Revenue issuance of secondary dividend payment.

Senator Therriault commented this is a method in which to "bridge the gap" in gaining approval for a POMV method and to address concerns relating to spending from the principal of the Permanent Fund.

Senator Bunde appreciated the addressing of public concerns, noting they do not "go away". He noted the Legislature currently expends approx \$5 million annually to distribute dividends and implement the program and asked how the secondary dividend process would be funded.

Senator Therriault replied that printing and distributing costs would be the only expenses of a secondary dividend payout, noting that applications would already be processed and qualification for the secondary dividend would be based on qualification for the

regular dividend of 2004.

Senator Therriault furthered that status quo is likely to result in larger dividends in the near term, but lower dividend payments in the future.

Senator Bunde agreed, but questioned the expense of a multiple dividend distribution and asked if it would be less costly to inform residents of both dividend amounts with the intent to distribute one dividend payment in December 2004. He relayed concerns of school boards in rural areas about the receipt of dividends in October causing school disruptions as families travel on "week-long shopping trips". He asked if a delay of regular dividend payments to December would accomplish the same result.

Senator Therriault noted this would be possible, but cautioned against such action. He stated that people have come to expect payment in October and would be suspicious of any delay. He suggested the operating costs of a secondary dividend could be a lesser amount since many recipients receive the payments electronically.

Senator Hoffman agreed to the importance of securing voter confidence before any changes are made to the Permanent Fund. He spoke of having one more chance to convince voters of the legislators' intentions. He cited language on page 2, line 6 of the proposed committee substitute and stated this does not provide that assurance, noting, "may". He commented this language could also be interpreted as "may not" and instead recommended, "shall". He predicted questions would remain. He then addressed the dialog on the varying percentages proposed for distribution of funds from 80 percent for dividends and 20 percent for government services to equal percentages to each. He asserted that a formula providing at least 60 percent for dividends should be guaranteed. He attributed the failure in the special election of September 1999 to approve a plan to utilize a portion of the Permanent Fund earnings for government services to the lack of understanding of the issue.

Senator Therriault explained that if the Fund performs poorly and no funds were available for distribution for 2004, the issue of the language providing for a second dividend payment would be irrelevant. However, he deferred on the decision of whether to include "may" or "shall" in the enabling legislation. He also stated that a 50-50 division of available funds to dividends and government services could result in larger dividend payments than the current status quo. He therefore recommended that the legislature could adopt statutory language to determine an actual percentage division that is contingent upon adoption of this

resolution by voters. This, he stated would allow voters to understand the impact on their dividend payments.

Senator Hoffman agreed to the necessity of "may" under the current formula utilized for calculating the dividend, but expressed that under a POMV method funds would always be available.

Senator Therriault clarified that under a pure POMV methodology this would be correct, however if the formula were written with the intention to protect the principal of the Fund, the risk remains that there is always a chance of no earnings available to spend.

Senator Hoffman commented that if in the future, once voters understood and approved a constitutional amendment would he support "shall".

Senator Therriault reiterated "shall" would be more appropriate for a pure POMV method; however, "may" would allow flexibility for legislators.

Senator Hoffman preferred consideration to voters than to legislators.

Senator Olson referenced other legislation to change the use of the earnings of the Fund was introduced in the Senate State Affairs Committee during a previous session and asked why it was not enacted.

Senator Therriault replied that questions arose at that time relating to federal taxation if the fund were changed. Since then, he stated the Alaska Permanent Fund Corporation has had adequate time to review the matter and secure a legal opinion that federal taxation of the Fund would not occur.

Senator Olson asked if any other obstacles are anticipated in addition to the federal taxation issue.

Senator Therriault replied that the federal taxation question has received a definitive answer. He knew of no other obstacles.

Co-Chair Green asked if further definition of "public education" were considered.

Senator Therriault suggested the Committee could further restrict the definition if desired.

Co-Chair Green asked if Senator Therriault's intention is that of an expectation that an appropriation from the established earnings

reserve sub-account for public education would be higher than the normal appropriation for education.

Senator Therriault responded this funding might only comprise a portion of the funding necessary for public education with the remainder appropriated from the general fund. He noted this would depend on the amount needed each year to adequately fund education. He qualified that additional funding could be necessary.

Co-Chair Green surmised that earnings of the Permanent Fund would therefore be one component of education funding.

Co-Chair Green asked clarification of the earnings that would be deposited into the sub-account and asked if this could consist of dividends on investments and returns on investments, or funds from other sources that would be deposited into the earnings reserve sub-account.

Senator Therriault answered that only the earnings from investments of the Fund would be deposited into the proposed sub-account. He clarified that the provisions relating to the deposits of royalties from oil and gas resource development into the Fund would remain unchanged.

Senator Bunde commented, "much has been made" of the wisdom of not allowing dedicated funds. He noted this proposal would provide for dedicated funds.

Senator Therriault stipulated that if any funds were appropriated from the proposed earnings reserve sub-account those funds could only be allocated for education. He agreed this would be a "flavor" of dedicated funds.

Senator Bunde understood that if the "fiscal political realities" of the legislature chose to make an appropriation from the Fund for education, such an appropriation would supplant the general fund appropriation to education. He commented this could thus make other general fund monies available for other State services.

Senator Therriault acknowledged this could occur.

Co-Chair Green cited from Section 15 of the proposed committee substitute, "All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law." She asked if Senator Therriault anticipated difficulty obtaining voter approval to deposit income directly into the general fund.

JOE BALASH, Staff to Senator Therriault, testified that currently

statute provides that funds are deposited into the statutorily established earnings reserve account. He reminded that in the years 1976 through 1980, earnings were deposited to the general fund.

Senator Hoffman asked if adequate funds would remain for inflation proofing if the proposal to issue two dividend payments were adopted.

Senator Therriault replied that the POMV method does not require cash for inflation proofing, but rather the Fund would retain three percent of earnings for automatic inflation proofing.

Senator Hoffman surmised this proposal would not implement a true POMV method and that an issuance of a second dividend payout would remove additional funds from income earnings. He wanted to know if adequate funds would remain to ensure the Fund were inflation proofed.

Senator Therriault clarified that although not a pure POMV, this proposal would allow the Fund to operate as a POMV in that no more than five percent of the value of the Fund could be distributed. He emphasized this method would retain a "firewall between earnings and principal" to prevent an "erosion of the principal". He pointed out that a series of "down years" could erode the principle of the Fund if it were operated under a pure POMV. He qualified the chance of this is minimal, but possible. He qualified that if a second payout were made it would be possible that adequate funding would not be available for appropriation to education services in the first year.

Senator Therriault deferred to the Corporation to address technical issues.

Senator B. Stevens noted that inflation proofing would occur on June 30 and that the projected balance of the earnings reserve account made on December 31, 2003 is expected to change and would be approximately \$850 million after dividend a payout and inflation proofing. Therefore, he remarked, the concerns are unwarranted.

Senator Therriault calculated that during the first transition year, after inflation proofing and the first dividend payout, adequate funds would be available in the current earnings reserve account for a second dividend payout. In future years, he stated, management of the Fund would change to a POMV-type methodology.

Senator Hoffman asked how the ballot resolution would guarantee that dividends would be made. Under the current program, he cited claims of the potential that no funds would be available for

dividends in some years. He stated that the assurance of continued dividends has been a "selling point" of a POMV proposal according to accounts he has received. He therefore supported changing the aforementioned language from "may" to "shall" to guarantee dividend payments.

Senator Therriault responded that the current proposed language would provide no less guarantee of a dividend than the existing program provides.

Co-Chair Wilken announced that the proposed resolution would not be reported from Committee at this meeting. He stated that the matter of the specific language could be addressed at a future hearing.

Co-Chair Green remarked that the proposed committee substitute language provides more assurance of a dividend than the existing program.

Senator Bunde commented that "shall" would imply a guarantee of a dividend and would subsequently "enshrine" the dividend.

Senator Therriault noted that "shall" could result in a challenge similar to the situation in the litigation Bess versus Ulmer, relating to the difference between constitutional amendments and constitutional changes.

SENATOR HOLLIS FRENCH asked if the balance of the earnings reserve account established within the Fund would be included in the calculation of the five percent to determine the POMV.

Senator Therriault affirmed it would.

Senator French asked if public education, in this context, would include the University of Alaska.

Senator Therriault replied that the language could be written to include or exclude the University of Alaska and could be contained in either the Constitution or in statute. He commented that the Constitution should only contain language that is necessary, and that he would recommend a statutory definition of public education for this purpose.

Senator French expressed concern that the proposal is a "hybrid" of the current system and the POMV system, and that rather than combining the benefits of each system, could contain the weaknesses. He remarked that the public is able to understand the existing system; that market performance affects the amount of the dividend. He stated that this proposal does not provide the benefit

of the POMV system to the Fund managers. He explained that the "insulation" from dependence on the amount of funds available in the earnings reserve account for a dividend payout would not be provided. This proposal, he predicted would likely increase the public's expectation of receiving a dividend and would create pressure to provide dividends.

Senator Therriault remarked that the risk would be low, especially given the current balance of the earnings reserve account of \$5 billion. He furthered this would not increase pressure on the trustees of the Fund to generate a profit from the management of the Fund.

BOB BARTHOLOMEW, Chief Financial Officer, Alaska Permanent Fund Corporation, Department of Revenue, understood the proposal would retain the concept of principal in the Constitution. He relayed that the Trustees underwent significant discussion on the matter.

SFC 04 # 52, Side B 2:34 PM

AT EASE 2:34 PM / 2:35 PM

Mr. Bartholomew emphasized the importance of understanding the Permanent Fund is invested as one entity, although comprised of "three different buckets" for accounting purposes: \$23 billion is the principal, which is the accumulation of all revenues from oil development, other special appropriations and inflation-proofing; \$4 billion is unrealized earnings, which is the increase value of assets that had not been sold; and, \$1 billion of realized earnings account, which is actual income from interest payments on bonds, dividends from stocks, rental income from properties, etc. He qualified that the principal is actually a combination of the deposits and unrealized gains. He stated that as long as the assets are not sold, the unrealized gains are part of the principal. If the Fund managers decide to sell an asset, the unrealized gain converts to realized income and becomes available for appropriation.

Mr. Bartholomew shared that the Board decided to recommend a change from this current method to a POMV method because of the volatility in the market. He noted that market volatility could make significant amounts of money available in years of high performance that could be saved as a "cushion" for use during years of poor market performance. However, he cautioned that if the market "drops" before assets are sold and the value of the Fund is reduced, dividend payouts would be dependant upon future earnings

and that possibly no money would be available for distribution.

Mr. Bartholomew relayed that some deem it appropriate that if earnings are not adequate dividends should not be paid.

Mr. Bartholomew stated that historically, the earnings reserve system has operated as intended, although it peaked in March 2000 at \$8 billion. He told of four factors in the year 1999 that reduced the amount of earnings reserve funds available for dividends the following year to \$100 million: approximately \$2 billion was paid out in three dividends, approximately \$1 billion was transferred from the earnings reserve account to the corpus of the Permanent Fund to offset the effects of inflation, and an extended bear market eliminated much of the unrealized appreciation of assets, and the legislature in FY 99 appropriated \$250 million to the principal of the Fund. He cautioned of the risk in years of bear markets if the balance of the earnings reserve account is diminished, that no funds would be available to pay dividends. He calculated the probability of having no dividend at ten to fifteen percent each year and the probability of paying dividends at 80 percent. He stressed this is a decision that must be made.

Senator B. Stevens referenced the witness' statement that the amount of realized earnings was reduced to \$100 million as of July 1, 2003, and the amount of unrealized earnings was \$1.1 billion as of December 31, 2003 totaling \$1.2 billion. Senator B. Stevens also cited the Corporation's December 31, 2003 projection of the amount of unrealized earnings on June 30, 2004 of \$3.4 billion and realized earnings balance of \$850 million after inflation proofing and a dividend payout. He calculated the total to be \$4.2 billion.

Mr. Bartholomew affirmed.

Senator B. Stevens stressed the need to clarify this for the record because the witness had incorrectly testified that the earnings reserve account was reduced to less than \$100 million.

AT EASE 2:43 PM / 2:45 PM

Co-Chair Wilken referenced a spreadsheet titled, "Alaska Permanent Fund, Financial Projections 2004 - 2014, as of December 31, 2003" [copy on file.]

Mr. Bartholomew outlined the data included in the spreadsheet clarifying the amounts available for distribution and inflation proofing and the balances of the earnings reserve account.

Senator Therriault summarized this proposal is a hybrid intended to

address concerns and offer solutions.

AT EASE 2:50 PM / 2:52 PM

Sales Tax Proposal Worksession  
By Senator B. Stevens

Senator B. Stevens referenced a handouts titled, "Comparison of State and Local Retail Sales Taxes 2003 (January 2003)" [copy on file] and pointed out this demonstrates that several states implement a sales tax in conjunction with local sales taxes. He referenced a table titled, "Appendix B. State Sales Tax Rates, as of January 1, 2003" from the Tax Policy Handbook for State Legislatures [copy on file.] He noted the three largest exemptions from sales taxes as food, prescription drugs and non-prescription drugs. He then referenced another spreadsheet titled, "Table 1, 2002 Municipalities: Class, Populations and Tax Types" [copy on file], which lists municipalities of Alaska, their status as first class cities, home rule boroughs, etc., population, and types of taxes imposed, if any. He also distributed draft legislation, 23-LS1051\S, [which would later be introduced as SB 366] relating to a State sales tax [copy on file].

Senator B. Stevens pointed out that this State sales tax proposal allows very few exemptions. He stated the old methodology has depended upon tangible objects; however, a significant portion of Alaska's economy has shifted to non-tangible services.

Senator B. Stevens noted the inclusion of heating oil as an exemption from the proposed sales tax, in addition to goods and services used for manufacturing.

Senator Bunde reiterated the conversation at the previous meeting of the Senate Finance Committee that an income tax would allow for no exemptions. He remarked that the purpose of a tax is to generate revenue and that the more exemptions allowed, the less revenue that could be collected. He suggested that if a debate between a sales tax and an income tax were to ensue, exemptions should be allowed for neither.

Senator Hoffman asked Senator Bunde if his intent is that large purchases would have no tax limits.

Senator Bunde responded if the plan were to raise money this would be appropriate.

Senator B. Stevens noted that this could create a conflict, as the intent is to establish a maximum tax per purchase. He stated he was

researching how this would impact local government sales tax limits.

Senator Hoffman asked if this proposal would establish two systems of sales tax exemptions for those communities that impose a local sales tax.

Senator B. Stevens replied this proposal would impose a State sales tax in addition to a local tax, although both taxes would be governed by the State rules. He explained that local exemptions would be "absorbed" into the State process and therefore one community would not exempt taxation on an item that another community would tax.

PHELAN STRAUBE, Staff to Senator B. Stevens, clarified that the proposed legislation would establish exemptions that would supersede any local exemptions. He gave the tax exemption extended to senior citizens by the City and Borough of Juneau as an example, noting that this legislation would not allow exemptions for senior citizens. He qualified that local governments could provide rebates for certain purchases or to certain purchasers if desired.

Senator B. Stevens assured this proposal would not reduce revenues to local governments, as one percent of the State portion would be appropriated to those local governments that currently impose a sales tax.

Co-Chair Wilken asked clarification of the portion of the collected tax returned to local governments.

Senator B. Stevens detailed that the State would collect four percent of the amount of purchases made in communities that did not impose a local sales tax. Purchases made in those communities with a local sales tax would be assessed four percent, plus the percentage of the local sales tax. He continued that the State would retain three percent and return to the local government the percentage it levied plus an additional one percent. He gave an example a community with a three-percent sales tax. Under this proposal, he stated the consumer would be levied a seven-percent tax, the State would retain three-percent and the community would receive four-percent.

Co-Chair Wilken asked if therefore the highest amount that the State would collect would be three percent of the purchase price.

Senator B. Stevens corrected the State could receive up to four percent. He stated this would be from purchases made in those communities that assess no local sales tax.

Co-Chair Wilken requested further examples.

Senator B. Stevens compared Fairbanks and Juneau. He noted that because the Fairbanks North Star Borough collects no sales tax, purchased made in that area would be assessed a four-percent tax, all of which would be retained by the State. He then explained that the tax revenues received by the City and Borough of Juneau under this proposal would increase from the current five percent to six percent. He noted the tax assessed on purchases would increase from five percent to nine percent. He pointed out that the Juneau government would have the options of retaining the additional funding for government services, reduce the amount of the local tax to four percent, or offer rebates.

Senator B. Stevens furthered that if the Fairbanks North Star Borough chose to implement a three-percent tax, consumers would be assessed seven percent on purchases; the State would retain three percent and the Fairbanks government would receive four percent, consisting of the three percent it levied and a one percent "bonus" from the State. He suggested the Fairbanks government could decide to lower property taxes as a result of the revenues received from sales taxes, or decide to increase funding for education, roads or other services.

Senator Hoffman asked if a community that currently imposes no sales tax could implement a one-percent sales tax to become eligible to receive one-percent of the State portion.

Senator B. Stevens replied that under this proposal, a local government must impose a minimum sales tax of three percent to qualify for the additional one-percent "revenue sharing".

Senator B. Stevens clarified the minimum amount the State would collect would be three percent of purchases and the maximum amount would be four percent of purchases, depending upon whether the local government imposed a sales tax of at least three-percent. He informed that the four-percent amount was chosen for this proposal because it would be among the lowest amounts collected by states imposing a statewide sales tax.

Co-Chair Wilken noted that if a local government was restricted to a revenue or taxation limit, it could not accept the additional one percent and that money would revert to the State. Otherwise, he surmised the local government would be forced to reduce the local tax percentage.

SENATOR BERT STEDMAN requested further discussion on the issue of

limiting the maximum amount of sales tax that could be collected on each purchase. He. He asked if the proposal would allow the State tax limitation and a local limitation to differ.

Senator B. Stevens replied that \$60 would be the highest amount levied on single purchases by the State, although the limit could be higher for the local sales tax portion on purchases. He agreed this is an issue that must be resolved. He emphasized the intent is to not preclude any municipality from collection of taxes currently in place.

Senator Stedman knew of some municipalities that limit the tax to the first \$1,000 of each purchase, and proposals to increase the amount to \$5,000. He asked the flexibility provided to local governments if the State limited the tax to the first \$1,500 of a purchase.

Senator B. Stevens indicated the issue would require further investigation to determine the impact on communities.

Senator Olson asked how the sales tax would be enforced in small communities and gave examples of residents selling candy bars out of their homes. He reported that some high school students practice this type of retail sales.

Senator B. Stevens was unsure how the Department of Revenue would implement a statewide sales tax. He noted that systems are in place in some boroughs and assumed the process would be related to the tax collection systems merchants have in place. He admitted "leakage" and abuse would occur, but noted the federal Internal Revenue Service (IRS) also experiences such problems.

SENATOR TOM WAGONER furthered on Senator Stedman's comments, pointing out that a tax limit on sales of \$1500 would cost consumers an additional \$75 on purchases made in Kenai over purchases of the same amount made in Anchorage. He predicted that shoppers would travel to Anchorage for larger purchases.

Senator B. Stevens remarked this occurs currently.

Senator Wagoner corrected this does not occur because the sales tax collected by the Kenai Peninsula Borough is levied on a maximum of \$500 of each invoice, with a total tax of \$25.

Co-Chair Wilken noted the existence of obstacles that must be addressed.

Senator Hoffman referenced Sec. 43.44.040. Payment of use tax.,

established by Section 13 on page 6, lines 5 - 8 of the proposed committee substitute. He noted the 30-day deadline for submitting collected taxes. He expressed concern that this would create hardship for businesses that collect a minimal amount. He suggested extended reporting periods to allow businesses to submit taxes and reports after accumulating a reasonable amount.

Senator B. Stevens agreed to this suggestion. He stated the submission process should not be so onerous as to create more work than the initial transaction.

**ADJOURNMENT**

Co-Chair Gary Wilken adjourned the meeting at 03:21 PM