

HOUSE FINANCE COMMITTEE
FOURTH SPECIAL SESSION
May 24, 2016
8:38 a.m.

8:39:04 AM

CALL TO ORDER

Co-Chair Thompson called the House Finance Committee meeting to order at 8:38 a.m.

MEMBERS PRESENT

Representative Steve Thompson, Co-Chair
Representative Dan Saddler, Vice-Chair
Representative Bryce Edgmon
Representative Les Gara
Representative Lynn Gattis
Representative David Guttenberg
Representative Scott Kawasaki
Representative Cathy Munoz
Representative Lance Pruitt
Representative Tammie Wilson

MEMBERS ABSENT

Representative Mark Neuman, Co-Chair

ALSO PRESENT

Randall Hoffbeck, Commissioner, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Representative Ivy Spohnholz; Representative Sam Kito.

PRESENT VIA TELECONFERENCE

Brandon S. Spanos, Deputy Director, Tax Division, Department of Revenue.

SUMMARY

HB 4001 OMNIBUS TAXES & CREDITS; MINING LICENSES

HB 4001 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson discussed the meeting agenda.

#hb4001

HOUSE BILL NO. 4001

"An Act relating to taxation, including establishing an individual income tax; relating to the marijuana tax and bonding requirements for marijuana cultivation facilities; relating to the exploration incentive credit; increasing the motor fuel tax; increasing the taxes on cigarettes and tobacco products; taxing electronic smoking products; adding a definition of 'electronic smoking product' and requiring labeling of an electronic smoking product; increasing the excise tax on alcoholic beverages; relating to exemptions from the mining license tax; removing the minimum and maximum restrictions on the annual base fee for the reissuance or renewal of an entry permit or an interim-use permit; increasing the mining license tax rate; relating to mining license application, renewal, and fees; increasing the fisheries business tax and fishery resource landing tax; relating to refunds to local governments; and providing for an effective date."

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, provided opening statements about the legislation. He discussed the governor's introduction of a comprehensive package to reform the government's current fiscal situation, which included new revenue, reduced expenditures, and use of financial assets to balance the budget and close the \$4 billion gap. He believed that over the course of the session it become clear \$4 billion was a very large number and closing the gap was a very difficult task. He detailed the House Finance Committee had already dealt with two of the large components including the oil and gas tax credit reform [HB 247] and the budget. Two major components were remaining that would come before the committee during the current special session including the Permanent Fund Protection Act [HB 245] and the omnibus tax bill currently before the committee [HB 4001].

Commissioner Hoffbeck relayed the committee had already seen some of the bill components including those related to mining, fishing, motor fuel, and income taxes; the alcohol

and tobacco taxes had not yet been considered by the committee. Additionally, a marijuana enforcement component had been added to the bill, which was a portion of Representative Gabrielle LeDoux's HB 337. The revenue package included in HB 4001 would raise approximately \$350 million per year by FY 19 and would be a substantial portion of the effort to close the fiscal gap. The bill combined previous tax bills before the legislature [during regular session] including income tax (HB 250 and SB 134), motor fuel tax (HB 249 and SB 132), tobacco tax (HB 304 and SB 133), alcohol tax (HB 248 and SB 131), mining tax (HB 253 and SB 137), fish tax (HB 251 and SB 135), and marijuana tax enforcement (HB 333). For the most part HB 4001 incorporated work that had already been done during session; most of the committee adjustments had been included within the bill.

Commissioner Hoffbeck addressed the structure of the presentation titled "New Sustainable Alaska Plan: Pulling Together to Build Our Future; Governor's Special Session Omnibus Tax Bill HB 4001" dated May 24, 2016 (copy on file); there were two pages for each of the bill components including what the bill did and how it differed from legislation heard during regular session and how much money it raised and how it impacted individual Alaskans. The original bills had included a component for electronic filing, which had been taken care of with the passage of HB 375 [related to the filing of electronic tax returns and reports]; therefore, it had been stripped out of the various components of HB 4001.

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KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, addressed slide 5 related to income tax. He relayed he would discuss the items in the sequence they appeared in the bill. The income tax statute would be a new AS 43.22 for individual income tax tied to 6 percent of the federal tax liability. He explained it was very similar to a previous income tax in Alaska that had lasted for several decades and had been repealed in 1980. The former rate had peaked as high as 16 percent of the federal liability (6 percent was slightly more than one-third of the former tax). The bill language provided for withholding by employers that would send money to the state (effectively equivalent to a W2 form). The bill would enable the state

to tax income out of state residents, partnerships, and S-corporations.

Mr. Alper highlighted how the income tax section differed from the regular session bill. He relayed it cleaned up language related to the taxation of trusts. He elaborated that Alaska was something of a trust haven and the administration did not want to harm money residing in Alaska for trust purposes. He noted the department had just heard the bill did not remove fishery crew shares from the withholding tax requirements; however, the intent was to remove the language in the withholding section of the bill. He explained that fishery crew tended to be contractors as opposed to wage employees and it would be burdensome on the captain to have to do withholding taxes for non-wage employees. Individuals with no taxes withheld would have a higher tax liability at the end of the year, which would have to be dealt with on the enforcement side. The most important change was the delay of the effective date to January 2018 from the initial January 2017 date. He detailed the change made a big difference for the Department of Revenue (DOR) because it would provide the department with time to gain some outside expertise, learn about building an income tax from scratch, and removed much of the implementation cost out of the fiscal note. The department did not currently have a complete sense on the cost it would take to implement the income tax; it intended on reporting back to the legislature in the coming January on the actual cost including a staffing plan and software needs. The project was large and the department did not want to base the implementation on a partially constructed idea on cost.

Mr. Alper moved to slide 6 and addressed the fiscal aspects of the income tax. The bill had originally been projected as \$200 million and was a \$205 million bill based on inflation by the time the full value would be reached in FY 19. The revenue was only \$100 million in FY 18 because the state would begin collecting withholding taxes in January 2018; therefore, by June 30, effectively half a year's worth of taxes would have been withheld. The first full year the tax would be in effect was FY 19. After FY 19, revenue numbers would increase slightly every year based on inflation and the expectation of income growth.

Mr. Alper relayed the tax would only be paid by people who owe the federal government money. The department estimated

that between 20 to 30 percent of Alaskans had zero federal liability and would therefore have zero state liability. The percentage was a bit lower than the national average - typically about 40 percent of households paid no federal income tax. He detailed part of the reason the state had a lower number was due to the Permanent Fund Dividend, which provided a base income for Alaskans and pushed some individuals up into a tax bracket they may not otherwise fall into. The tax was somewhat progressive, meaning the effective rate increased the higher a person fell on the income scale. There was a very low or no tax burden on households making less than \$50,000 per year. He elaborated most households would pay substantially less than 1 percent of their income and no one would be over the 1 percent threshold until they earned over \$100,000 in household income. He specified state income taxes were deductible from federal income tax; therefore, individuals who itemize (generally homeowners with a mortgage) would have the ability to deduct their state income tax and save from their federal income tax at the marginal tax rate (typically 25 percent); some of the money would be coming out the federal government's pocket. There were 43 states that currently had an income tax.

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Mr. Alper turned to slide 7 related to the motor fuel tax (AS 43.40). He relayed the subject had previously been heard by the House Finance Committee after going through the House Transportation Committee during regular session. He highlighted the various tax changes:

What it Does

- Increases current tax rates
- Highway Fuel: 8 cents to 16 cents
- Marine Fuel: 5 cents to 10 cents
- Aviation Gas: 4.7 cents to 7 cents
- Jet Fuel: 3.2 cents to 6.5 cents
- Doubles the credit for highway fuel used off-road

Mr. Alper relayed there was a current credit of \$0.06 for highway fuel used off-road, generally claimed by mining operators or people purchasing large amounts of fuel for use off the road system. The credit was applied to the \$0.08 cent tax, bringing it down to \$0.02. He explained that because highway fuel tax would double under the

legislation to \$0.16, the credit was doubled to \$0.12, which would mean an increase to \$0.04.

Mr. Alper addressed how the motor fuel tax differed from the regular session bill on slide 7. He explained the administration had used language from a House Finance Committee substitute for HB 249, which reduced proposed increases on aviation and jet fuel. Additionally, the bill did not incorporate a two-year sunset that had been included in the House Transportation Committee bill [HB 249]. The sunset had been built into FY 18 with the expectation the issue would be revisited based on the price of oil at the time. The current bill would implement a permanent tax increase.

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Mr. Alper addressed slide 8 and relayed that the motor fuel tax would generate about \$43 million per year. The tax would roughly double the current motor fuel collections. He detailed that about \$200,000 would be shared with municipal airports. He elaborated it related to standard statutory formulas on aviation fuel collected from areas with municipal airports and included a revenue sharing component. He relayed the last time the highway fuel increased had been in 1970. He referred to a remark by Deputy Commissioner Jerry Burnett that he could fill his car for \$3.00 in 1970. He specified the state would still have one of the lowest tax rates in the country if it were doubled to \$0.16. He explained that a typical person driving 12,000 miles per year in a vehicle getting 20 miles per gallon, would pay an additional \$48 in tax.

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Mr. Alper addressed tobacco tax (AS 43.50) on slide 9. The cigarette tax was measured in mills (one-tenth of one cent); the current tax was 100 mills between two different taxes with two slightly different funding destinations, which for all intents and purposes was a single tax of 100 mills per cigarette. The bill would increase the tax to 150 mills or \$0.15 per cigarette or from \$2.00 to \$3.00 per pack. He referred to the tax stamp sold by the State of Alaska, which was placed on every pack of cigarettes sold. He detailed a new series of stamps would be generated and would be sold for \$3.00 instead of \$2.00; it was considered a pre-paid tax in some ways. Other tobacco products were

taxed at a percentage of the wholesale value; the bill would increase the tax rate from 75 percent to 100 percent of total sale value. Electronic smoking products fell under a new industry also known as the "vape" industry. He elaborated the industry was becoming quite sophisticated and there were several full-time vape shops in the Anchorage area; the product was currently untaxed. The product was made of generally tobacco derivatives and typically contained nicotine. The bill expanded tobacco definitions in order to tax the new products; however, because the products were currently not taxed the administration felt it was appropriate to establish a lower tax rate of 75 percent.

Mr. Alper elaborated the tobacco sections of the bill were the longest because there were numerous definition changes involved with electronic smoking products. There was also a definition cleanup for wholesale price in order to clarify some issues which had arisen in some tax audits within the excise tax group related to tobacco taxes. He addressed how the sections differed from the regular session bill. He explained it was the only one of the governor's bills with distinctly different language introduced to the House and Senate at the beginning of session. He explained the Senate bill had been introduced at the beginning of session and some corrections had been made before the House bill had been introduced a week or so later related to the definition of electronic smoking products. The House bill had been used as the starting point for the current sections in HB 4001 and definitions had been cleaned up based on work done in the Senate. He detailed the bill would only tax electronic smoking products that contained nicotine. He furthered that people used vape technology for non-nicotine purposes, which the bill would not tax; however, it added a labeling requirement - products had to show whether or not they contained nicotine.

Mr. Alper discussed how much the tobacco tax would raise about \$29 million per year (slide 10). The tax would decline a little bit every year due the forecast projecting a decreasing number of smokers in Alaska over the next several years. He added the decline was not anticipated to be tremendous, but the projected revenue for later years was closer to \$27 million. The revenue represented about a 50 percent increase above current tobacco tax collections. The fiscal note was indeterminate because revenue from electronic cigarettes was currently unknown, which was in

part why the department felt the need to include the product under the tobacco umbrella. The department could only guess at the actual revenue that could come in because it did not know how much the product was out there. About \$2 million of the new revenue would go to the Tobacco Use Education and Cessation Fund, which represented a statutory percentage of the mill rate tax on cigarettes.

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Mr. Alper continued to address slide 10 and addressed how the tobacco tax would impact Alaskans. The bill did make it more expensive to smoke; \$1.00 per pack at a pack per day would be an increase of \$365 per year. The state currently had the 11th highest cigarette tax and would move to 5th place with the increase. He noted the numbers were a bit misleading because there were numerous local cigarette taxes all over the country including some cities within Alaska. For example, Juneau had an additional cigarette tax of at least \$2.00. The state had substantial healthcare costs through the Department of Health and Social Services (DHSS) related to tobacco illness, which the increase would help offset. He detailed the state's chief medical officer had testified in the previous committee about the issues. The bill would add a tax for the first time to the new vape industry.

Mr. Alper moved on to discuss alcohol tax (AS 43.60) on slide 11. He detailed the alcohol tax had not received significant hearings apart from in the House Labor and Commerce Committee. The bill would double current tax rates:

- Distilled Spirits: \$12.80/gallon to \$25.60
- Wine: \$2.50/gallon to \$5.00
- Beer and Cider: \$1.07/gallon to \$2.14

Mr. Alper explained the numbers were not random. He explained that the last time the alcohol tax had been increased in 2002 the decision had been made to tie the tax to \$0.10 per drink. He elaborated that 1 gallon was 128 ounces, 1 ounce was about a standard shot of liquor; therefore, a tax of \$12.80/gallon or \$0.10 per drink was established. Likewise, 1 gallon of wine based on a 5 ounce pour would be \$2.50 and \$1.07 per gallon for beer was the equivalent of \$0.10 for a 12 ounce beer. The craft brewery rate was tied to the federal definition of a small craft

brewery - not just breweries in-state, which would be unconstitutional - it also included small breweries from outside Alaska. The first 60,000 barrels per year from a craft brewery would have a tax of one-third of the full rate: \$0.35/gallon increasing to \$0.70. The bill created something of an advantage for the industry; the spread between larger and small breweries became larger when the taxes were doubled. The tax would increase the cost of a drink from \$0.10 to \$0.20. He explained the bill would change the requirement tax payers had to pay a security bonding payment to DOR from \$25,000 to variable based on the department's decision about what would be the best number for the individual taxpayer. He noted that many taxpayers were quite small and the \$25,000 was somewhat onerous; whereas, some taxpayers were quite large and \$25,000 may not be an adequate incentive for them to continue paying their taxes. The bill contained no differences between the one introduced during regular session. He reiterated the prior bill had not received many hearings.

Mr. Alper addressed the increased alcohol tax would raise approximately \$40 million per year (slide 12). He drew attention to a table on the back page of the fiscal note showing the 2017 revenue from alcohol would be \$4 million. He corrected the amount was actually \$40 million, which would add \$36 million to the bottom line total in FY 17. The tax increase roughly doubled current collections. About \$20 million would go to the Alcohol and Other Drug Abuse Treatment and Prevention Fund. He elaborated the fund was included in the mental health budget and funded many DHSS programs. He added that the funds were supplemented by a large number of GF. He noted it did not mean the state needed to be putting \$20 million more into the programs; the GF could be backed out in the budget making process.

Mr. Alper addressed how the bill would impact Alaskans. He relayed it would make it more expensive to drink. The tax could equal \$0.10 per drink or could be built into the wholesale price and could lead to a larger increase than the typical price of a drink. The state had among the highest alcohol taxes in the country at present and the increase would make Alaska number one by a substantial margin, which he was certain the alcohol industry would be quick to point out.

Mr. Alper moved to slide 13 related to marijuana tax (AS 43.61) and relayed the bill would not increase the specific tax. The bill included some provisions from a bill Representative LeDoux had submitted during the regular session, which had come out of the House Labor and Commerce Committee. He did not believe the bill had been heard by the House Finance Committee. The 2014 marijuana initiative had established a \$50 per ounce rate; through the regulatory process a lower rate had been established for the non-smokable portions (i.e. the concentrates industry). The bill would require a surety bond of \$5,000 for taxpayers (i.e. the growers). The requirement was slightly atypical among the department's surety bonds because it gave the option for the growers to provide the money in cash rather than an insurance plan because there was some concern the marijuana taxpayers would not be able to access traditional banking services and would therefore be working in a cash economy. The primary goal was to give certain enforcement powers to DOR that it had for some other taxes.

Mr. Alper explained the bill would empower DOR to enforce the tax against a marijuana retailer who is selling product that did not come from a licensed/taxpaying cultivator. Additionally, the bill would empower DOR to enforce a tax penalty on illegal grow operations in excess of the personal use limit. He noted the limit had been six, but HB 75 had increased the limit to 12. He referred to a recent arrest of a grower in Homer with 1,000 plants and relayed that 988 of the plants were illegal, which could be a felony. However, an alternative enforcement mechanism that would be much easier to collect would be to include a tax penalty on that marijuana. For example, the state could charge \$50 an ounce for the illegal plants; it would be a civil fine and in the case of the Homer growing operation it would have equated to approximately \$250,000. He furthered it would hopefully act as a deterrent from large illegal grow operations.

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Representative Wilson clarified that the number of plants had not been increased. She stated that the limit had been 6 plants per person and HB 75 had changed it to 12 per household regardless of the number of individuals living in the home. She reasoned effectively the number had been lowered because previously if there were three adults

residing in a home they could have had 18 plants, but now they could only have 12.

Mr. Alper replied in the affirmative. He relayed the bill contained no difference in the marijuana sections from the bill that came out of the House Labor and Commerce Committee several weeks back.

Mr. Alper moved to slide 14 and relayed the revenue from the marijuana tax was indeterminate. He detailed that any money raised by the changes would be through enforcement actions, which were impossible to predict. Ultimately the administration's goal was to make it as advantageous as possible to be a legal and licensed business and disadvantageous to remain in the black market. He equated the current situation to 1934 when alcohol prohibition had just been repealed. The bill would indirectly increase revenue to the state from legal marijuana.

Mr. Alper turned to slide 15 related to mining license tax (AS 43.65), which had been included in a bill with several small taxes previously considered by the House Finance Committee. The bill would increase the current top tax rate on net profits greater than \$100,000 per year from 7 percent to 9 percent. The bill would reduce the production tax holiday for new mines from 3.5 years to 2 years. The bill would prevent the mining exploration incentive credits from being used to reduce royalties, limiting to just the tax (the change had originally been incorporated in the House Resources Committee). He explained the credits were not cashable and were rolled forward for use against taxes. He elaborated the state was only the land owner for a couple of the large mines in Alaska. The bill would add a \$50 annual license fee for miners. He noted that miners were exempted from needing a business license, which was also \$50. He furthered that because miners already had mining licenses there was no reason to make people get a second license.

Mr. Alper addressed how the bill differed from the regular session bill. The original bill sought elimination of the tax holiday; the 2-year tax holiday was a compromise proposal. Additionally the exploration incentive credits and royalty change made in House Resources Committee had been incorporated. The 2 percent increase at current commodity prices (the industry was closely tied to the global price of gold and zinc) would bring in about \$7

million per year (about \$25,000 of the total would result from the \$50 license fee). He addressed how the increase would impact Alaskans. He relayed the typical "mom and pop" miner would not feel an impact apart from the \$50 fee. He shared that in 2014 there were only 14 taxpayers earning over \$100,000 in taxable profits and were the only ones who would be impacted by the tax increase. Out of the 14, there were only about 5 large mines in the state. He specified there were smaller miners who had a particularly good and earned over \$100,000; only the amount above \$100,000 would be subject to the tax. He relayed that if someone owned land leased by a mine and the mine paid the landowner a private royalty, the royalties were current subject to a mining license tax; therefore, several of the \$100,000 taxpayers were not actually miners, but were landowners who were paid royalties by a miner.

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Mr. Alper turned to slide 17 and addressed the fisheries business tax (AS 43.75) and the fisheries landing tax (AS 43.77). He highlighted that the business tax applied primarily to processors and the landing tax applied mostly to federal fisheries. The bill would increase the current tax rates by one percentage point. The rates were currently between 3 percent and 5 percent depending on status (i.e. onshore, offshore, canneries, shore-based, etcetera). Currently the fisheries taxes were shared with the municipal government 50/50. Under the bill, the first 1 percent of the increased tax would go 100 percent to the state and the rest would be shared 50/50, effectively holding the municipalities harmless. He noted that the tax increase would not be shared with the municipalities.

Mr. Alper explained the bill would remove the \$3,000 cap on annual Commercial Fisheries Entry Commission (CFEC) entry permit fees. The elimination of the cap would increase the permit fee for certain large boat owners (a couple hundred large boat owners who were almost entirely non-resident). The developing fisheries designated annually by the Department of Fish and Game were exempted from the increase. He discussed how the sections differed from the regular session bill. The original bill had increased the rate for one of the developing fisheries, which had been removed in the current bill. Additionally, the entry permit fee had not been included in the original bill, but had been added in committee. He believed it may have been in

other legislation, but he had not found the source document.

Mr. Alper highlighted the increases would bring in about \$18 million from the tax change and about \$2 million from the CFEC fee change. He addressed how the sections would impact Alaskans. He relayed the price of fish was generally set by the commodity market; the market would not necessarily absorb the tax increase. He elaborated that although the tax would be paid by processors, it was typically backed out of payments made to harvesters. So in effect, the fisherman would pay the tax.

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Representative Gara addressed the state's \$4 billion-plus deficit. He noted that the governor's revenue proposal did not reach \$4 billion. He discussed that there were opponents of each of the various taxes; therefore he thought it seemed to be a recipe for failure to put all of the taxes in one bill. He asked why it was the strategy that the administration had chosen.

Commissioner Hoffbeck answered that there had been much discussion about whether to offer the bills separately or combined during regular session. The administration had weighed whether combining them or leaving the taxes in separate bills would give people the ability to vote for something they did not necessarily like because they were potentially alright with the other five components of the bill versus a situation where people would not vote for the bill. The administration had offered the taxes in separate bills during regular session, but the bills had not moved forward. Therefore, the administration had elected to introduce the taxes in an omnibus bill where it was easier to see all of the components in one place at one time. One of the major pushbacks the administration had received was there had not been a large desire to work on an individual tax bill separate from other tax bills.

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Representative Gara expounded on his prior question. He remarked that when numerous popular bills were combined it was a method for increasing votes; however, combining numerous bills that people did not love, resulted in fewer votes. Based on conversations he had with other legislators

he surmised the bill was almost guaranteed to fail because people disliked various components of the bill. He asked the administration to rethink the strategy. He spoke to the income tax component. He believed the administration testified it had chosen an income tax that was the lowest in the country. He elaborated the income tax would raise close to \$200 million or one-twentieth of the state's \$4 billion deficit. He reasoned that the public would say the administration was imposing the tax at present and would increase it in the future. He believed there was some logic behind that line of thinking. He wondered why the administration chose not to propose something more similar to the state's former income tax or a proposal offered by Representative Paul Seaton earlier in the regular session, which would raise more money. He continued the current proposal only applied to people making capital gains income. He equated the individuals who would be impacted by the tax to the Warren Buffets of the state; he added there were few individuals in that category in Alaska. He concluded the income tax would be less than 1 or 2 percent on a person's 15 percent capital gains tax.

Mr. Alper answered that no one wanted to add an income tax just to add an income tax; there was no strong desire to tax the Alaskan people. The income tax had been the last component added to the governor's revenue plan the previous fall. The size had been chosen based on what was needed to balance the state's budget. The administration had looked at the other components including what the change to the Permanent Fund would do, all of the smaller taxes, the oil and gas tax credit reform, and the expected and additional budget cuts and without the income tax the plan had been \$200 million short by FY 19. Therefore, the last component chosen was the income tax, which was as small as it needed to be in order to balance the budget. Until it became clear which bills passed or did not pass by the current legislature, it was not possible to calculate what the income tax rate may need to be. At present, the number had been selected in order to balance the budget assuming the passage of the other components.

Representative Gara countered that the administration knew its Permanent Fund Protection Plan had been replaced by a plan that raised less money. He stated that if HB 4001 passed he would have to be honest with the public that people would pressure a second income tax increase. He reasoned the last thing people wanted was to be taxed

twice. He referred to the current \$4 billion deficit and discussed that any version of the passed oil and gas credit bills brought in zero revenue in FY 17 or FY 18.

Co-Chair Thompson asked to the committee to stick to the current bill.

Representative Gara continued that the oil and gas tax credit bill brought in no revenue and the proposed income tax brought in no revenue for two years. He wondered why it was a good idea.

Mr. Alper answered that the income tax was new. The administration could quadruple the other taxes if the legislature desired and absorb it into the existing staff. The dollar part was not the difficult part. However, the state did not have the infrastructure, people, or equipment to handle the income tax; it was necessary to procure the items and the state needed to learn how to implement the income tax from people who know about the issue. He furthered developing the infrastructure would take time; it was not that the administration did not want the money at present to balance the current budget, but the state was physically incapable of beginning to collect an income tax at present. The decision had been made to delay for a year. He continued that it was currently May and the thought of having the infrastructure in place by January 2017 was challenging. He reasoned the work would be done better if implemented in FY 18. Additionally, the administration would do a better job asking for the resources if it came back in January with expertise about what it would take. He remarked the legislature had seen a fiscal note a few months ago specifying \$14 million and 60 new employees were needed. He believed the estimate was probably about right, but the administration honestly did not know; it would take real money to implement an income tax. He would rather be accurate than need to ask for funding twice.

Representative Gara asked for verification that it would be the lowest income tax in the nation. Additionally, he asked how much revenue the income tax would raise if it was imposed at the level of the state's former income tax.

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Mr. Alper answered in the affirmative. He elaborated that 2 states had a tax on capital gains (not a true income tax).

Out of the 41 other states with an income tax, Alaska would have the lowest if the 6 percent tax was implemented. He relayed Representative Seaton's HB 182 during the 2015 session, had included Alaska's former income tax of 16 percent combined with a capital gains component and would have generated \$650 million in revenue per year.

Vice-Chair Saddler asked if the administration believed combining seven taxes together would make the bill more or less likely to pass.

Commissioner Hoffbeck answered that based on the administration's lack of success passing the bills individually, he surmised combining the taxes together in one bill it was probably not less likely the bills would pass. He detailed some people had been willing to vote for a package if they liked six out of the seven taxes. He continued that others would have preferred to vote against an individual tax and hope that the rest of the legislators would pass it. He believed it was "six to one, half dozen to another" as far as the best way to get the taxes through. He believed the option to take the bills apart again was still within the legislature's purview even in a special session. However, the administration thought it was important for all of the bills to be in one place at one time. He elaborated that addressing the taxes separately had been one of the biggest criticisms the administration had received during regular session - people had vocalized they were not willing to move a bill until the other bills were also available to move. He added that legislators had vocalized they did not want to move a bill they did not support only to see other bills they supported not make it.

Vice-Chair Saddler surmised that based on advice by some legislators, the administration believed it was more likely to see the taxes passed in a combined package.

Commissioner Hoffbeck that the decision had not been based on advice by legislators. He elaborated that some legislators believed individual bills were better and others thought an omnibus bill was better.

Vice-Chair Saddler asked if the administration believed it was more or less likely for the taxes to pass as a combined package. He recognized different legislators had different views on the issue.

Commissioner Hoffbeck believed it was more likely some form of a bill would pass as a package because the taxes were now all in play in the same location for everyone to deal with.

Vice-Chair Saddler surmised the administration believed it was more likely some elements would pass, but not others. He asked which elements the administration believed would pass.

Commissioner Hoffbeck answered that the governor had included all of the taxes because they were each important. He chose to avoid placing odds on which taxes would pass versus not.

Vice-Chair Saddler remarked on Commissioner Hoffbeck's statement that some legislators thought the taxes would all pass and others did not. He referred to the grounds that some of the taxes may pass. He was trying to determine if the administration believed it was more likely to get the taxes passed in the current combined form.

Commissioner Hoffbeck answered that the governor wanted to see all of the proposed taxes passed; the idea was for all of the taxes to pass.

Vice-Chair Saddler asked if the governor told anyone in the legislature that he planned to call a special session on bills such as the one before the committee regardless of what legislators had passed during regular session. Commissioner Hoffbeck asked Vice-Chair Saddler to repeat the question. Vice-Chair Saddler complied and restated his question.

Commissioner Hoffbeck answered not that he knew of. He believed the governor's statement all along was that he would look at what passed and if the numbers had been sufficient to bring the budget in line he was willing for some things to not be part of the package as long as the numbers worked.

Vice-Chair Saddler asked if the answer was a "no." Commissioner Hoffbeck replied that as far as he knew the governor had not told anyone that.

Vice-Chair Saddler asked if Commissioner Hoffbeck would be in a position to know. Commissioner Hoffbeck replied he believed he would know.

Co-Chair Thompson asked about the tobacco tax stamp. He noted the tax had been included in HB 155 related to indirect expenditures and had required the industry to place the stamp on packages. Currently the state paid over \$300,000 to have the stamp put on cigarette packages. He reasoned the work should be done by the industry. He noted it was not addressed in the current bill, but he believed the issue needed to be addressed in the future.

Mr. Alper answered that he did not know whether HB 155 had passed during regular session.

Co-Chair Thompson replied that the bill did not pass; it had been hung up in Senate Rules.

Mr. Alper explained how tax was paid on cigarettes. He relayed the wholesaler purchased stamps from the State of Alaska, which the state bought in bulk. The stamps were valued at \$2.00 apiece and were kept in a safe. Subsequently, it was the wholesalers' responsibility to get their money back by sticking the stamps to the cigarette pack and selling the pack. In years back a tax credit had been proposed for the physical act of applying the stickers to help defray the costs of some advanced sticker applying equipment that had been purchased a few decades ago. He explained that HB 155 would have eliminated the credit. He furthered it was the wholesalers' responsibility to put the stamps on the cigarettes and they continued to do so. He explained with HB 155, they had tried to eliminate any advantage or payback for the act of placing the stickers on the packages. He explained that the equipment should have all been paid for at present; it was an old piece of legislation.

[9:25:26 AM](#)

Representative Gattis referred to about the craft brewery component of the alcohol tax. She was uncertain what a craft brewery was. She wondered if the craft brewery component pertained to craft distilleries and wineries.

Mr. Alper answered that the federal definition of craft brewery was broader than one may think and related to

facilities producing "something like less than 2 million barrels per year." Almost all companies other than the largest 10 or fewer in the country fit within the definition. The state's statute specified that from the qualifying breweries, 60,000 barrels per year were taxed at the lower rate. He did not know whether there were distinct federal definitions for craft wineries or distilleries. He relayed something could certainly be worked into the statute for a lower tax rate on craft distilleries, which was a growing industry; the topic had not been included in the conversation in 2002 when the legislature had last addressed the alcoholic beverage tax. He was certain craft distilleries would appreciate it. He clarified that the state would not have the ability to only carve out Alaskan distilleries; it would open the door for a lower tax rate for craft distilleries for products made out-of-state as well.

Co-Chair Thompson asked how many breweries qualified for the credit. Mr. Alper deferred to his colleague.

BRANDON S. SPANOS, DEPUTY DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE (via teleconference), answered that there were only three of the major brewers that did not qualify under the federal definition of a craft brewer. Therefore, many of the applicants (not all breweries submitted an application) received the credit.

Representative Gattis asked how many in-state and out-of-state breweries applied for the credit. She was asking the question from the standpoint of looking out for Alaskan distilleries and breweries. She referred to Mr. Alper's testimony that the state could not offer the credit to in-state businesses only.

Mr. Alper replied that there were 20 in-state breweries that qualified for the credit. He noted Mr. Spanos may have detail on the number of out-of-state applicants. He provided an example of an out-of-state brewery such as Red Hook, which sold through a distributor in Alaska. He clarified the distributor was the taxpayer. The state was not able to parse out the individual products going through the distributors; therefore, it was hard to say how many products were receiving the credit. He explained there was beer sold directly, which was easy to parse out and included mostly local businesses; and the beer sold through

a warehouse distributor, which was a much larger volume of beer receiving the craft brewery exemption.

Representative Gattis noted that there were a few Alaskan distilleries and she wanted to explore the idea of including a credit for craft distilleries.

Representative Wilson asked for clarification on the state's actual deficit. She noted the committee kept hearing the state's deficit was over \$4 billion, but it was her understanding that figure was actually the amount of the state's budget. She reasoned the state still had revenue. She detailed the budget was approximately \$4.3 billion and the state had approximately \$1.3 billion in revenue at present, which left approximately \$3 billion to fill. She asked for the accuracy of her estimates.

Mr. Alper answered that the original \$4.3 billion budget did not include the oil and gas tax credits that were in the governor's original budget; therefore, the revenue was about \$700 million short pertaining to the specific component. He understood the conference committee was funding a portion of the amount with another funding source through a Constitutional Budget Reserve (CBR) appropriation from the previous year. Presuming that nothing changed and the operating budget passed as is, the GF portion would be \$4.3 billion and the deficit would realistically be about \$3 billion. He agreed her assessment was correct; however, there were still a few missing pieces before "we get to the finish line."

[9:31:17 AM](#)

Representative Wilson countered that the pieces were not missing and everyone knew they were there. She believed the real question was how the legislature may or may not pay them. She wanted to be clear about the state's actual deficit. She stressed that the deficit was definitely not the entire budget. She had heard statements repeatedly made that the state's deficit was over \$4 billion; however, it was really \$3 billion at present that the legislature needed to fund with a combination of its savings account and incentives/enhancements.

Mr. Alper responded that the prior year budget (FY 16) was closer to \$5 billion. There had been cuts and components that had yet to be funded. Based on Representative Wilson's

reasoning, the anticipated deficit was down to about \$3 billion for FY 17.

Vice-Chair Saddler noted that some of the bill's components had been heard earlier in the regular session. He recalled the administration had relayed the only analysis the administration had done on the impacts of the taxes on the economy was consultation with its own departments. He asked if the administration had contracted for any analysis outside its own departments in the past several months.

Commissioner Hoffbeck answered that the only new piece of information introduced, which dealt with the income tax more than anything else was the Institute of Social and Economic Research (ISER) study. The study had looked at the impacts of various income and sales taxes and the various cuts that needed to be made.

Vice-Chair Saddler asked if Commissioner Hoffbeck believed it was important to understand what the impact of the taxes would be on the state's economy. Alternatively, he asked if the only criteria was how much money the taxes would raise.

Commissioner Hoffbeck answered that the administration's concern was the state's large deficit. He elaborated that everything they did to close the deficit would have an impact. He reasoned the same statement could be made for every cut that had been made in terms of how it would impact the state's economy. The administration recognized that difficult decisions needed to be made and that the changes would have impacts. The department had worked to highlight the relative size of the state's tax compared to other taxing jurisdictions. He furthered that other places had taxes to fund governments and their economies thrive. He believed the assumption that any tax increase would devastate the economy was probably an overstatement. He agreed there would be impacts and the administration could not specify at present what the impacts would be. He believed a fairly major study could be conducted and the precise impacts would still be unknown and how they would compare to doing nothing to address the deficit, which would have to be dealt with one way or another. The question was whether to do it at present or later when the impacts would be even greater.

[9:35:13 AM](#)

Vice-Chair Saddler remarked the administration acknowledged there would be impacts, but he saw no evidence the administration tried to assess what the impacts would be. He addressed the legislative process for compiling information including speaking to the administration and talking to the public about what the impact may be. He reiterated the department testified that it had not studied the impacts other than how much money the taxes would raise.

Commissioner Hoffbeck replied with an example related to the motor fuel tax of \$0.08 per gallon. He noted the price for gas in Anchorage had increased by \$0.35 in the past few months. He questioned whether the \$0.08 per gallon increase would have a greater impact than the \$0.35 per gallon increase going to refineries. Some of the taxes would be absorbed within the normal volatility of the markets. General statements could be made, but the administration did not have information showing the exact economic impact of the various components.

Vice-Chair Saddler countered "or even generally."

Representative Gara wanted a balanced fiscal plan. However, he believed individuals with the least amount of money were being hit hard, while wealthy individuals were not impacted. He looked at the income tax, which was basically 1 or 2 percent. He added the Permanent Fund Dividend was about 20 percent of the income for people in the lowest 50 percent of wage brackets. He wondered why the administration had not considered a corporate tax for companies making over \$250,000 per year. He remarked that over 6,000 Alaska corporations paid no corporate tax because they were not C corporations. He continued that the companies would pay a tax of about 2 percent if the income tax passed; however, the state's corporate tax was about 9.5 percent.

Commissioner Hoffbeck answered that the governor's decision on the income tax was to spread the burden of the economic issues across the broader economy. The administration had looked at a specific corporate income tax to include S corporations and limited liability companies (LLC), but it was more complicated. He detailed the revenues in those cases flowed to the individual; therefore, it was not an easy piece of legislation. He furthered that many LLCs were not big lucrative businesses; many were mom and pop

businesses that were just getting by. He explained that the income really equated to personal income than a corporate income in many cases. He added there were some very large companies as well.

9:39:05 AM

Representative Gara replied that he had proposed a corporate tax bill for companies making over \$250,000 per year. He reasoned it was not overly challenging to apply a corporate tax to profitable businesses. He asked a separate question related to craft breweries. He surmised the lowest income tax had been proposed, but the administration was also proposing the highest alcohol tax in the nation. He supported the growing craft brewery industry and he had no problem with taxing the group at a lower rate. He reasoned that locally owned restaurants were locally owned as well. He wondered why the decision had been made to make a distinction between locally owned craft breweries but not restaurants selling alcohol. He declared a conflict of interest related to his restaurant in Anchorage. He made remarks about the specific restaurant. He reasoned there were families who owned local restaurants and he wondered why the state would treat the businesses differently.

Mr. Alper answered that the restaurant owner would be paying individual income tax under the plan. To the extent the alcohol tax would impact restaurants it would increase the cost restaurants paid to a supplier, which restaurants would have the ability to pass on to customers. The business owner was impacted by the income tax. He addressed the idea of an s-corporation specific tax or partnership specific tax and conceded it could be done, but the decision had been made that the broadest way to reach the entire population was to implement an income tax. He detailed an income tax was inherently progressive, meaning it had a higher percentage of income for the higher income earners. He continued it would offset the inherent regressiveness of anything changing the nature of the Permanent Fund Dividend, which disproportionately hit the lowest income households. To get to a true balance it would probably take a higher income tax to have an equal percentage of income participation across the different income levels.

HB 4001 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson relayed that the afternoon meeting was canceled. He recessed the meeting to a call of the chair [Note: the meeting never reconvened].

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ADJOURNMENT

9:42:43 AM

The meeting was adjourned at 9:42 a.m.