

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

April 15, 2005

8:36 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Ralph Samuels
Representative Paul Seaton
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Norman Rokeberg

COMMITTEE CALENDAR

HOUSE BILL NO. 262

"An Act relating to the taxation of income."

- HEARD AND HELD

HOUSE BILL NO. 263

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

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 262

SHORT TITLE: INCOME TAX

SPONSOR(S): WAYS & MEANS

04/08/05	(H)	READ THE FIRST TIME - REFERRALS
04/08/05	(H)	W&M, STA, FIN
04/15/05	(H)	W&M AT 8:30 AM CAPITOL 106

BILL: HB 263

SHORT TITLE: EMPLOYMENT TAX

SPONSOR(S): WAYS & MEANS

04/08/05	(H)	READ THE FIRST TIME - REFERRALS
04/08/05	(H)	W&M, L&C, FIN

04/15/05

(H)

W&M AT 8:30 AM CAPITOL 106

WITNESS REGISTER

CHUCK HARLAMERT, Juneau Section Chief

Tax Division

Department of Revenue

Juneau, Alaska

POSITION STATEMENT: Offered information on HB 262 and HB 263.

MICHAEL WILLIAMS, Auditor

Tax Division

Department of Revenue

Anchorage, Alaska

POSITION STATEMENT: Offered information on HB 262 and HB 263.

LARRY MESHKIN

Wasilla, Alaska

POSITION STATEMENT: Testified in opposition to HB 262 and HB 263.

ART CURTIS, Co-Chair

Alaskans for Fair Taxes

Anchorage, Alaska

POSITION STATEMENT: During hearing of HB 262, expressed support for an income tax; and testified in opposition to HB 263.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at [8:36:38 AM](#). Representatives Weyhrauch, Samuels, Seaton, Wilson, and Moses were present at the call to order. Representative Gruenberg arrived as the meeting was in progress.

HB 262-INCOME TAX

[8:37:07 AM](#)

CHAIR WEYHRAUCH announced that the first order of business would be HOUSE BILL NO. 262 "An Act relating to the taxation of income."

CHAIR WEYHRAUCH explained that this legislation is essentially the House Bill introduced by Representative Moses during the Twenty-Third Legislature. However, HB 262 includes a provision such that an income tax would only take effect in the event of a

fiscal gap. Furthermore, the amount of the tax depends on the amount of the gap as specified under Section 1. He highlighted that this particular legislation places the onus on the legislature to develop a budget so that reoccurring revenues meet reoccurring expenses. This legislation doesn't prohibit the legislature from using the earnings of the constitutional budget reserve (CBR) or the earnings of the permanent fund to balance the budget. However, if the legislature doesn't balance the budget, the citizens of Alaska pay and can lay the blame on the legislature. He reiterated that HB 262 implements measures to bring revenues into the state if the legislature doesn't balance the budget, which is a way in which to force the legislature to step up to the plate and explain why it would rather impose an income tax than balance the budget. The aforementioned is the reasoning behind Section 1. The remaining sections of HB 262 are [basically] Representative Moses' income tax bill by which one pays a state income tax based on the size of his/her federal income tax. Furthermore, it allows property tax exemptions and requires everyone, residents and nonresidents alike, to pay the income tax. Chair Weyhrauch acknowledged that the Department of Revenue isn't happy with this type of legislation because it doesn't offer a stable revenue source.

[8:40:36 AM](#)

CHUCK HARLAMERT, Juneau Section Chief, Tax Division, Department of Revenue, explained that within the Tax Division duties are split and his are related to the cost side of taxes. As specified in the fiscal note analysis, Mr. Harlamert related that a broad-based tax that turns on and off is relatively inefficient because the department has to maintain a technical base of staff and infrastructure to process returns. The department projects that the best way to handle this tax type is to invest heavily in technology, which enables the division to process these returns on an intermittent basis with relatively untrained staff. However, in the off years a base level of technical staff will be necessary to administer the program and handle appeals and ongoing issues.

[8:43:00 AM](#)

REPRESENTATIVE SEATON inquired as to what is included in the calculations when determining there is a fiscal gap. He asked specifically if the income tax would only go into effect after all the earnings are spent.

MR. HARLAMERT related his belief that in this legislation the language "state expenditures" means current expenditures and revenues. Therefore, it wouldn't include dipping into [the state's] savings accounts but rather the revenues would be those that are earned through taxation or royalties during the year. He said that the tax would be imposed when expenditures [exceed] current revenues.

[8:45:07 AM](#)

REPRESENTATIVE SEATON asked, for clarification purposes, whether the current earnings of the permanent fund that are available to the legislature are included in the calculations of revenues versus expenditures.

MR. HARLAMERT said he cannot answer that question because it depends upon how broadly the term "revenues" is defined. As the legislation is currently written, it's very broad, he said.

[8:45:56 AM](#)

REPRESENTATIVE SEATON turned to the fiscal note, which details \$15-\$20 million for the capital set-up and \$7-\$8 million for operating expenses. Even if the rate is 1 percent, the state would collect less revenue than it costs to implement the income tax, he highlighted.

MR. HARLAMERT explained that when he calculates the cost of a program he assumes a program that's roughly the quality of the current standards. For instance, the key performance criteria the public has for a state income tax is that the public receives its tax refunds before its federal tax refunds. The aforementioned involves a considerable amount of infrastructure and attention, and therefore at some level a minimal level of service has to be provided, even if it's uneconomical. Mr. Harlamert said that if the division knew that these tax rates were going to be at low levels, such as 5 percent, the division would probably "back off" with regard to the program quality aspect.

REPRESENTATIVE SEATON opined that a quality enforcement program is necessary when instituting taxes, especially an income tax.

[8:49:27 AM](#)

MICHAEL WILLIAMS, Auditor, Tax Division, Department of Revenue, began by highlighting that the revenue analysis of this

legislation is particularly difficult given its mechanics and uncertainty with some of the definitions. He then turned attention to the fiscal note which makes assumptions about the federal tax liability and the various rates of income tax imposed depending upon the deficit. He highlighted that 99 percent of individuals report their income on a calendar year basis whereas the state's revenue system is on the fiscal year (FY), which would allow the possibility of dividing the FY income under separate rates. Therefore, the fiscal note analysis provides information for the half year and full year revenue provisions for each rate. The other part of the uncertainty of HB 262 is the property tax credit provision, which is written so broadly that one could presume that real estate taxes or residential property taxes qualify as well as personal property taxes. For instance, a small business owner who pays personal property taxes on items such as furniture and equipment inventory could, under certain interpretations, use his/her business or personal property tax credits against his/her individual income tax.

MR. WILLIAMS said that the other complexity with the provisions of this legislation is that they include withholding requirements such that employers are going to withhold payments on the gross tax before any credits. Although the Department of Revenue could conceivably collect upwards of \$100-\$150 million throughout the year, it will have to issue large refunds after people have filed returns and claimed credits. Therefore, mechanically this legislation has "large swings in the revenue" coming in and going back out as an refund, because generally credits aren't available until a return claim is filed.

[8:53:08 AM](#)

MR. WILLIAMS, in response to Chair Weyhrauch, clarified that credits are available when a return is filed. He posed a situation in which the return is filed on April 15, 2005, for property taxes that were paid during 2004 and during which time the individual's wages were withheld at 10 percent throughout all of 2004. However, the individual doesn't file his/her return and claim his/her credit until April 2005. For example, if an individual has \$1,000 withheld in 2004, that individual might have a \$1,000 in property taxes paid to the municipality and thus [the state] will end up giving it all back to the individual on April 15.

[8:53:48 AM](#)

MR. WILLIAMS, in response to Representative Gruenberg, answered that the state would collect the interest from the withheld money until it's refunded. In further response to Representative Gruenberg, Mr. Williams said the additional income generated by that depends on the short-term "marginal" rates, which he estimated to be about 1 percent.

[8:54:48 AM](#)

REPRESENTATIVE SEATON asked if the Internal Revenue Service (IRS) law that allows tax credits for Alaska sales tax deductions would be applicable to property tax or income tax.

MR. WILLIAMS clarified that the sales tax, much in the same way as the income tax, could be claimed as a deduction for those able to itemize deductions. Under this legislation, that would go into the calculation of one's state tax because it's based on the federal tax liability. However, it's unclear whether the numerous credits, such as the child tax credit, education credit, foreign tax credit, business tax credits, and earned income tax credit, would be included in the calculation of the state's tax liability.

REPRESENTATIVE SEATON asked if the property tax paid would be deductible from the federal income tax.

MR. WILLIAMS replied yes, and added that property taxes are currently deductible for itemized deductions and thus property taxes would be allowed as an itemized deduction before calculating the federal tax liability. Therefore, it would essentially reduce what one would pay the state and those same dollars would be allowed as a credit against the state tax liability. "So ... in essence you get it twice," he pointed out.

[8:57:06 AM](#)

REPRESENTATIVE GRUENBERG inquired as to how much the state refunds taxpayers annually because of overpaid taxes. He recalled testimony indicating that [the income the state earns from overpayment] is invested in short-term treasury notes with low interest rates. He questioned why the state is investing in such low rates of interest, and then he inquired as to what could be done to earn more interest.

MR. HARLAMERT replied that he can't answer the aforementioned questions accurately. The Tax Division issues refunds on a

regular basis for various tax types of which the total refund for corporate income tax is no more than about \$5 million for a peak year. He informed the committee that all of these funds come out of the short-term or liquid portion of the state's portfolio, which needs to be maintained in order to pay the state's bills. He said that essentially [the funds] are invested in short-term securities similarly to the funds used to pay wages. He opined that it's the short-term nature or the liquidity that drives the return. Therefore, the more refund liabilities potentially available, the larger the pool of liquid assets is required and as a result they receive a lower rate of return.

REPRESENTATIVE GRUENBERG related his belief that earning 1 percent on \$5 million totals \$50,000, which is hardly a lot of money. He asked if there's a way to invest in order to receive a fair amount of return.

[9:00:24 AM](#)

MR. HARLAMERT specified that the \$5 million in tax refunds issued during a high refund year for a corporate tax, for example, is immaterial on an annual basis to the overall cash management function. "I don't think it would effect us at all ... whether that \$5 million existed or not," he opined.

REPRESENTATIVE GRUENBERG commented that \$100,000 here and \$100,000 there adds up.

[9:01:01 AM](#)

LARRY MESHKIN, said:

I strongly object to the income tax on principle, because it's a violation of private property rights and privacy. I believe it's a form of legal plunder because my property is taken from me by force and for the use of others. A federal income tax is hated by many Americans for good reason. The founding fathers did not favor a direct tax because of its damage to the liberties of the people. They favored an indirect tax or a consumption tax Myself, I believe that state spending should be cut to what's constitutionally mandated and then when taxes are needed it should be a flat sales tax on all purchases, except for the basic necessities of life and medicine. And this would help the poor. ... a person who pays

no tax or very little tax would not be motivated to keep state spending in line and they would just vote for Representatives to keep the other guy paying the taxes. I also don't believe that targeting nonresidents ... with an income tax is right because they use little or no state services and since they can't vote [in Alaska], they're a political vulnerable target. And I believe if there was a flat sales tax, the services they do use would be paid by the sales tax

[9:03:49 AM](#)

CHAIR WEYHRAUCH highlighted that the aforementioned idea of a consumption tax to exempt the basic necessities becomes a debatable notion depending on the definition of "necessity." He related that the chairman of the Federal Reserve Board has discussed shifting from an income tax base financial management structure in the U.S. to a consumption tax. However, the aforementioned would take a significant structural and policy seat change with regard to the way business is run in this country.

[9:05:24 AM](#)

ART CURTIS, Co-Chair, Alaskans for Fair Taxes, encouraged the committee to consider reviewing a variety of taxes and a long-term fiscal plan. He related that most Alaskans for Fair Taxes favor making an income tax part of any long-term fiscal plan. Furthermore, the group believes that an income tax is the most equitable tax and is preferable to a state sales tax, which would overburden those communities that already have a sales tax in place. Moreover, an income tax is helpful for the business community because its effects are predictable, which would encourage business. He acknowledged that no income tax is foolproof. Although a consumption tax, as is used in Europe, may be desirable, one must remember that Europeans have also constructed a solid social net that's not found in the U.S. presently. He reiterated his belief that an income tax is essential to the long-term fiscal health of Alaska.

[9:08:11 AM](#)

MR. CURTIS, in response to Chair Weyhrauch, replied that Alaskans for Fair Taxes is a small group of interested people who communicate via email to alert one another about the action taking place at the legislative level and to push the idea that

an income tax should be an important component of the state's fiscal solution.

[9:09:07 AM](#)

CHAIR WEYHRAUCH reminded the committee that part of its duty is to put these things on the table for discussion purposes as various alternative measures to bridge any fiscal gap. He acknowledged that the bill has structural problems and uncertainties, particularly in the management of how the tax would be imposed, the revenue collected, as well as determining what revenues would be available under the bill. Furthermore, there is a question with regard to how to manage the bureaucracy of the bill if it were implemented in this form. Section 1 places the burden on the legislature to balance the budget because it imposes the tax only if the legislature can't get its fiscal house in order, which would result in the public paying the price. Ultimately, the politician pays at the ballot box if the legislature doesn't balance the budget. This legislation, he pointed out, doesn't preclude use of any fund or any source of revenue available to the legislature to balance the budget.

[9:11:19 AM](#)

REPRESENTATIVE WILSON quoted an article from the Anchorage Daily News, which presented a study from Alaska's Department of Labor & Workforce Development (DLWD). She related her belief that the article highlights the changes taking place in Alaska, such as [the fact] that the fishing industry has more employees than any other industry in the state. She read the following: "Over the last two decades people living out of state have come to domineer Alaska's commercial fisheries. With nonresident fisherman now accounting for the majority of both the weight and the value of the catch." She opined that the aforementioned article highlights one area in which the state could pick up money from out-of-state workers. She related that the case is similar in the oil industry because the majority of its workers also are from out of state.

[9:13:18 AM](#)

CHAIR WEYHRAUCH recalled an earlier observation that those out-of-state employees don't vote [in Alaska].

[9:13:29 AM](#)

REPRESENTATIVE SAMUELS said that he, too, has seen statistics that attempt to have others pay the tax. However, [no matter the type of tax] Alaskan's would pay the overwhelming majority. He highlighted that it will be difficult to "plug all the holes" of getting around a tax.

[9:15:22 AM](#)

REPRESENTATIVE GRUENBERG explained that Alaska's unitary tax creates an exception to the "huge problem" many other states have with corporations moving income into tax shelter states such as Delaware or Nevada. Therefore, with the institution of an income or sales tax there also needs to be a provision in order to prevent such tax shelters, he added.

[9:17:02 AM](#)

REPRESENTATIVE SEATON relayed that many of his constituents support an income tax that is simple, fair, and has the lowest amount of enforcement and collection mechanisms needed instead of the complicated structure proposed in HB 262. He turned to the credit proposal which shifts the burden to the out-of-state workers, and opined that those without property tax credits are going to be hit the hardest because it allows more credits to those who have accumulated the most wealth and property in the state. He offered that shifting the property tax credit has genuine appeal in relation to targeting the out-of-state worker, although it doesn't seem to take into account the Alaskan residents who don't own property and are potentially less affluent. Therefore, he encouraged the committee to carefully consider to whom the burden is shifted when discussing property credits. Representative Seaton then expressed concern with regard to when [a proposal such as encompassed in HB 262] would be implemented because permanent fund earnings would be revenue available to the legislature in a given year, and furthermore if that revenue is counted, then there [probably] wouldn't be a fiscal gap.

[9:21:05 AM](#)

REPRESENTATIVE MOSES pointed out the he has advocated for an income tax for some time, although there are provisions in HB 262 which he doesn't favor. He related his belief that a long-range fiscal plan is overdue, and that any long-range fiscal plan should include a broad-based tax to be paid by the people. However, a statewide sales tax is not acceptable, he opined, because it's one of the main methods local governments have to

raise money at the local level. He turned to the property tax exemption, and noted that there are vast areas in the state that don't pay property taxes. He opined that the nonresident income figures provided by DLWD aren't complete because it doesn't seem to include fisherman because they are considered businessmen.

MR. HARLAMERT said he believes Representative Moses is correct in that DLWD's figures are based on wage income, which doesn't include those who are self-employed.

HB 263-EMPLOYMENT TAX

9:24:31 AM

CHAIR WEYHRAUCH announced that the final order of business would be HOUSE BILL NO. 263, "An Act imposing a tax on employment; and providing for an effective date."

CHAIR WEYHRAUCH explained that this legislation reinstates the 1980 education tax which deducted \$10 annually from the payroll of employees 19 years old or older. The monies would be placed into a fund that would be held separately for education. He opined that \$10 per person is a small amount of money, and furthermore it illustrates that people value education. Essentially, this is an income tax for the employed. He highlighted that currently a \$40 payment is imposed on those in rural education attendance areas (REAA's) and this legislation exempts them from paying the additional \$10 education tax proposed in HB 263.

9:27:42 AM

CHUCK HARLAMERT, Juneau Section Chief, Tax Division, Department of Revenue, agreed that the proposed tax is relatively small and broad-based and thus it's a relatively inefficient tax in that the state will spend a lot to collect a little. From an enforcement point of view, there is the need to prevent fraudulent refund claims. He acknowledged that employees are likely to have more than one job during the year and thus may have this withheld twice, which necessitates having a refund program. Therefore, the choice becomes whether to track payments by individuals on an individual basis in order to ensure a refund claim is true. The division has evaluated this before and determined that at the \$100 level, such tracking is economically justified, although it may not be justified at the \$10 level. Mr. Harlamert also commented that it's difficult to

justify what would be normal decisions regarding the quality of the program with a tax at this level.

CHAIR WEYHRAUCH asked if the \$750,000 in capital expenditures listed on the fiscal note is a one-time capital expenditure.

MR. HARLAMERT answered that the aforementioned capital expenditure would be over the first two-three years of the tax. The operating expenditures usually include maintenance costs for systems. The \$750,000 is intended to generate a system that efficiently captures employee data that allows the division to validate refunds. In further response to Chair Weyhrauch, Mr. Harlamert confirmed that after the \$750,000 is paid out, the program would require \$1.1 million in annual operating costs. He also confirmed that the estimated revenue generated from this tax in the second year would be \$3.8 million.

[9:31:44 AM](#)

REPRESENTATIVE SAMUELS asked if the permanent fund dividend (PFD) is included in the definition of "compensation."

[9:31:56 AM](#)

MICHAEL WILLIAMS, Auditor, Tax Division, Department of Revenue, clarified that the PFD wouldn't be considered income under the provisions of HB 263. The forms of compensation that are being reviewed typically include wages, salaries, bonuses, tips, or income from self-employment. With regard to the overall program, the fiscal note views this program as a stand-alone program. He explained that if HB 263 were passed at the proposed lower level in conjunction with a broad-based income tax, the additional costs wouldn't likely be incurred because it could be included in the overall administration of the broad-based income tax. He agreed with Mr. Harlamert that the lower the tax, the less efficient the tax becomes in terms of revenues and costs. Generally, an efficient tax is one in which a program operates at under 5 percent of the cost of revenue generated. At the \$10 tax level, the program is operating at roughly 33 percent cost to revenue level.

[9:34:13 AM](#)

CHAIR WEYHRAUCH inquired as to the amount the tax would have to be in order to be minimally efficient.

MR. WILLIAMS answered that when the tax is \$100 it brings in about \$38 million a year, which results in a cost of roughly 3 percent of the total revenue. He submitted that at the \$100 level it would be a more efficient tax system.

[9:35:27 AM](#)

REPRESENTATIVE SEATON asked if the division would envision sending back to the employer a card specifying that an employee with multiple employers could [prove] that he or she has already paid the tax.

MR. HARLAMERT answered that ideally the division would desire collecting as much of the tax as can be withheld and condensed at the employer level with as few refunds as possible. In order to strike that balance, the division would want to hold employers responsible for withholding, as far as practically possible. However, the division would provide a way in which to administer the program on [the state's] behalf. Therefore, the division would envision that the employee would need to show the employer a pay stub that evidences the withholding from a prior employer.

REPRESENTATIVE SEATON surmised then that the pay stub would include a line item denoting the education tax deduction rather than utilizing a web-based system by which the employer could access, by using the employee's social security number, whether the employee has paid the tax that year.

MR. HARLAMERT acknowledged that one choice could be to capture and manage such detailed information on an employee every withholding period. The other choice could be to do something similar to what the Internal Revenue Service (IRS) does with W-2s and wage withholding such that summary information is collected at the end of the year for all the employer's withholding by individuals for the year. The aforementioned is cheaper, but doesn't allow real-time information on-line during the year. Therefore, Mr. Harlamert said that it's a matter of how much the state wants to pay for the service because once the data is obtained it's not expensive [to manage it].

[9:39:20 AM](#)

LARRY MESHKIN stated his opposition to the employment tax because in principle it's just like an income tax. Mr. Meshkin related the following quote from Robert Nosik (ph): "Taxation of earnings from labor is on a par with forced labor." He also

offered quotes along the same sentiment from Walter Williams (ph) and Allen Keys (ph). Mr. Meshkin then opined that a flat sales tax, when it's necessary, is the way to go because everyone would share in paying for state services. Furthermore, when everyone's involved, he opined that there will be more efficiency with the use of state services.

[9:41:27 AM](#)

ART CURTIS, Co-Chair, Alaskans for Fair Taxes, said that taxation is the price everyone pays for living in a civilized society. However, he expressed concern with regard to the employment tax because if it's too small, it's hardly profitable to collect it, but if it's large, it's very regressive.

[9:43:11 AM](#)

REPRESENTATIVE SEATON commented that the employment tax would make more sense if it was a minimum within a generalized income tax. He recalled that Representative Wilson's income tax proposal last year incorporated a minimum amount of the tax going into the education trust, which seemed to make sense. As a stand-alone tax, Representative Seaton expressed concern with regard to its [lack] of efficiency.

[9:44:50 AM](#)

REPRESENTATIVE WILSON clarified that her proposed legislation last year incorporated a \$100 [education tax]. She indicated that her proposal took into account the fact that many people don't pay anything, although they receive a lot of services from the state. Therefore, under her proposal everyone paid something and the thought was that everyone received a PFD and thus could afford to [pay] \$100.

[9:45:35 AM](#)

REPRESENTATIVE SEATON pointed out that Representative Wilson's legislation included the PFD as income, and therefore one could check a box on the PFD for the tax to be taken from it. However, this legislation doesn't include the PFD as income.

[9:46:02 AM](#)

REPRESENTATIVE GRUENBERG asked if the PFD was in place when the proposal encompassed in HB 263 was originally instituted.

CHAIR WEYHRAUCH replied no, and added that the income tax of the time was repealed at about the same time [as the education tax].

REPRESENTATIVE GRUENBERG pointed out that the only folks who would pay this proposed tax would be employed individuals while those with passive income escape.

[9:47:13 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:47 a.m.