

HOUSE FINANCE COMMITTEE  
February 13, 2017  
1:33 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:33 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair  
Representative Paul Seaton, Co-Chair  
Representative Les Gara, Vice-Chair  
Representative Jason Grenn  
Representative David Guttenberg  
Representative Scott Kawasaki  
Representative Dan Ortiz  
Representative Lance Pruitt  
Representative Steve Thompson  
Representative Cathy Tilton  
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Taneeka Hansen, Staff, Representative Paul Seaton; Jane Pierson, Staff, Representative Neal Foster; Brandon S. Spanos, Deputy Director, Tax Division, Department of Revenue.

SUMMARY

HB 115 INCOME TAX; PFD CREDIT; PERM FUND INCOME

HB 115 was HEARD and HELD in committee for further consideration.

Co-Chair Foster reviewed the agenda for the day. He relayed that only a brief walk-through of HB 115 would be heard. He invited the testifiers to the table.

#hb115

HOUSE BILL NO. 115

"An Act relating to the permanent fund dividend; relating to the appropriation of certain amounts of the earnings reserve account; relating to the taxation of income of individuals; relating to a payment against the individual income tax from the permanent fund dividend disbursement; repealing tax credits applied against the tax on individuals under the Alaska Net Income Tax Act; and providing for an effective date."

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TANEEKA HANSEN, STAFF, REPRESENTATIVE PAUL SEATON, read from a prepared statement:

The goal of HB 115, the State Revenue Restructuring Act, is to create a balanced, stable, and sustainable approach to resolving our state's deficit, for now and for future Alaskans. A stable fiscal plan requires multiple approaches and should be addressed this year because our reserve account is running low.

For over 30 years the state has relied almost exclusively on volatile resource revenues. This has led to years where the state budget has been high, with large capital budgets creating infrastructure throughout the state. But it has also led to years where the budget has contracted quickly to try to match reduced revenue streams, leaving little money to maintain our existing infrastructure or for our state needs.

State government does not function efficiently or effectively with so much volatility. Volatility in state government is also unhealthy for the economy. As we heard from Mr. King on Friday, businesses do not feel comfortable investing in the state when they do not know what the state will look like next year, or the year after that. We have heard from business

leaders throughout the state that uncertainty is freezing their investment decisions.

We also see the effect of volatility on the state's credit rating. Even though the State of Alaska has more assets than most other states, all three credit rating agencies downgraded the state's credit rating last year. Without a fiscal plan they are likely to downgrade us again this year, because without a stable and sustainable plan there is no way for the rating agencies to predict what the state's finances will look like in future years.

To provide business leaders and rating agencies with the confidence they need to invest in Alaska, we need a fiscal plan that will stabilize state revenues and will be sustainable into the future. The plan must be a comprehensive solution, not a partial one, or the economy will continue to struggle with questions of uncertainty and the legislature will be back in the same situation next year.

How does HB 115 create a stable plan?

The State Revenue Restructuring Act reduces volatility in the state budget by diversifying our revenue sources from one single source, oil, to many. HB 115 will utilize earnings from the Permanent Fund based on 4.75% of the market value. The fund is invested in a diverse portfolio, protecting it from fluctuations in value of one investment type or another. As was demonstrated last week by David Teal, a draw based on a percent of market value of the fund is the most stable option.

In addition, the State Revenue Restructuring Act implements a modest income tax which will further diversify state revenues and protect against fluctuations in any one source.

How does HB 115 create a sustainable approach?

The intent is to craft a fiscal framework that will not drain value from our savings but will instead preserve those assets, so they continue to provide for future Alaskans. A sustainable draw on the Permanent Fund earnings will allow the fund to grow and to continue to maintain the same value for future Alaskan as it has for us today. Draw rates that are too high

could risk the future value of the fund if they are drawing above the rate of inflation.

How does HB 115 create a balanced approach?

This bill asks every Alaskan and non-resident worker to contribute to the core state services that we all utilize, while recognizing that some are more capable of contributing than others. The necessary restructuring of the permanent fund earnings and of the dividend, which is paid from those same earnings, will impact every Alaskan but does not touch the non-resident workers. However, rural Alaskans and low-income Alaskans, especially those with families, will feel this impact the deepest. A progressive income tax, based on 15% of the federal tax liability or the amount you pay to the federal government, will offset this impact by collecting revenues from non-residents and those with higher incomes. It will also collect income from those non-resident workers who use our state services while they are here but take their money earner here out of state. The income tax includes a \$25 minimum tax that will be paid by all filers, ensuring that most Alaskans will be contributing to this revenue source.

The State Revenue Restructuring Act is the foundation for a fiscal plan that is balanced, sustainable, stable, and comprehensive to help remove the uncertainty that is freezing business investment and credit ratings in the state currently.

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JANE PIERSON, STAFF, REPRESENTATIVE NEAL FOSTER, read the sectional analysis for HB 115:

Section 1 (page 1, line 7) - Clarifies that all components of this bill are part of a comprehensive revenue act.

---Appropriations from the Earnings Reserve Account---

Section 2 (page 1, line 10) - Amends AS 37.13.140, net income of the Permanent Fund, to remove "income available for distribution" and adds "market value" to section title.

Section 3 (page 2, line 9) - Adds a new subsection (b) to AS 37.13.140 determining the amount available for distribution each year from the earnings reserve account, equal to 4.75 percent of market value of the entire fund. Defines how the average market value of the fund is calculated.

Section 4 (page 2, line 19) - States that 33 percent of the amount available for distribution under AS 37.13.140 may be directed to the dividend fund and 67 percent to the general fund.

Section 5 (page 2, line 27) - Amends AS 37.13.145(d), relating to the Amerada Hess settlement, to clarify that income from that settlement may not be used for distribution. Additionally, removes references to subsection (c), relating to inflation proofing, which is repealed by this act.

Section 6 (page 3, line 6) - Provides that money from the earnings reserve may be transferred to the principal of the permanent fund for purposes of inflation proofing the fund when the value of the earnings reserve account is four times the annual amount calculated under AS 37.13.140(b).

Section 7 (page 3, line 11) - Includes the unexpended balance of the Alaska Permanent Fund Corporation's budget in the calculation of the fund's market value; this budget balance is already calculated as a part of the net income of the fund under current law.

Section 8 (page 3, line 18) - Clarifies that income from mental health trust fund, which is managed by the Alaska Permanent Fund Corporation, is not included in the market value of the Permanent fund.

Section 9 (page 3, line 22) - Asserts that the income of the mental health trust fund shall continue to be calculated as before, in the same manner as the net income of the entire fund.

---Start of Income Tax section---

Section 10 (page 3, line 29) - AS 43.05.045(a) states that there is a penalty if a state income form is not

filed electronically but that individuals are exempt under AS 43.22.020 (f).

Section 11 (page 4, line 8) - Creates the Individual Income Tax within AS 43.

Subsection: Sec. 43.22.010 (page 4, line 10) - Imposes an income tax and a long-term capital gains tax on residents, as well as nonresidents with income from within the state. The tax is equal to 15% of the taxpayer's total federal income tax due or \$25.00, whatever is greater. Long term capital gains are additionally taxed at the lesser of 10% or the federal tax rate difference between earned income and capital gains. Currently capital gains are taxed by the federal government at a lower rate than earned income.

Subsection: Sec. 43.22.020 (page 5, line 14) - Establishes how a taxpayer will submit the tax return for the individual income tax. It clarifies that this tax is due and payable to the department at the same time and in the same manner as the tax payable to the U.S. IRS for federal taxes.

Subsection: Sec. 43.22.030 (page 6, line 17) - Defines income from sources in the state for the purpose of the tax. Note - the Internal Revenue Service definition for income is adopted in a later section.

Subsection: Sec. 43.22.035 (page 7, line 12) - Provides a credit to residents for taxes paid to another state based on income earned in that other state, ensuring a resident is not taxed twice on the same income.

Subsection: Sec. 43.22.040 (page 7, line 27) - States a person may choose to apply some or all of their PFD as a refundable tax payment to their upcoming state income tax due (see Sec. 12). Any remaining dividend after the payment will be refunded to the dividend applicant.

Subsection: Sec. 43.22.050 (page 8, line 6) - Establishes how taxes will be withheld by employers making payment of wages or salaries, or a person paying crew shares, similar to the way in which employers withhold federal income taxes.

Subsection: Sec. 43.22.055 (page 9, line 4) - Allows a person's income tax information to be shared with a banking institution to verify direct deposit of refunds.

Subsection: Sec. 43.22.060 (page 9, line 7) - Authorizes the department to create all necessary forms and adopt regulations to implement this tax.

Subsection: Sec. 43.22.190 (page 9, line 17) - Provides definitions of terms used in this section, including the definition of resident for the purpose of this tax.

---End of Income Tax section ---

Section 12 (page 10, line 9) - Directs the Permanent Fund Division to create a place on the PFD application where an applicant may choose to apply some or all of their PFD to their upcoming state income tax due.

Section 13 (page 10, line 15) - Repeals AS 37.13.145(c) inflation proofing of the permanent fund. Also, repeals sections relating to a former tax credit for political contributions that existed under Alaska's prior individual income tax which was repealed in 1980.

Section 14 (page 10, line 16) Clarifies that the state income tax created under section 11 of this act only goes into effect starting on January 1, 2018 and will not be applied to any income earned prior to that date.

Section 15 (page 10, line 20) - Authorizes the Department of Revenue to adopt regulations to implement the act.

Section 16 (page 10, line 25) - If sections 2 through 9 take effect after June 30th of 2017, sections 2 through 9 are retroactive to June 30th, 2017. The appropriation from the earnings reserve described in sections 2 through 4 will be applicable in fiscal year 2017.

Section 17 (page 10, line 29) - Sections 1 through 9, relating to the earnings reserve account and the

permanent fund, and sections 15 and 16, take effect immediately.

Section 18 (page 10, line 31) - The effective date of the act, except those noted in Section 17 above, is January 1, 2018.

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Vice-Chair Gara mentioned that when he first read the bill the capital gains tax was 10 percent. Looking through the sectional he thought the tax appeared more complicated. He asked if the issue could be addressed.

Co-Chair Foster acknowledged that Representative Pruitt had joined the meeting.

Ms. Pierson did not know the answer.

Ms. Hansen responded that 10 percent would be the maximum tax on capital gains. The tax could change if the federal government changed the differential between the capital gains rate on long term capital gains currently. If the federal government increased the rate in the future, the state's rate would decrease.

Vice-Chair Gara asked if the rate was 10 percent for short-term and long-term capital gains based on existing law.

Ms. Hansen answered, "long-term capital gains."

Vice-Chair Gara asked if there was a provision on short term capital gains.

Ms. Hansen responded in the negative. She indicated that short term capital gains under federal law are currently taxed at the same rate as other income.

Co-Chair Foster invited Ms. Hansen to begin her PowerPoint.

Ms. Hansen introduced the PowerPoint Presentation: "State Revenue Restructuring Act HB 115" (copy on file). She turned to slide 2: "Fiscal Foundation." She reported that Alaska was currently undergoing some economic contractions. She suggested that how big the recession ended up being would depend, in part, on the approach the legislature decided to take to address the deficit. She argued that a

diversified approach would help minimize the impact on any one group of Alaskans and should help provide for a smoother transition for the economy as a whole.

Ms. Hansen advanced to slide 3: "Four Pillar Plan." She indicated that the legislation being considered in the House contained four key pillars to a diversified plan. The first pillar was a structured use of the Permanent Fund (PF) earnings reserve account (ERA), the state's single largest asset. The second pillar was new revenue from a broad-based tax, which would allow everyone to contribute to the services Alaska was utilizing. The third pillar was protecting and maintaining a Permanent Fund Dividend (PFD) for Alaskans within the restructuring of the ERA. The fourth pillar was smart budget cuts while maintaining functioning core services. Smart budget cuts could include reductions to some of the state's liabilities such as the oil and gas liability that the state currently had.

Ms. Hansen continued to slide 4: "Four Pillar Plan." She explained that not all the components would be addressed in one piece of legislation. However, in the State Revenue Restructuring Act would consider a structured use of the ERA, new revenue from a broad-based tax, and a protected structure for the dividend.

Ms. Hansen turned to slide 5: "HB 115: Permanent Fund Earnings":

- 4.75% Permanent Fund POMV. Inflation proofing contingent on surplus.
- 1/3 of POMV to pay dividends. \$1100 and growing over years, with payouts more stable than current calculation.
- 2/3 of POMV directed to the General Fund. \$1.5 billion in FY18 growing to \$2 billion in FY25.
- Residents may choose to apply their PFD to their upcoming state income tax due as a Refundable Tax Payment. Any amount left over after paying taxes will be refunded by the Tax Division.

Ms. Hansen detailed that the changes that were made to the use of the PF earnings came down to 4 points. First, there would be an annual draw based on 4.75 percent of the

Permanent Fund's full value. Inflation proofing of the principle of the fund would be contingent on surpluses in the ERA. The current annual transfer from the ERA to the principle for inflation proofing was being replaced. In years when the balance of the ERA exceeded 4 times the Percent of Market Value (POMV) draw calculated for the general fund in the dividend, the excess in the ERA would be transferred to the principle. She continued that of the 4.75 percent that was available for distribution, one-third or 33 percent would be transferred directly to the dividend fund for the PFD. Two-thirds or 66 percent of the draw from the ERA would be deposited into the general fund (GF). The final component of the bill relating to the PF earnings was that Alaskan residents could choose to apply their PFDs against their state income taxes due. The option would be entirely voluntary and would appear as a check box on the dividend application.

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Ms. Hansen addressed the question of how an income tax would be implemented on slide 6: "Income Tax." She reported that the numbers on the slide were based on 2015 estimates from the Department of Revenue (DOR). She had just received updated fiscal notes but had not had the chance to update the slide in time. The income tax would be 15 percent of federal liability due. The amount would be listed on line 56 of the federal 1040 form which would equal the adjusted gross income minus standard deductions and many common exemptions and credits but would not include the self-employment tax and some other more specialized taxes that were generally considered beyond the traditional idea of income. It also excluded things like federal bonds which states were not supposed to tax. She suggested that how it would translate exactly would be created through regulation by DOR. It would also not include the earned income tax credit which came after federal taxes were due.

Ms. Hansen continued that not everyone would have a tax liability. However, everyone who filed a federal income tax form would at least pay a minimum tax of \$25. The \$25 minimum tax was not included in the 2015 estimates. The fiscal note reflected an amount of about \$2 million in the first year of implementation. Additionally, the income tax would include a 10 percent tax on long-term capital gains. As discussed previously, the federal government currently taxed long-term capital gains differently than it taxed

short-term capital gains or other forms of income. For the lowest tax brackets, long-term capital gains were not taxed at all. For tax brackets where other incomes were taxed between 25 and 35 percent, the federal government currently taxed long-term capital gains at 15 percent. By adding an additional 10 percent Alaska tax on long-term capital gains, the differential between other incomes and long-term capital gains would be equalized. She reported that in the bill there was a calculation such that, if the federal government were to tax long-term capital gains close to an amount of what other income was taxed at, Alaska's tax rate on long-term capital gains would adjust accordingly.

Representative Pruitt asked if she was saying the tax was a 25 percent tax (15 plus 10). Alternatively, he wondered if she was suggesting that the tax would be 10 percent of the gains.

Ms. Hansen explained that capital gains were reported on federal taxes. The capital gains would be 15 percent of federal tax liability. However, the capital gains that was reported on the federal tax liability would be taxed at between zero and 15 percent compared to other income which was taxed at a higher rate. There would also be a 10 percent tax specifically on the taxable income from long-term capital gains. She relayed that for somebody who had long-term capital gains who was paying taxes in Alaska, they would be paying what would be equal to the same tax rate they were paying on other income.

Representative Pruitt asked how it would impact 401 K plans and retirees. That was a long-term capital gain. He wondered if a 10 percent tax would be required or if there would be an exemption. Ms. Hansen deferred to the Department of Revenue (DOR). She was aware that some retirement income had different taxing rules at the federal level, which meant that the way it was taxed at the state level would also be different.

Co-Chair Foster mentioned that someone from DOR was online. Representative Pruitt would leave it up to the chair. Co-Chair Foster would circle back to the issue later.

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Representative Wilson asked if the state would only be imposing an additional tax on long-term capital gains but

not on short-term capital gains. Ms. Hansen responded affirmatively. Representative Wilson wondered if the tax only applied to residents. Ms. Hansen replied that the calculation would also apply to any income earned within the state.

Representative Wilson asked if it would only apply to real estate rather than stocks and bonds. Ms. Hansen relayed that stocks and bonds fell in the definition for potential income earned within the state. She referred to AS 43.22.030 which defined income from sources in the state for the purposes of non-residents. It included income from stocks, bonds, notes, bank deposits, and other intangible personal property having a taxable or business interest in the state.

Representative Wilson indicated she had done taxes for a long time and she was under the impression that if a person had long-term or short-term capital gains it would apply in the state they resided in as opposed to the state a person worked in. She asked if the concept was taken from another state. She provided an example to her question. She asked for clarity. Ms. Hansen believed, because it was on income from a source in the state, it would have to be stocks or bonds considered a source in the state. She thought Mr. Spanos might be able to speak more directly to how it was differentiated. The person would not be taxed on all of their long-term capital gains.

Representative Wilson was unsure of her next question. She remarked that she did not know what, besides real estate, would have long-term capital gains. Ms. Hansen reiterated that the definition for the different incomes that were considered from a source in the state was on page 6, subsections 4 and 5. She deferred to Mr. Spanos to provide examples of stocks and bonds that might be from the state.

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BRANDON S. SPANOS, DEPUTY DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, thought the question was about what long-term capital gains would be applied to Alaska other than real property.

Representative Wilson understood that the tax would apply to a resident. She wanted an example of a capital gain within Alaska that applied to an out-of-state resident.

Mr. Spanos indicated that real estate was a good example. A non-resident who owned real estate in the state, held it for investment purposes for more than a year, and sold it at a gain would be liable for a long-term capital gain tax. The person would owe long-term capital gain rates on the federal tax return. If the bill were to pass, that person would also owe the long-term capital gain rate to Alaska in addition to the 15 percent already taxed at the federal level. Other income sources could include trusts. If a person had income earned through a trust in Alaska that was incorporated in the state and the funds were held in the state, it would be considered a long-term capital gain.

Representative Wilson asked if the reverse applied. As an Alaska resident owning property outside of the state, she wondered if she would have to pay state taxes on that property even if it was out of state.

Mr. Spanos replied that a resident of the state whose assets were not in Alaska - as long as they were not taxed by another state - would be taxed in Alaska. The bill had a credit for taxes paid in other states. For example, if a person had income for a rental in another state that was taxed by the other state, they could get a credit for it in Alaska and would not pay the tax twice. If it was a long-term capital gain, the circumstance would be similar. If the other state had a higher tax than Alaska, a person would receive a tax credit up to the amount they would have paid in Alaska. If the rate was lower, then that person would pay the difference to the state.

Representative Wilson thought what was being proposed was a nightmare. She was unfamiliar with the trust market in Alaska but was aware that it brought in a significant amount of revenue. She surmised that the proposed tax could have a huge negative affect in the form of investors going elsewhere. She wanted to make sure the committee heard from someone who was knowledgeable about the trust market, the resulting revenue, and the potential repercussions from the capital gains portion of the proposed legislation.

Ms. Hansen responded that when the sponsor was drafting the section being discussed there had originally been some references to trusts which had since been removed. She would follow-up with Mr. Spanos to see if the Department of Revenue was interpreting it differently, or if it was based

on previous income tax versions in previous years where the language had been included.

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Representative Guttenberg indicated that a previous presenter had suggested that the state not tie taxes to the federal taxes in case of unintended consequences for the state. He mentioned the estimate for income tax and refundable PFD tax payments. He thought the committee was broaching the questions about the mechanics of how things worked and what the state was taxing or not taxing. He suggested having a one-pager on definitions and something other than estimates for clarification.

Co-Chair Foster would get the information to members.

Vice-Chair Gara agreed that the state had to raise revenue. He asked if his thinking was correct that 15 percent of federal tax liability was equal to 15/100 of the federal tax. Ms. Hansen replied that he was correct and added that in the back of the documents there was an estimated income tax. It showed the differing income levels, the associated taxes, and the state tax payment of 15 percent which equaled between .1 percent to 3 percent of gross income.

Vice-Chair Gara relayed that some people had misinterpreted the legislation to reflect a 15 percent tax on income, which was not accurate. He elaborated that a person would take their federal tax rate, for example, 25 percent. He continued that 15 percent of 25 percent was 3.75 percent. If a person was in a 25 percent tax bracket under the federal tax rate, under the proposed legislation, 15 percent of a person's federal tax liability would be about a 3.75 percent rate for that bracket. He asked if he was correct. Ms. Hansen thought that it sounded correct. She would have to have the numbers in front of her to confirm his math.

Co-Chair Seaton pointed to the tax tables provided in members' packets [HB 115: Estimates for Income Tax and PFD Refundable Tax Payment: Estimated Federal and State Income Tax for Year 2016] (copy on file). He pointed to the bottom 2 lines of page 1 that reflected the federal tax as a percent of gross income and the Alaska tax as a percent of gross income. He read the example of \$800,000 income [listed on page 9 under single with 2 children filing as

head of household]. At \$800,000 a person would incur a federal tax of 32.38 percent and an Alaska state tax of 4.86 percent, 15 percent of the federal tax rate. He read another example from the tables.

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Vice-Chair Gara reemphasized that the tax was 15 percent of the federal tax rate. For example, 15 percent of a 25 percent federal tax was a 3.75 percent tax. He did not want people walking around saying that the bill was imposing a 15 percent tax.

Vice-Chair Gara relayed there was a question about trusts. He suggested that the treasury industry was odd in Alaska. He was unsure of the number of attorneys and bankers it benefitted. He understood that the state could only tax Alaska income. He provided an example of a client from New York City with all their investments in publicly traded stocks on the New York Stock Exchange not being taxed. However, their attorney and/or banker in Alaska would be making income in Alaska off that trust and would be taxed. He thought the state would only be able to tax Alaska income and income made in Alaska.

Representative Wilson disagreed that the tax system was as simple as the previous speaker stated. She suggested there were several steps to getting to gross wages. Someone who did not have as many deductions would have a higher federal tax liability. Two people earning the same wages might pay a very different income tax amount. Ms. Hansen responded that it was based on federal tax liability. If a person was paying a different federal tax liability she would be correct.

Representative Wilson reiterated the differences in deductions. She asked about a side-by-side comparison of two different families with differing deductions. She thought the comparison would show a very differing tax liability to the state.

Co-Chair Foster added that tomorrow there would be an opportunity to ask additional questions. There would also be additional people from the departments that could answer questions.

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Representative Pruitt had heard earlier that if there was income derived from another state it would be taxed. However, from what Vice-Chair Gara mentioned that the state would not be able to tax income made in another state. He wanted clarification. Ms. Hansen indicated that for a non-resident, the only thing that could be taxed was income from the state. For an Alaskan resident all income was taxable, but they had credit against anything that had been taxed in another state. She believed there were only 6 other states that did not have income taxes but had sales taxes instead.

Co-Chair Seaton tried to provide additional clarification.

Representative Wilson asked if a person received credit for the amount paid to the other state, or was a calculation needed. She provided an example and asked if she understood correctly. Co-Chair Seaton responded that if a state did not have an income tax there would not be any credit. If the state had an income tax, there could be a credit for the amount up to the amount that would have been charged on the income from Alaska. He provided an example. If a person was from California, which had a 13 percent gross tax, then that person would not be able to subtract more tax from their Alaska earnings. That person would still have to pay 15 percent of the federal tax liability on the money earned in Alaska.

Representative Wilson provided an example pertaining to Missouri. Co-Chair Seaton would get DOR to provide an explanation. Ms. Hansen added that an explanation could also be found on page 7.

Vice-Chair Gara indicated that the taxable income was discussed on pages 6 and 7 of the bill. He relayed that if a person was an out-of-state worker who came to Alaska, paid nothing in Alaska, and took money out of the state, they would pay taxes on the money they earned in the state. They would not be able to take everything out of the state. The credit portion was described in .035 which only applied to residents of the State of Alaska. A person would be pay income tax on all their income earned in the state. Out-of-state workers would have to begin contributing to the state that they worked in and then left. An Alaska resident that paid income taxes for income earned in that other state, would receive a credit to avoid being double taxed.

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Ms. Hansen continued her review of slide 6. She indicated that the slide was based on estimates from 2015. She had just received an updated fiscal note which did not break out the income in the same manner as the previous estimate. She could not directly update the amount estimated to be coming from non-residents. However, in 2015 over 90,000 non-residents worked in the state taking more than \$2.7 billion in wages out of state. The income tax would be implemented starting January 1, 2018. For the first year the state, which functioned on a fiscal year, would only see half of the revenue. The estimate for that period in the new fiscal note was \$321 million versus the approximated \$300 million reflected on the slide.

Ms. Hansen scrolled to the flow chart on slide 7: "Current Permanent Fund System." The slide showed the existing flow into and out of the Permanent Fund. Currently 25 to 30 percent of oil royalties went into the PF and the rest of the royalties went into the general fund. The earnings on the investments came out of the principle and went into the ERA which could be spent by any legislative appropriation. Historically the legislature had not chosen to appropriate from that fund except for the dividend and for inflation proofing. The option existed. She highlighted the distributable income out of the ERA, which was currently how the dividend was paid. The calculation was based on 21 percent of the 5-year average of the net income of the fund. The net income of the fund did not include unrealized gains or losses. As was demonstrated by Mr. Teal in the previous week, it could be highly variable. For instance, there could be a year of negative realized earnings, which was why dividends had fluctuated between \$700 and \$2200.

Ms. Hansen reviewed the flow chart on slide 8: "HB 115 - State Revenue Restructuring Act." Under the bill there would be an additional cash flow from an income tax. The amount would be 15 percent of federal income tax due and 10 percent of long-term capital gains which would go directly into the general fund.

Ms. Hansen reviewed slide 9: "HB 115 - State Revenue Restructuring Act." She reported that additionally the bill made changes to how the earnings from the Permanent Fund that came out of the ERA were considered available for

distribution. Previously, the calculation was based on the 5-year average - 21 percent of the statutory net income. Under the bill the amount would be calculated based on a Percent of Market Value (POMV) of the entire fund, which would also be averaged over 5 or 6 years. Instead of being based on only the earnings (net income), it would be based on the whole value of the fund - a more stable calculation.

Ms. Hansen expounded that two-thirds of the draw that would come out of the earnings reserve, the structured draw of 4.75 percent, would go into the general fund. The amount would be approximately \$1.5 billion in FY 18 and \$1.59 billion in FY 19 according to LFD numbers. According to the Department of Revenue's estimate on its fiscal note, the amount was closer to \$1.6 billion in FY 19. The Legislative Finance Division and DOR had slightly different assumptions regarding the earnings over the following couple of years. On Wednesday they would be available to answer questions on the subject.

Ms. Hansen stated that the other third of the 4.75 percent POMV draw would be sent directly to the dividend fund, which was where the current draw from the earnings reserve went. The monies would not be going through the general fund but would be going straight into the dividend fund for calculating the current year's dividend. The value of the draw would be \$762 million for FY 18 with an estimated dividend of \$1100.

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Ms. Hansen turned to slide 10: "HB 115 - State Revenue Restructuring Act." She reported that the slide looked at how the change affected the dividend distributed to Alaskans. Once the draw from the earnings reserve was placed into the dividend fund, it would be computed in the same way it was presently calculated. Residents would still have the option of donating to Pick-Click-Give or would have the added option of using their dividend as a payment against their state income tax due. If residents chose to apply their dividend to their state taxes owed, once they filed their taxes, they would receive any remainder of their dividend as a refund. If they did not select that option, they would receive the dividend as they had every year.

Representative Pruitt wanted to better understand the logistics of how the system would work. He wondered about the burden on the individual and the burden on the state to manage the system. He thought it sounded complex.

Ms. Hansen responded that DOR would be better able to explain the technical details. Her understanding was that it would not be complicated or burdensome for the state. There was already an option for withholding quarterly payments and prepayments. The dividend would be an additional pre-payment option that DOR would be holding in the tax filer's account, the same as they would for any of the payment options already. Once a person filed their tax return, they would know whether they owed money or if they could expect a return, just like filing a federal tax return. She deferred to Mr. Spanos about how withholdings worked. However, she believed a person could set the rate of withholding. Regarding the dividend amount being changed by the legislature, the intention of the proposed structure was to make the amount of funds going into the general fund stable. Stability would remove some of the need for the legislature to reconsider the dividend. She indicated that the hope was that the format would protect the dividend by creating a stable source of revenue for state government. Ultimately, the legislature had the power of appropriation and could not bind future legislatures.

Representative Pruitt provided an example. He wondered if the state had to change the way in which people filed for the PFD. He asked how the system would work. Ms. Hansen asked if Representative Pruitt was referring to using the dividend against the payment. Representative Pruitt responded affirmatively.

Ms. Hansen answered that it would be an option for each individual filer to use their dividend against their tax liability. It would not have any direct impact on their employer unless the employee made the choice to change their withholding rate. Her conversations with the Permanent Fund Division indicated that there would not be a need to change the way individuals filed. Mr. Spanos could speak to how money would be transferred between departments. Typically, a person applied for their dividend by the end of March and filed their taxes in April. The dividend was calculated in October. If a person did not choose to apply their dividend against their taxes, they would receive the full dividend in October. If a person

chose to apply it against their taxes, the amount would be transferred to DOR in October and marked as a pre-payment for taxes filed the following April.

Representative Pruitt thought it was complex.

Co-Chair Foster asked if Mr. Spanos would like to address the question. Mr. Spanos answered that the payment would be like any other payment. For instance, if someone were to select on their PFD application that they wanted a portion of their dividend to be used for a tax payment, the department would expect it to be similar to any other scenario where someone made a pre-payment or quarterly payment. It was unlikely that someone getting a refund would want to make a payment to the tax division. The division would piggyback the W-4 Form. There would be tax payables for employers to withhold. The department would not be releasing any information to employers on pre-payments. It would be up to the employer to simply put the data into the system and to allow the withholding to take place.

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Representative Tilton asked if the state would place a lien on a person's future dividends if they had a tax liability greater than what they had paid in payments and contributed in PFD monies by checking the box on their application. Mr. Spanos replied that the division would handle the issue in the same way it handled other outstanding tax payer balances. If there was a liability after a tax return was filed, the person would receive a bill in the mail. It would have the payment information on it including the interest and penalty fees. If a tax payer did not make payments, the division would go into collections with them. The division had an agreement with the PF Division to withhold payments when an individual owed tax. Other methods used by the division were levying bank accounts and placing liens on properties.

Co-Chair Foster suggested that without knowing the amount of the PFD until the Fall, it would be difficult for an individual to determine the exact amount they owed in taxes to the state. He suspected the number of the discrepancy would not likely be large, but filers would incur penalties and interest if there was a shortfall. He asked if he was correct. Mr. Spanos asked for clarification. Co-Chair

Foster reiterated his question. He wondered if he had the timeline correct.

Mr. Spanos replied that the PFD application would be at the beginning of the year between January and March. For instance, if he filed for his PFD in March 2017 his tax return would not be due until April 2018. The PFD announcement would be in October 2017. If he selected to make a payment from his PFD, it would be in October 2017 that the payment would be transferred from the Permanent Fund Division to the Tax Division. He would file his tax returns between January - April 2018 and would know exactly how much was transferred and whether he owed more or was receiving a refund.

Ms. Hansen moved to slide 11: "HB Proposal: Total Estimated Revenue to General Fund FY18 -Half Year of Income Tax." The slide showed the estimated revenue to the general fund which was based on the numbers before she received the new fiscal notes. Using the new fiscal note, the income tax revenue would reflect \$321 million in FY 18. The total revenue going into the general fund would be \$1.84 billion. There would be \$762 million going straight to the dividend.

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Ms. Hansen advanced to slide 12: "HB Proposal: Total Estimated Revenue to General Fund FY19 - First Full Year of Income Tax." She reported that in FY 19, which would be the first full fiscal year of the income tax, the estimate on the new fiscal note was slightly lower. She would have to ask Mr. Spanos to speak to the changes in the department's calculations between the years. The new fiscal note reflected income tax revenues to be \$640 million in FY 19. The draw was calculated as slightly higher at \$1.6 billion in FY 19. The total revenue to the general fund was \$2.2 billion with an additional \$797 million going straight to the dividend rather than coming out of the general fund.

Ms. Hansen moved to slide 13: "What kind of Alaska do we want to live in?" She suggested that, to answer the question about why the state needed to take action on a comprehensive plan, another question had to be answered first. What kind of Alaska did people want to live in? She reasoned that finding out the standard of living and the services that Alaskans thought made the state worth investing in could help legislators understand how

comprehensive of a solution the state needed this year and for the future.

Ms. Hansen continued to slide 14: "State Spending." She noted a pole run by the Senate Majority of and responded to by over 7028 participants revealed that 49.9 percent of Alaskans believed state spending was about right or too low compared to with those that believed state spending was too high. She added that more Alaskans then in past years were saying that they wanted to keep the level of state services that they had currently.

Ms. Hansen discussed slide 15: "Income Tax." She reported that out of the same poll conducted by the Senate Majority when asked whether they could support a state income tax, 54.6 percent of participants indicated they strongly or somewhat strongly supported the idea. The number was an increase of more than 6 percent over the previous year.

Ms. Hansen reviewed the graph on slide 16: "2017-2026 Employment Forecast under Three Budget Scenarios." In looking at a plan to address the state's fiscal situation it was important to consider how the legislature's choices would affect the state. The majority of Alaskans had indicated that they supported the current level of spending or that they believed that spending was too low. All the choices made would have an effect on the economy including changing the dividend or implementing a broad-based tax. However, if the legislature chose not to implement a comprehensive fiscal plan and instead continued with major budget cuts as the main approach, the predicted effect on employment would be more severe than other choices.

Vice-Chair Gara was looking at Mr. King's presentation which had 3 lines. The first was a line with a combined PFD and income tax plan similar to the one on the slide. It stopped job losses in 2017. Another line reflected only the PFD without income tax, which showed greater job losses. The third line was one with cuts only. It showed the largest job losses, approximately 25,000 jobs, that would persist midway through the 2020s.

Ms. Hansen responded that the slide was from Mr. King's presentation; it was his presentation to the Senate Labor and Commerce Committee. The slide did have 3 lines, but the dividend line and the broad-based tax line were essentially on top of each other.

Vice-Chair Gara suggested that the difference was that the top line was an income tax or a restructuring. Whereas, he had a third line that he provided to House Finance that had a combined restructuring and income tax, which had the least job losses. He noted that he was speaking of page 19 of Mr. King's presentation from an earlier meeting.

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Representative Wilson asked where the impact on the private sector was shown. She noted the ongoing discussions about oil taxes. She noted the industry reporting several job losses in the previous year. She wondered where she could find the information on the graph. Ms. Hansen asked if Representative Wilson was referring to the discussion on oil and gas taxes. Representative Wilson clarified that she was talking about job losses in the private sector. She wondered where the private sector job losses resulting from low oil prices would fall on the graph. She mentioned other industries such as mining.

Ms. Hansen spoke to slide 16, which was looking at the employment forecast for the entire state. She believed the slide included the losses to the private sector, rather than just looking at state jobs. It was looking at jobs throughout the state. She highlighted that the losses that have already occurred where the lines combined in 2015 and 2016. The deviation was the expected forecast effect on employment for the different choices. If she was speaking to the revenue impacts having to do with non-residents, there were not as many non-residents working in the oil sector which could be why DOR had slightly revised their estimations for the income tax, but she would differ to Mr. Spanos to speak to the point.

Representative Wilson commented that the jobs were not lost because the PFD's were reduced, because of a broad-based tax, or because the legislature was cutting the budget. The jobs were lost due to the change in the price of oil.

Vice-Chair Gara referred to slide 19 of Mr. King's presentation ["Forecasting Alaska's Economy: 2017-2026" by Northern Economics] (copy on file). Mr. King's point was in alignment with what Institute of Social and Economic Research (ISER) had reported in the previous year. Every \$100 million in budget cuts cost about 1000 to 1500 private

and public-sector jobs. According to Mr. King, Alaska was down 20,000 private-sector and public-sector jobs with \$1 billion reductions in the budget. If a plan was implemented along the lines of those on the slide, job losses would be stemmed.

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Co-Chair Seaton indicated that the lines on slide 16 were going down from a high employment in 2015 of about 465,000 jobs. The reduction in the lines down to 2017 to about 425,000 equated to about 20,000 jobs that were both public and private jobs and reflected actual numbers. The legislature was looking at making decisions about how to go forward. Both a reduced PFD and the implementation of a broad-based tax had the same effect of preventing job losses. However, if the state only cut the budget, the state would be faced with losing another 25,000 more jobs between 2017 and 2020. The legislation being considered would include a PFD reduction and a broad-based tax as well as a restructuring of the Permanent Fund for a sustainable draw.

Ms. Hansen noted that the boxes on the chart were added because the lines were difficult to distinguish. She thought the labels were misleading because the chart did not reflect the effect on the economy under the different scenarios.

Representative Wilson suggested that by combining industries, private and public, it was difficult to determine what was contributing to an upswing. She supposed that an upswing might be due to keeping government strong, which would result in more jobs in the public sector. She thought the lines should be divided. She wondered if private sector jobs would increase or if public sector jobs would increase if taxes were imposed or PFD's were cut. She wondered what types of jobs would continue. She posed a question about a private sector economy versus a government driven economy. Ms. Hansen replied that the question would be a good follow-up question for Mr. King. She noted that the slide showed job employed in the thousands. She did not believe that under either scenario the state would be hiring 10,000 extra state employees. Some of the jobs would be lost from the private sector and not just from the state.

Ms. Hansen detailed the budget scenario on slide 17: "A \$3.2 Billion Budget Scenario:" She explained that the slide showed a different perspective of what choosing \$100 billion in budget cuts versus a plan that would help stabilize the state's revenues. There would be potential cost shifts to the communities. The slide was taken from OMB's presentation at the beginning of the year. The scenario was hypothetical. They spread \$100 billion budget cut scenario out among the different communities based the amount of state funds that were currently sent to communities through education and other services provided by the state. It also showed the burden on communities to continue to provide the services they had.

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Ms. Hansen scrolled to the Legislative Finance Division slide 18: "Real Per Capita Unrestricted General Fund Revenue/ Budget History (2015 Dollars Per Person)." She noted the reliance on volatile resource revenues resulting in expansions and contractions in the state budget based on a revenue factor outside of the state's control. It meant that in years when the state's private economy was shrinking due to decreased oil and gas investment, as was currently the case, it could not help to provide a safe glide path for the economy. The only option was to try to match the greatly reduced resource revenue by cutting jobs and the budget, which, in turn, would have a multiplier effect on the state economy. She concluded that to avoid the volatile state budget and economy, the intention of the state revenue restructuring act was to provide a more stable source of revenue avoiding fluctuations and contractions. The slide showed that per capita and adjusted for inflation the state budget had already been reduced to some of its lowest levels.

Ms. Hansen asked members to consider why it would be valuable for the State of Alaska to have a stable source of revenue instead of a volatile one. One of the reasons was the sheer amount of infrastructure the state built up over the previous 30-40 years when it had money. If the legislature chose to cut the budget drastically to meet the state's expected resource revenue, the first place the cuts would be taken from would be the capital budget. She opined that the state would likely see a growing list of deferred maintenance. The university had deferred maintenance nearing \$1 billion. There was a significant amount of

differed maintenance of roads, and DOT had its own way of prioritizing how the roads would be repaired and in what order. She indicated that if the state wanted to maintain some of its core services and core infrastructure, a stable revenue would be required for the state to budget in some of those deferred maintenance costs.

HB 115 was HEARD and HELD in committee for further consideration.

Co-Chair Foster noted the agenda for the following meeting.

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ADJOURNMENT

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The meeting was adjourned at 2:57 p.m.