

ALASKA STATE LEGISLATURE
SENATE LABOR AND COMMERCE STANDING COMMITTEE

March 18, 2003

1:35 p.m.

MEMBERS PRESENT

Senator Con Bunde, Chair
Senator Ralph Seekins, Vice Chair
Senator Gary Stevens
Senator Hollis French

MEMBERS ABSENT

Senator Bettye Davis

COMMITTEE CALENDAR

SENATE BILL NO. 86

"An Act relating to the rate of interest on delinquent taxes."

HEARD AND HELD

CS FOR HOUSE BILL NO. 9(FIN) am

"An Act relating to the registration of individuals who perform home inspections; relating to regulation of contractors; relating to registration fees for specialty contractors, home inspectors, and associate home inspectors; relating to home inspection requirements for residential loans purchased or approved by the Alaska Housing Finance Corporation; relating to civil actions by and against home inspectors and to civil actions arising from residential unit inspections; repealing a law that limits liability for damages based on a duty to inspect a residential unit to damages caused by gross negligence or intentional misconduct; and providing for an effective date."

HEARD AND HELD

SENATE BILL NO. 114

"An Act increasing the fee for a state business license; and providing for an effective date."

HEARD AND HELD

PREVIOUS ACTION

SB 86 - No previous action to consider.

HB 9 - No previous action to consider.

SB 114 - No previous action to consider.

WITNESS REGISTER

Mr. Darwin Peterson
Staff to Senator Wilken
Alaska State Capitol
Juneau, AK 99801-1182

POSITION STATEMENT: Commented on SB 86 for sponsor.

Mr. Dan Dickenson, Director
Tax Division
Department of Revenue
PO Box 110400
Juneau, AK 99811-0400

POSITION STATEMENT: Supported SB 86.

Mr. Wayne Walker, President
A & W Wholesale
2525 Phillips Field Rd.
Fairbanks AK 99709

POSITION STATEMENT: Supported SB 86.

Representative Rokeberg
Alaska State Capitol
Juneau, AK 99801-1182

POSITION STATEMENT: Sponsor of HB 9

Mr. Rick Jarvis
2600 Cordova #100
Anchorage AK 99503

POSITION STATEMENT: Supported SB 9

Mr. Bill Brady, Chairman
Anchorage Board of Realtors
PO Box 11010
Anchorage AK 99511

POSITION STATEMENT: Supported HB 9.

Ms. Carol Perkins, Inspector
PO Box 871825
Wasilla AK 99645

POSITION STATEMENT: Commented on HB 9.

Mr. David Owen
Owen's Inspection Services
PO Box 3589
Palmer AK 99645

POSITION STATEMENT: Supported HB 9.

Commissioner Edgar Blatchford
Department of Community & Economic Development
PO Box 110800
Juneau, AK 99811-0800

POSITION STATEMENT: Supported SB 114.

Mr. Rick Urion, Director
Occupational Licensing
Department of Community & Economic Development
PO Box 110800
Juneau, AK 99811-0800

POSITION STATEMENT: Commented on SB 114.

Mr. Ronald Jordan
8170 Woodgreen Creek
Anchorage AK 99518

POSITION STATEMENT: Commented on SB 114.

ACTION NARRATIVE

TAPE 03-13, SIDE A

Number 0001
#SB86

SB 86-INTEREST ON DELINQUENT TAXES

CHAIR CON BUNDE called the Senate Labor and Commerce Standing Committee meeting to order at 1:35 p.m. and announced SB 86 to be up for consideration. Present were Senators Seekins, French, Stevens; Senator Davis was excused.

SENATOR WILKEN, sponsor, related to the committee that:

SB 86 was brought to him by a constituent and is an act relating to the interest on delinquent taxes. When a business in Alaska submits a tax report to the Department of Revenue, the department reviews the report to insure its accuracy. When an error is found in a report resulting in an under payment or an over payment in the taxes, an interest of 11% is attached by statute. This interest rate is set in statute, AS

43.22.05, which mandates the interest on the delinquent taxes to be 5 percentage points above the District 12 Discount Rate or 11%, whichever is greater.

SB 86 proposes to eliminate the reference to 11% interest and retain the 12th District Discount Rate, plus 5% as the formula for calculating interest on delinquent taxes. This will establish a fair and reasonable method of calculating interest by allowing it to float with the market. We believe it is inappropriate to charge Alaskans 11% on delinquent taxes, especially since many delinquencies result from honest mistakes, as you will hear today.

Another disturbing practice is that the department often doesn't find the discrepancy in a tax report for two or three years. Unfortunately, for the business owner, the 11% interest accrues from the date the tax report was filed, not the date the discrepancy was discovered.

According to the Department of Revenue, the fiscal impact to the state as a result of this legislation will be marginal. The state will receive a fair and reasonable interest from the delinquent taxpayers and will also pay a fair and reasonable interest on refunds to tax payers.

CHAIR BUNDE asked what were the typical interest rates throughout the nation when the 11% was first set.

MR. DARWIN PETERSON, Staff to Senator Wilken, replied that the interest rate was higher than that. The interest rate in statute was simple 8% until the legislation was enacted that changed it to 5% above the 12th District Discount Rate or 11%, whichever is greater.

CHAIR BUNDE asked what the discount rate was then.

MR. PETERSON replied in 1980 the discount rate was 12% in the 12th District.

SENATOR STEVENS asked how this legislation would change the date of filing for the charges starting to accrue if a mistake had been made.

MR. PETERSON replied that all this bill does is change the interest rate. The fact that it takes the department years to discover a mistake begs the question that could be answered under separate legislation at the end of the budget process. He understands that statute requires the department to discover a mistake within three years. Since that is what is in statute, the department often waits and reviews tax reports when it gets close to the statutory deadline. It was 20 months before they realized there was an honest mistake in Mr. Walker's tax reports. At that time the 11% interest rate had accrued for the entire 20 months.

SENATOR STEVENS continued saying that if it's a floating rate, it could be greater or lesser than when the mistake was actually filed. This would base it on when it was discovered.

SENATOR SEEKINS said this would also have an effect on the interest the state pays for overpayments of taxes and asked where that would tie in statutes.

MR. PETERSON said that the state is also liable for the 11% if there is an overpayment of taxes.

SENATOR SEEKINS asked if they had considered putting a cap on the rate.

MR. PETERSON said that is a possibility.

MR. DAN DICKENSON, Director, Tax Division, Department of Revenue, said he wanted to give them a little history of this section of the law.

Up until 1980, if the taxpayer underpaid his taxes, interest was calculated at 12% simple interest when a company finally paid the amount due. As Governor Hickel characterized this situation in his March 1991 letter of transmittal for the bill that resulted in the current law, he said the state ends up loaning billions of dollars to its tax payers at very low interest rates.

As everyone knows, a huge backlog built up of oil and gas taxes over the state. I was able to locate an accounts receivable payment from March 1991 that shows \$3.6 billion dollars in outstanding taxes. As you can imagine, over \$3 billion of that was in oil and gas back taxes.

The legislature and administration made a good decision in 1991; they changed the law. They made three cases. First of all interest was moved from a simple to more standard commercial practice of compounding interest. The change to compound interest made a dramatic difference in the interest owed on long delayed cases. Second, interest was defined as the federal reserve inter-bank rate plus 5% or - and this third point is the interesting point - a minimum of 11%. This change was designed to get the attention of companies that had been underpaying their taxes and it did.

At the same time, in 1991, a change was made in Title 38 putting oil and gas royalties on the same higher intra bank rate or 11% compounded. Over the next five years, \$3.5 in back taxes and royalties flowed into the CBRF, the constitutional budget reserve fund and a whole different attitude became apparent. Clearly, there was more than just interest rate changes at work in this situation, but it is also clear that the interest rate change played a significant role.

Now, in 2003, our accounts receivable in the tax division is \$71 million or about 2% of what it was in 1991. So now it's time for another good decision, to bring the interest rates more in line with market rates. I don't think this will bring about a return to backlog. Since this change sticks with compound rates, tax payer delay will rapidly become more and more expensive to the tax payer. This bill does not change the interest rate on tax due oil and gas royalties. This legislation simply eliminates the 11% minimum rate on taxes and allows the rate to float at 5% above the federal reserve's intra-bank rate. And just as the new rate structure applies to back taxes owed the state, it would also apply to certain tax refunds paid by the state, thereby saving us some money. The administration supports this bill and urges you to do the same.

CHAIR BUNDE asked him to comment on language stating that the clock starts ticking at the time the taxes are filed rather than when the error is found.

MR. DICKENSON, in response, asked the committee to "put on the glasses" of a large corporation who is paying hundreds of millions of dollars in taxes to the state. There are frequently conceptual problems about how things get characterized in both royalty or the tax situation. These are sophisticated tax requirements and sophisticated royalty payers.

In those situations, we don't want to have the state essentially lending money to the companies; in other words, have the companies underpay. We'll be in a dispute with them for a year or two, three, four, these can go on, and, then when it's finally agreed, then the interest clock starts to run. The notion should be that when a tax amount is agreed upon, we go back and look when that was due and we make sure that the company doesn't gain any advantage from not having paid when it was due. That's a very different perspective than the small business owner who perhaps made an inadvertent error and is faced with the same situation.

CHAIR BUNDE asked what would preclude the interest clock from starting to tick the moment you found an error rather than waiting until after everything was litigated.

MR. DICKENSON replied that nothing would preclude it and that would set a small advantage for the companies for not paying their taxes.

What it would really do is totally change the way the division was organized and approaches problems. Right now when we, and I'll just use Exxon, because everyone understands that they're a tax payer here and they're the world's largest industrial organization. When we audit them, we don't want to be going in every month and - the pay production tax as a monthly tax - and try to catch the errors so that we start the interest clock running. We wait until we have a two-year cycle and go in, step back, look at it closely, sometimes subsequent events have occurred that are important, sometimes we need to hire experts that understand some aspects of the business.

We are certainly organized around a principle that if a company has underpaid, we can be thorough and careful and make sure that we get the right amount and that we're not penalized for taking the time to do it

correctly. If we were to change the statute, we would have to think about our emphasis and think about how dealt with the timeliness of findings and pointing out these kinds of errors...

SENATOR FRENCH asked where the statute says the refund interest rate is set the same as the delinquent tax.

MR. DICKENSON replied AS 43.05.280 - Interest on overpayments (a) - Interest shall be allowed and paid on an overpayment of tax under this title at the rate and the manner provided in AS 43.05.225, section 1.

SENATOR FRENCH said the fiscal note spoke about the potential difference of close to \$1 million per year in the amount going to the constitutional budget reserve and asked him to comment on that.

MR. DICKENSON replied that it's hard to estimate because the number of payments is fairly small and the volatility is fairly high. Interest is about one third of the dollars going into the CBRF and that could change because the division is getting more and more caught up, currently auditing 2000 and 2001 for the major companies and 2002 for some of the smaller ones. They also need to look at what future interest rates are going to look like. Most folks think we're at an historic low and it's not safe to use the 7.25%, which is what the interest rate is today. Using assumptions, they came up with a ballpark figure of \$1 billion.

In the income tax arena, we based our analysis on what the IRS does. They are much further behind than we are. So, let's say we got notice of an adjustment [indisc.] to 1993 and made a tax adjustment and the taxpayer paid us more tax based on that. From 1993 until the effective date of this law, you'd use the 11% and then for the number of months after that, you would drop down and use the 7.25%. So, for the first couple of years, you see almost no drop in the CBRF, but then as you go out several years, that's where you see the drop in [indisc.] and perhaps even go over it.

SENATOR FRENCH asked how he picked the fed plus 5% figure.

MR. DICKENSON replied that he wasn't directly involved with that legislation, but they take what someone characterized as a risk

free rate and added 5%. Credit card rates are much higher than that.

CHAIR BUNDE asked if they wanted to keep enough penalty "to keep a careful pencil."

MR. DICKENSON replied that is exactly right. He added that the Supreme Court has ruled that interest has no punitive aspects to it; it is merely the time value of money.

MR. WAYNE WALKER, President, A&W Wholesale, thanked Senator Wilken and Mr. Peterson for working on this issue and thanked the Department of Revenue for trying to help him. He explained that since 1970 he has been the sole respondent in filing the tax returns for his company on cigarettes and they have as clean a business as anybody. A precedent was set by the Department of Revenue that within a few weeks after receiving their filing, the department would send a letter on whether it was overstated or understated and penalties and interest and by the time of their next month's filing, they were expected to pay whatever they owed including penalties and interest. That went on from 1970 at least through 1995 and maybe further. The report in question was sitting somewhere for 20 months before they received a report from the Department of Revenue. If they had received a report from them sooner, the fine would have been paid immediately.

MR. WALKER said the first letter he received was for what was owed on the cigarettes, which was almost \$16,000. Five days later, they got another letter adding \$3,000 worth of interest. The reason they were upset is because they couldn't understand why 20 months passed when there was 25 years worth of precedent of a couple of weeks. He said also it came at a bad time for his company as they had discontinued selling cigarettes almost two years ago, which means they didn't have the cash flow they used to have.

CHAIR BUNDE thanked him for his testimony. There were no further testifiers and he announced that he would hold the bill for further work.

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#HB9

HB 9-HOME INSPECTORS/CONTRACTORS

CHAIR BUNDE announced HB 9 to be up for consideration.

REPRESENTATIVE ROKEBERG, sponsor, said this was the 23rd public hearing on this bill. He explained that 25% of the state domestic product (GDP) is real estate transactions. This legislation sets forth the requirements for becoming a home inspector including continuing education and the regulatory scheme under which one would be working.

SENATOR FRENCH asked why he would choose such a short period of time for bringing an action if the statute of limitations for contract law is three years.

REPRESENTATIVE ROKEBERG referenced page 10, section 17, and answered he thought it was important that the timeframe to bring an action forward should be quite limited because any defect or omission should be discoverable within one year or with a new home, within a two year period. The basis for that is that there is a warranty by homebuilders for condos for a two-year period. He noted this was only for residential activities. He intended to keep the commerce of the state moving forward by limiting the time in which a lawsuit can be brought forward.

SENATOR SEEKINS said language on page 4, line 26, says there are three different examining organizations for existing homes and one for new homes and asked him to explain those.

REPRESENTATIVE ROKEBERG replied that the American Society of Home Inspectors (ASHI) is the primary national organization for existing home inspectors. The other two are the American Home Inspectors Training Institute and the National Association of Home Inspectors that are somewhat competing organizations and are recognized by various states to a lesser degree than ASHI is. New home inspectors use International Conference of Building Officials. He just codified existing practice.

SENATOR SEEKINS asked if he was satisfied that any examinations offered by those organizations would meet the nation-wide standard and be adequate in protecting the home buyer if they passed the test.

REPRESENTATIVE ROKEBERG replied yes.

MR. RICK JARVIS, Anchorage resident, supported HB 9. He said that they are looking for continuity of education for all home inspectors who might have different industrial backgrounds. Nearly half the states regulate home inspectors.

MR. BILL BRADY, Chairman, Anchorage Board of Realtors, said he was a member of Alaska Association of Realtors and that both associations supported this bill. He said that this is the biggest purchase some people are going to make in their lifetime and it would be nice to know that all home inspectors are on a level playing field with the same basic knowledge and requirements. "If one consumer gets hurt, that's one consumer too many."

MS. CAROL PERKINS said she is a new construction inspector and has followed this bill for three years. "With a few more tweakings, I think I can live with this bill and make a living and continue to serve my constituents out here."

One of her biggest concerns was section 41 that repeals protection from Alaska Housing. Any city inspector has that protection given to them through the building codes. She is a private building inspector and doesn't have a building department to back her up and if they repeal that, she will have very little protection from anyone who thought she didn't interpret codes the way they wanted her to.

2:22 p.m.

TAPE 03-13, SIDE B

MS. PERKINS explained that new home and existing home inspections are two different reports. She saw a lot of improvement in the current version and a few more tweaks and they would be there.

MR. DAVID OWENS, Owens Inspection Services, said he had opposed HB 9 for the last five years, but changed his position to support. However, he requested some amendments especially the liability clause being removed from Alaska Housing statutes. With the insurance crisis, he is no longer able to buy errors and omissions insurance in the state of Alaska for new construction. Existing construction inspectors have that luxury.

He suggested three amendments, one a partial title change and another deals with the liability that might impact small inspectors in rural areas who does only 10-15 houses per year.

CHAIR BUNDE asked him to make sure he faxed his amendments to his office.

REPRESENTATIVE ROKEBERG asked if two of the amendments were a title change that went with the section 41 repeal.

MR. OWENS replied yes, the second amendment would be changing the language from two years to one year on page 10, line 6, so it would be consistent with the existing home inspectors and the general warranty that builders offer new home owners on new construction.

REPRESENTATIVE ROKEBERG said he had an amendment on page 8, line 19.

SENATOR SEEKINS moved amendment #1.

23-LS0029\SA.1

Lauterbach

4/7/03

A M E N D M E N T

OFFERED IN THE SENATE

TO: CSHB 9(FIN) am

Page 8, line 19, before "unless":

Insert "or "home inspector""

CHAIR BUNDE objected for discussion purposes.

REPRESENTATIVE ROKEBERG explained that it closed a loophole about who can hold themselves out to be a home inspector.

CHAIR BUNDE removed his objection and amendment #1 was adopted. He asked him to speak to the repeal issue.

REPRESENTATIVE ROKEBERG said the public's good is best served by taking the immunity out for Alaska Housing, because no other lender has it. One of the witnesses said the municipal inspectors inspecting homes have immunity under the locally adopted codes. If there are complaints, people do have recourse, but here a private homeowner engages a private home inspector to make a home inspection. It seems that there is a duty owed by the inspector to the builder under new home construction.

CHAIR BUNDE thanked him and said he would hold this bill for further work.

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#SB114

SB 114-INCREASE BUSINESS LICENSE FEE

CHAIR BUNDE announced SB 114 to be up for consideration.

COMMISSIONER EDGAR BLATCHFORD, Department of Community and Economic Development, supported SB 114. The legislation would increase the business license fee from \$25 per year to \$200 per year, collected on a bi-annual basis. This is a large increase, but the cost of the business license has remained the same since 1949 and the census of 1950 had the population at about 130,000 people, many in the military. A business license that cost \$25 in 1950 adjusted for inflation would cost about \$188 in 2003. The increase would generate an additional \$8.5 million in FY04 and would provide general fund revenues, which would contribute to a variety of state services ranging from public safety and protection to road maintenance and education, to business support.

CHAIR BUNDE asked why the fiscal note says only \$6.9 million.

COMMISSIONER BLATCHFORD replied that additional research indicated that \$6.9 was a more accurate figure.

CHAIR BUNDE asked if an attrition rate is built into the figures.

COMMISSIONER BLATCHFORD said he thought it was, although he didn't want to speculate as to the intent of people who file their IRS returns.

SENATOR SEEKINS asked what attrition rate he used.

MR. RICK URION, Director, Occupational Licensing, answered that they assumed 50% of the sole proprietors would drop out, a little over 21,000 licenses.

SENATOR SEEKINS asked if he was assuming that the people who dropped out would be the small 1-4 employee license purchaser.

MR. URION replied that they assumed all of them would be in the 0-4 category.

CHAIR BUNDE asked if he had a way to determine how many have zero employees.

MR. URION replied that his department didn't have those statistics, but the Department of Labor has statistics for employees. There are less than 16,000 employers in the state with employees that file quarterly reports for the Department of Labor. There are 56,000 business licenses.

SENATOR SEEKINS asked if he had built any kind of model based on a variable rate where maybe less than half of those small proprietorships would fall out if they had an increased rate that was reasonable, but not the \$200 rate.

MR. URION replied that the House adopted an amendment that would have a stepped number of employees and directed him to come back to them with a number of scenarios. He would share that information with the committee when it was fully developed.

SENATOR SEEKINS said he mentioned it because there are other reasons to have a business than for tax reasons, like insurance.

SENATOR STEVENS asked if a franchises and large businesses like Safeway with multiple sites get just one business license.

MR. URION replied that franchisees are individual owners and all must get their own license, but there are a number of businesses in the state that have more than one location, like Safeway and Cost Co. Under existing law, they only have to get one business license, if their business is exactly the same in all locations.

SENATOR FRENCH pointed out that the proposed fee of \$200 exceeds the fee adjusted for inflation, which the commissioner said was \$188. He also wondered if the administration wanted to pad education costs to keep up with inflation.

SENATOR SEEKINS said that one size never fits all.

The mom and pop having to pay exactly the same rate as someone with multiple locations that has multiple employees is not a fair system. That one size fits all doesn't sit well with me personally. I'd kind of like to look at some models and see what they do in that regard.

MR. URION said that his research shows them that 90% of the business licenses have 0-4 employees.

MR. RONALD JORDAN said he had owned several small businesses over the years and he had some anxiety about the fees.

CHAIR BUNDE asked if there was a substantial increase in fees, would it be more palatable to go back to a yearly instead of a bi-annual payment system and what would it cost to do that.

MR. URION replied that the business license fee is the first license and the only license that they issue that has been brought into the 21st Century with technology. It is available to purchase on-line. "We would prefer to have a bi-annual license if we could do that....We could do it on an annual basis, but we would have to change our software."

CHAIR BUNDE said it would be interesting to know what the cost would be and if that would reduce some anxiety. He asked Mr. Urion to get that information for him and said this issue needed a little more gestation and appointed Senator Seekins as a subcommittee to address the multiple model issue.

SENATOR SEEKINS accepted with enthusiasm.

CHAIR BUNDE adjourned the meeting at 2:57 p.m.