

**ALASKA STATE LEGISLATURE
HOUSE EDUCATION STANDING COMMITTEE**

March 22, 2017

8:04 a.m.

MEMBERS PRESENT

Representative Harriet Drummond, Chair
Representative Justin Parish, Vice Chair
Representative Zach Fansler
Representative Ivy Spohnholz
Representative Jennifer Johnston
Representative Chuck Kopp
Representative David Talerico

MEMBERS ABSENT

Representative Lora Reinbold (alternate)
Representative Geran Tarr (alternate)

COMMITTEE CALENDAR

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 146

"An Act imposing a school tax on certain income of residents, part-year residents, and nonresidents; relating to a payment against the school tax from the permanent fund dividend disbursement; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 146

SHORT TITLE: SCHOOL TAX; PFD PAYMENT FOR SCHOOL TAX

SPONSOR(S): REPRESENTATIVE(S) CLAMAN

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|----------|-----|---|
| 02/24/17 | (H) | READ THE FIRST TIME - REFERRALS |
| 02/24/17 | (H) | EDC, FIN |
| 02/27/17 | (H) | SPONSOR SUBSTITUTE INTRODUCED-REFERRALS |
| 02/27/17 | (H) | READ THE FIRST TIME - REFERRALS |
| 02/27/17 | (H) | EDC, FIN |
| 03/22/17 | (H) | EDC AT 8:00 AM CAPITOL 106 |

WITNESS REGISTER

REPRESENTATIVE MATT CLAMAN
Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Introduced SSHB 146 as the sponsor.

OWEN PHILLIPS, Staff
Representative Matt Claman
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Provided the sectional analysis for SSHB 146, on behalf of Representative Claman, sponsor.

KEN ALPER, Director
Tax Division
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Responded to questions during the hearing of SSHB 146.

ACTION NARRATIVE

[8:04:30 AM](#)

CHAIR HARRIET DRUMMOND called the House Education Standing Committee meeting to order at 8:04 a.m. Representatives Drummond, Parish, Fansler, Johnston, Kopp, and Talerico were present at the call to order. Representative Spohnholz arrived as the meeting was in progress.

HB 146-SCHOOL TAX; PFD PAYMENT FOR SCHOOL TAX

[8:04:58 AM](#)

CHAIR DRUMMOND announced that the only order of business would be SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 146, "An Act imposing a school tax on certain income of residents, part-year residents, and nonresidents; relating to a payment against the school tax from the permanent fund dividend disbursement; and providing for an effective date."

[8:05:28 AM](#)

REPRESENTATIVE MATT CLAMAN, Alaska State Legislature, sponsor, introduced SSHB 146, paraphrasing from a prepared statement, which read as follows [original punctuation provided]:

Alaska faces major financial challenges. Our goal in proposing [Sponsor Substitute for] House Bill 146, a School Tax, is a responsible action plan to meet those

challenges. The Alaska Constitution, Article VII, Sec. 1 requires the legislature to "establish and maintain a system of public school." The public supports a strong public school system, and an investment in our students is an investment in our future.

When asked about the possibility of a broad-based school tax, many people wanted to know what such a tax would look like. The School Tax in HB 146 sets a tax based on adjusted gross income on federal tax returns for every person who earns income in Alaska. All Alaskans and out-of-state residents who work in Alaska would help solve our financial challenges. The minimum tax would be \$100 a year, for those who make \$20,000 or less. In this way, the school tax is similar to the school head tax—everyone contributes. The tax then increases on a graduated scale based on income. Those making between \$50,000 and \$75,000 a year would pay a school tax of \$750. The revenue collected from the school tax would be designated to support public education in Alaska. It is not a dedicated tax fund, which would violate our constitution. (Because it is well below the budget amount, there would be no need to argue the designation as well.)

The values of the tax range from 1% in the lowest bracket to 3.4% at the uppermost bracket. There is also a cap on the uppermost level, allowing the highest earners to reinvest in the economy and support a positive investment climate.

We based our values off a \$1000 permanent fund dividend. Everyone is able to contribute, while individuals who depend on the PFD still receive a reasonable portion. To make payment of the tax simple, the bill includes a provision allowing use of future Permanent Fund Dividends to pay the tax.

I would like to close by saying that this school tax bill responds to public concern about the funding of education in challenging times. It is a transparent way to produce new revenue and create a responsible action plan for Alaska. At full implementation, the school tax bill is projected to raise \$540 million—approximately one third of the state funding for

education. We believe that if the public has a more direct investment in funding education, they will become more involved in the education that we deliver. The school tax is not a proposal to increase education funding. The intent is to raise revenue to help close the budget deficit, designate those funds to support education, and reduce the undesignated general fund appropriation for education on a dollar-for-dollar basis.

[8:08:31 AM](#)

OWEN PHILLIPS, Staff, Representative Matt Claman, Alaska State Legislature, provided the sectional analysis for SSHB 146, paraphrasing from a prepared statement, which read as follows [original punctuation provided]:

First, I would like to provide a brief sectional analysis of the bill. Please note that while this is a Sponsor Substitute, the only change from the original bill is the title. The old title did not include out-of-state residents or specify income.

Section 1 concerns the use of the permanent fund as payment for the tax. This section directs the department of revenue to prepare the permanent fund application to allow an applicant to hold their PFD to pay the tax.

Section 2 is the meat of the bill. Its features include:

- Requiring residents and non-residents with income from a source in state to pay the school tax.
- A school tax based on adjusted gross income, broken into progressive levels. The lowest, less than \$20,000, are still required to pay \$100—this will include those individuals who only collect a PFD. At the top of the scale, there is a cap for taxpayers whose adjusted gross income is greater than \$250,000. This cap will allow individuals to reinvest in the economy, making a positive investment climate.

For the purposes of this bill, adjusted gross income for a resident is their total adjusted gross income, whereas non-residents or part-time resident's adjusted

gross income is calculated from that earned from an in-state source.

The tax is assessed per tax return, meaning that joint filers will pay based on total adjusted gross income. The bill allows the department of revenue to establish procedures for collection of the tax, including regulations for use of the PFD.

There are also lines that explain repercussions for failure to pay on time and a procedure for requesting extensions.

Regulations include:

Annual interest rate of 18% on delinquent taxes

Assessment of fees up to \$2,500 for collection of delinquent taxes

90-day extension, with departmental discretion

Determination of adjusted gross income for joint filers who are not both state residents

Section 3 allows the department of revenue to adopt regulations to implement this act.

Section 4 sets an immediate effective date for section 3.

Section 5 sets an effective date of Jan 1, 2018 for the rest of the act, which includes the tax component of the bill. I will note that this effective date accounts for the lower revenue calculation in the first year of implementation on the fiscal note from the DOR, OMB: 2476.

[8:12:15 AM](#)

REPRESENTATIVE JOHNSTON said she has heard holders of fishing permits are concerned that the state may view them as tax collectors [should the bill become law].

REPRESENTATIVE CLAMAN said a payroll tax is not part of SSHB 146. The bill would impose a single payment, based on income, and would establish collection fees of up to \$2,500, plus

interest for nonpayment; fishing boat owners would not be asked to collect the school tax [from their employees].

REPRESENTATIVE PARISH noted that the delinquent tax collection fee of not more than \$2,500, plus an 18 percent interest rate, seems very "aggressive." He asked whether alternative disincentives have been considered.

REPRESENTATIVE CLAMAN explained the sponsors of the bill did not wish to establish a monthly payroll tax collected by employers and administered through the Department of Revenue (DOR), thus the proposed penalty is a meaningful consequence of nonpayment. He pointed out one could avoid payment of the tax by not applying for a Permanent Fund Dividend (PFD) [administered by the Permanent Fund Dividend Division, DOR].

REPRESENTATIVE PARISH observed residents' PFDs are already in the possession of the state, which provides a mechanism of collection prior to the issuance of the dividend, and thereby voids the need for a stiff penalty and interest. Further, he suggested the penalty should be relative to a person's annual income, and free from manipulation by officials. He proposed that in place of a penalty plus interest, a future PFD could be garnished with an interest rate of not more than 10 percent.

REPRESENTATIVE CLAMAN pointed out the bill provides the option to pay the school tax through one's PFD, which would negate any inability to pay and no penalty or interest would accrue. Nonpayment would occur if a resident declined the deduction from his/her PFD.

REPRESENTATIVE PARISH related the time value of money can be of particular concern for someone "living sort of at the margins," and suggested one may have an urgent need for one's dividend. To allow for the unexpected that happens to families and individuals, he urged for a mechanism to defer the payment of penalties and interest to a future PFD.

[8:20:50 AM](#)

REPRESENTATIVE KOPP recalled Alaska used to have an education head tax. He expressed concern about enacting an income tax - during a time the state is experiencing a recession - and asked how the structure of the bill as an income tax would strengthen the state's economy. Further, he asked whether the bill would replace general funds (GF) for education on a dollar for dollar basis, or add \$500 million for education.

REPRESENTATIVE CLAMAN responded that the bill differs from an income tax in three areas:

- the bill is modeled after the previous school head tax, to which everyone contributed, beginning at a minimum amount of \$100
- at an income level of \$250,000, unlike an income tax, there is a cap which would make capital more available for reinvestment into the economy
- the bill provides a plan to help close the state's deficit by infusing new revenue

REPRESENTATIVE KOPP surmised funding from the bill is permissive, to avoid the state's constitutional dedication to provide public education, and the legislature could spend the funding as needed.

REPRESENTATIVE CLAMAN agreed and added the bill does not represent an increase in education funding. Presently, the state's undesignated GF contribution to education is approximately \$1.4 billion-\$1.5 billion, but the bill would establish a designated general fund, reducing the undesignated allocation on a dollar for dollar basis, and ensure members of the public their school taxes would be applied to public education.

[8:26:57 AM](#)

CHAIR DRUMMOND asked whether the bill has been sufficiently compared to HB 115 [passed by the Alaska House of Representatives 4/15/17 and failed passage in the Alaska State Senate 5/12/17].

REPRESENTATIVE CLAMAN advised SSHB 146 is an alternative to HB 115. The intent of SSHB 146 is to create a tax that is not based on a formula and is collected by a different approach.

CHAIR DRUMMOND observed for those at a low [income] level, the proposed tax functions as a head tax, and asked if children, whose sole income is a PFD, would be assessed the tax.

REPRESENTATIVE CLAMAN related his personal experience that in a family of four, with two children under eighteen years-of-age, if each child filed separately and paid the tax separately, the husband and wife would file jointly and pay a school tax based on their joint income. If the family were advised to file one

tax return, they would pay one school tax based on their joint tax return.

CHAIR DRUMMOND directed attention to the fact that an increase in income from \$100,000 to \$101,000 would cause the school tax to increase from \$1,000 to \$2,500, and an increase in income from \$150,000 to \$151,000 would cause the school tax to increase from \$2,500 to \$5,000. She questioned why the increases do not follow a curve.

REPRESENTATIVE CLAMAN stated one of the goals for the bill was to create a simple mathematical structure that is transparent to the public.

REPRESENTATIVE PARISH surmised for the purpose of this bill a resident is someone who collects a PFD, and a nonresident does not; he inquired as to the status of a part-year resident.

REPRESENTATIVE CLAMAN said DOR would address this issue through regulations, as it does for income that is earned by seasonal employees. He advised the [Alaska Court System] and DOR have defined a resident for the purposes of the PFD based on residency of one year; however, he predicted that for the purposes of SSHB 146, the tax would be based on the amount of income earned in the state.

[8:33:50 AM](#)

KEN ALPER, Director, Tax Division, DOR, in response to Representative Parish, said the most important definition within the bill is not residency, but "income from a source in the state." He clarified for the purpose of the school tax it doesn't matter if a person is a resident or a nonresident; DOR would require a mechanism to determine the amount of one's income that originated in Alaska, and thus determine the bracket upon which to base the tax.

REPRESENTATIVE PARISH directed attention to [SSHB 146 on page 2, lines 15-16] which read:

- (1) the adjusted gross income of a
 - (A) resident is the total adjusted gross income of the resident;

REPRESENTATIVE PARISH said the foregoing language does not stipulate that the total gross income must be earned in the state. He asked whether DOR would agree that an Alaska resident

who earns money outside of the state would be taxed on the income earned outside the state.

MR. ALPER reminded the committee the last income tax in Alaska was repealed over 35 years ago, thus the tax division has no specific expertise on personal and related income taxes. In fact, the tax division is in the process of assembling an implementation plan and consulting services as is reflected in the Fiscal Note Identifier: HB146-DOR-TAX-03-17-17. However generally speaking, all a resident's income would be taxed, and a credit would be given for the state income tax paid by the Alaska resident to a nonresident state.

REPRESENTATIVE PARISH expressed his understanding a Californian is taxed on income that is earned while he/she is working in both in Alaska and California.

MR. ALPER explained [the foregoing statement is true] because Alaska doesn't have a personal income tax. Were SSHB 146 or a similar bill to pass in Alaska, a California resident with income earned in Alaska would receive a credit against his/her California state income tax; comparably, an Alaska resident earning income in a state without a personal income tax would be taxed on his/her total income.

REPRESENTATIVE PARISH pointed out the bill does not collect revenue from another state.

MR. ALPER remarked:

I think it's actually the opposite. The [subsection] you pointed out - [subsection] (c), [paragraph] (1), [subparagraph] (A) - [directs that] we would tax the resident's income wherever it was located. What may be missing from this bill is the mechanism for the credit for taxes paid to other states.

REPRESENTATIVE PARISH asked about the language in the bill [on page 2, beginning on line 17, [subsection (c), paragraph (1), subparagraph (B)] which read:

(B) nonresident or part-year resident is the adjusted gross income of the nonresident or part-year resident that is attributable to a source in the state;

MR. ALPER confirmed the tax division does not have ability to collect tax on a nonresident's out-of-state income; similarly,

an Alaska resident earning income in California cannot be taxed on his/her income earned in Alaska.

[8:39:12 AM](#)

MR. ALPER directed attention to Fiscal Note Identifier HB146-DOR-TAX-03-17-17 and informed the committee at the time the fiscal note was issued, the tax division was unaware the bill did not provide a payroll tax or a withholding component. Without a payroll tax or withholding component, the estimated cost of staffing will be lower, and there will not be revenue expected in the amount of \$270 million for Fiscal Year 2018 (FY 18). In response to Chair Drummond, he said a new fiscal note is forthcoming.

[8:40:00 AM](#)

REPRESENTATIVE JOHNSTON asked for the method of modeling used by the tax division for the projected revenues, and for the year on which the labor force statistics were based.

MR. ALPER expressed his belief the last complete labor dataset available to the tax division was based on Internal Revenue Service (IRS) tax returns filed by Alaskans in 2014, and the same modeling was used for the Out-Year Cost Estimates [for FY 19-FY 23] analyses. In further response to Representative Johnston, Mr. Alper offered to confirm the foregoing.

CHAIR DRUMMOND asked whether the bill puts a significant burden on the tax division.

MR. ALPER said the tax division currently administers about 25 different tax programs; corporation income taxpayers reflect the largest group of about 13,000, many of which are type S corporations that file "information" returns. SSHB 146 would affect approximately 350,000-400,000 taxpayers; therefore, the bill would create "an order of magnitude change" to the current responsibilities of the tax division. Further, he pointed out at the \$250,000 income level, the bill would garner revenue in an amount similar to HB 115; however, SSHB 146 establishes a capped tax rate in that the bill does not capture income from the higher income earners. Therefore, the percentage of the total revenue coming from very high income levels is lower than that of traditional income taxes.

[8:44:00 AM](#)

CHAIR DRUMMOND assumed type S corporations would need to file Schedule C, or similar, tax returns in order to pay the school tax.

MR. ALPER explained a type S corporation does not pay an income tax because it does not legally retain income, but its income is distributed to corporate owners. Individual owners then pay personal income tax based on their share of the earnings; although there have been attempts to expand the corporate income tax, and thereby tax type S corporations, this is best accomplished by an income tax.

CHAIR DRUMMOND questioned the status of an owner of a type S corporation who lives out-of-state.

MR. ALPER clarified if the income originates in Alaska, it would be taxable under SSHB 146 or a similar bill; [if the bill becomes law], the tax division would need to undertake a rigorous regulatory process to address all the aspects of the legislation.

CHAIR DRUMMOND questioned whether the bill would impact the local share that communities pay into school operating budgets through property or sales taxes, or other means.

MR. ALPER said municipalities with a property tax assess millage rates to support school district funding, and the amount of funding is adjusted by the foundation formula. He opined revenue from SSHB 146 would replace a portion of the general fund contributions, following along the current formula structure.

[8:47:56 AM](#)

[SSHB 146 was held over.]

[8:48:36 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Education Standing Committee meeting was adjourned at 8:48 a.m.