

HOUSE FINANCE COMMITTEE
March 27, 2017
1:36 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:36 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 Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

Representative Steve Thompson

ALSO PRESENT

Taneeka Hansen, Staff, Representative Paul Seaton; Brandon S. Spanos, Deputy Director, Tax Division, Department of Revenue; David Teal, Director, Legislative Finance Division.

PRESENT VIA TELECONFERENCE

Carl Davis, Research Director, Institute on Taxation and Economic Policy (ITEP), Anchorage.

SUMMARY

HB 111 OIL & GAS PRODUCTION TAX; PAYMENTS; CREDITS

HB 111 was HEARD and HELD in committee for further consideration.

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.

#hb111

HOUSE BILL NO. 111

"An Act relating to the oil and gas production tax, tax payments, and credits; relating to interest applicable to delinquent oil and gas production tax; and providing for an effective date."

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Co-Chair Foster CLOSED Public Testimony.

HB 111 was HEARD and HELD in committee for further consideration.

#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, reviewed the PowerPoint Presentation: "State Revenue Restructuring Act." She relayed that the slide presentation had been presented earlier in the session but was updated to reflect the changes in the Committee Substitute (CS). She began with slide 2: "HB 115: Permanent Fund Earnings":

5.25% Permanent Fund POMV, 5% after FY19.

- 1/3 of POMV to pay dividends. \$1250 and growing over years, with payouts more stable than current calculation.
- 2/3 of POMV directed to the General Fund. \$1.69 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.

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Ms. Hansen moved to slide 3: "Income Tax":

Adjusted Gross Income
 \$4000 personal exemption
 PFD exemption

Total estimated revenue
 FY19 -half year \$330 million
 FY20- First full year \$663 million*

Non-residents pay between 7-14% of total tax revenue:
 \$44-93 million in a full year

Ms. Hansen explained that a \$4000 personal exemption would be allowed rather than itemized deductions similar to federal income taxes.

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Representative Wilson asked what data was used for the percentage of non-residents. Ms. Hansen responded that the percentage came from an ISER report and in combination with information from the Department of Labor and Workforce Development (DOL) and based on non-resident information cited from a Department of Revenue (DOR) previous fiscal note from HB 182 (Individual Income Tax and Tax Credits) [Withdrawn - 04/20/2016]. Representative Wilson asked how current the data was and where it ultimately was derived from. Ms. Hansen offered to verify the data she employed in her calculation of non-residents. Representative Wilson wondered about the personal exemption for non-residents and why it was offered to them. Ms. Hansen responded that the U.S. Constitution prohibited offering the exemption exclusively to residents. She noted that the way non-

resident income was calculated based on world-wide income, the Alaskan exemption would only account for a smaller portion of the exemption relative to the amount of their income connected to the state. Representative Wilson inquired whether the U.S. or state constitution prohibited the non-resident exemption. Ms. Hansen believed that the provision was contained in both constitutions.

Representative Kawasaki asked whether the half year calculation was based on the first year of implementation that began mid-way through the year. Ms. Hansen answered in the affirmative.

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Representative Kawasaki commented that Alaska had a winter season and a construction season. The construction season lagged a bit because of the weather. He wondered when the half year began. Ms. Hansen responded the current year would capture January 1, 2017 through June 30, 2017.

Representative Pruitt asked whether the information factored in the data for job losses in the state. He noted that "dramatic shifts had taken place in the last year and a half." Ms. Hansen responded that Mr. Davis' [Carl Davis, Research Director, Institute on Taxation and Economic Policy (ITEP)] numbers were reflected the 2016 tax year, which were the most recent. She relayed that his report noted unemployment as a possible change in revenue, but did not have enough definitive information to adjust the model. Representative Pruitt thought Ms. Hansen was referencing calendar year 2015 with the information filed through 2016. He opined that due to the loss of many high paying jobs in the oil sector and other job losses the figures were not dependable two years later.

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Ms. Hansen continued to the flow chart on slide 4: "AK Permanent Fund." The new committee substitute (CS) numbers were reflected on the chart. She noted the slight decrease in the Permanent Fund and that the income tax was based on adjusted gross income instead of federal tax liability. The intention of the chart was to show where state revenue funds currently flowed and where they would flow under HB 115. The green boxes reflected new information. The Permanent Fund Dividend (PFD) calculation was not altered.

The only difference was that the distribution was based on the structured draw from a Percent of Market Value (POMV) rather than distributable income. In addition, a resident can opt to apply the PFD to income tax liability. She continued to slide 5: "HB Proposal: Total Estimated Revenue to General Fund":

FY20 - First Full Year of Tax Implemented
Income Tax Revenue* \$663,000,000
2/3 of the 5% POMV Draw ** \$1,780,000,000
Total Revenue to General Fund \$2,443,000,000

Separate 1/3 of POMV Draw to dividend \$879,000,000

*Dept. of Revenue initial estimate updated fiscal note forthcoming

** 5.25% draw for previous two years, 5% POMV Draw starting FY20 amount based Legislative Finance calculations. 33% to the dividend and 67% to the general fund.

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Ms. Hansen advanced to slide 6: "Potential future impact based on projected status quo & HB 115 dividends in FY25." She reported that the chart portrayed the long-term distributional impact of HB 115 and the reduced PFD across income groups. She noted that the information was contained in the ITEP report that would be addressed later in the meeting. She relayed that the change in the dividend was not as great in the out years. She cautioned that the numbers were predictions, but the PFD draw was more stable under HB 115 because of the POMV draw. In the out years, the chart showed an even income impact between the lowest 20 percent and the top 1 percent.

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Representative Wilson asked how many actual individuals were included in each income group. Ms. Hansen deferred to Mr. Davis to answer Representative Wilson's question. Representative Wilson requested further clarification regarding the composition of the income groups.

Co-Chair Foster reported that Mr. Davis would be presenting after Ms. Hansen's testimony.

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Ms. Hansen turned to slide 7: "Why Adjusted Gross Income?":

Volatility of federal tax liability - If federal tax rates change this automatically impacts state revenue levels, with no state input. Issue is addressed by using adjusted gross instead of tax liability.

Exemptions & credits - Using adjusted gross gives a clean slate instead of automatically adopting federal credits and deductions.

Equity between capital gains & other income types - All income is taxed at the same rate under adjusted gross income, avoiding the federal tax reduction for capital gains.

Administrative ease - Calculating what non-resident income is taxable is simpler under adjusted gross income, and would have been very complex under federal tax liability.

Alaska Specific - Adjusted gross income now includes a deduction for the permanent fund dividend, which is not exempt on federal taxes.

Ms. Hansen elaborated that the bill was changed to base tax rates on adjusted gross income rather than a percentage of federal tax liability. She recounted that the previous version of HB 115 added a tax on capital gains on top of the federal tax rate due to the federal reduction on capital gains tax. The results were more complicated and had a greater impact than taxing capital gains with an adjusted gross income tax system. She furthered that the federal exemption on the sale of a primary residence was also exempted in the CS.

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Representative Wilson asked about the primary residence exemption. She thought that the exemption only applied if the value of the house was the same or higher and the tax payer lived in the house at least two years. She wondered whether the exemption applied to downsizing to a smaller home. Ms. Hansen understood that the tax was connected to a gain over the purchase price and the exemption applied if you lived in the house over two years. She offered to confirm the answer.

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Ms. Hansen continued to slide 8: "Where does Alaska sit currently?" The chart depicted that the state ranked in 50th place for its state and local tax burden of 6.5 percent as a percentage of state income in fiscal year 2012. She explained that the data was from the Tax Foundation and was updated in 2017, however, the 2012 data was included because the ranking remained the same and included more detailed data. She recapped that Alaska ranked the lowest in state and local taxation in the country.

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Representative Wilson asked about Alaska's property tax exemptions and how they factored in the 6.5 percent burden. She felt that the exemptions would "skew the numbers a lot." Ms. Hansen offered to reexamine the data. She recollected that the rankings were based per capita and per homeowners. The data did not adjust for the senior exemption, but it did adjust for the ratio of the number of people in the state that were homeowners; the exemption did not affect the ranking. Representative Wilson commented that the chart was from 2012. Ms. Hansen replied in the affirmative and reiterated the reason previously stated for including the 2012 versus the 2017 data. She furthered that the 2017 data did not include the information regarding the taxes paid to the home state, taxes paid to other states, and the income rank. Representative Wilson wondered if the number reflected the number of individuals that had left the state because of job losses. Ms. Hansen believed the data was based on residency.

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Representative Pruitt asked for clarification regarding the amount of taxes paid to other states. Ms. Hansen offered to provide the information regarding how the organization performed the modeling. She highlighted that the taxes paid to other states included tourism taxes and production taxes on oil and gas. She did not have a short answer because the model was complex but would provide the information later. Representative Pruitt cautioned that the tax was too complex.

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Ms. Hansen scrolled to slide 9: "State Personal Income Tax Revenue as a Share of Personal Income in States with Broad-

Based Personal Income Taxes." She explained that the proposed tax ranked Alaska the fourth lowest in the country. The figures included the effective tax rate; the tax revenue on personal income divided by the total personal income. The data was provided by ITEP. She advanced to slide 10: "Sample of Other State Income Brackets." She elaborated that the slide incorporated income tax bracket data from four other states: Hawaii, Ohio, Montana, and Kentucky. She noted the difficulty in making a direct state by state comparisons due to each states' unique modifications of its tax brackets. She reported that 25 other states adjusted its brackets for inflation, which was a provision in the CS. She indicated that the reason the CS did include inflation adjustments was to avoid including more tax payers in the top brackets.

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Representative Wilson asked for clarification. Ms. Hansen responded that income rises with inflation; therefore, more individuals would be included in the top brackets over time without inflation adjustments. She pointed to the Department of Labor and Workforce Development chart: "Workers and Wages, Major and Selected Industry Categories." She remarked that the chart excluded the self-employed, fishermen, and other agricultural workers, and private household workers. She highlighted that the 2015 report showed that the total number of nonresident workers was 21.3 percent and the wages earned by nonresidents reflected 16 percent of the states total wages. The income tax included provisions to raise income taxes from residents and nonresidents.

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Ms. Hansen moved to slide 12: "Corporate Income Tax avoided by Sub S Corps and Limited Liability Corps in Alaska." She relayed that the exemptions were "not the norm" in other states. The chart illustrated the state's corporate tax rates applied to C corporations. She furthered that the income tax proposal included Sub S Corps and Limited Liability Corps.

Representative Pruitt thought that the tax impacted small "Mom and Pop" operations by placing them in the "higher echelons of the corporate tax structure." He wondered whether there had been any studies done on the effects of the proposed taxes. Ms. Hansen replied that the amounts on the chart were not the brackets that applied to the sub s corporations and limited liability corporations. The income from the entities would be

included in the individual's income tax. Representative Pruitt provided an example and wondered whether he was accurate. He was very concerned about the "substantial change" for small businesses in Alaska. He emphasized that the CS represented a "dramatic shift" for small businesses. The legislation was not only taxing the individual but businesses as well. Ms. Hansen clarified that the provisions proposed taxing certain businesses through the income it provided to the individuals as owners, partners, or shareholders. The businesses would have the ability to write off their expenses and deduct their share of corporate taxes paid. Representative Pruitt wondered why the tax would not just be left to taxing the individual. Ms. Hansen replied that the provisions corresponded more to the nonresident corporations and attempting to "firmly establish income from sources within the state." She would work with Mr. Spanos [Brandon S. Spanos, Deputy Director, Tax Division, Department of Revenue] for a more precise response. Representative Pruitt believed that the provisions created "multiple levels of complexity." He wondered why the tax was not simply an income tax that was based on the distributions to the individual instead of adding the corporate tax as well. He deduced that it was a matter of "which side the tax would be taken from." Ms. Hansen responded that the corporations were already taxed in every other state. The corporations retained a "certain amount of leniency for where they record the income." She deferred the answer to Mr. Spanos.

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Representative Pruitt surmised that if an out-of-state corporation could choose where it paid taxes, the action "dampened" the effect of the state attempting to collect taxes on income gained in Alaska. He questioned the reasoning behind taxing s corporations. Ms. Hansen communicated that sections AS 43.22.50, AS 43.0.55 and other sections that dealt with the "pass through" entities and how they distributed its shares was based on how the income was connected to a source within the state and on the multi-state compact. Representative Pruitt pointed out that Ms. Hansen had just stated the entities had the option to choose. He reiterated his concerns about adding another layer of tax. Ms. Hansen replied that the entities could decide whether the corporation or the individual paid the tax, however the tax remained connected to the source within the state.

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Vice-Chair Gara believed that the last line of questioning was very confusing to him. He ascertained that the tax rate for an individual who gained income from their business was the same as the tax rate for a wage earner. Ms. Hansen responded in the affirmative. Vice-Chair Gara deduced that the tax rate in the CS for an individual who made \$20 thousand per year or \$40 thousand per couple minus the \$4 thousand exemption was 2.5 percent. He asked whether the statement was correct. Ms. Hansen stated that he was correct. Vice-Chair Gara calculated that a couple that owned a business making \$40 thousand paid approximately \$300 in taxes. He did not view the amount as a hardship. He stated that currently only C corporations were taxed. He asked whether he was correct. Ms. Hansen replied in the affirmative. He stated that a lawyer or doctor in Alaska making \$5 million per year did not pay any state taxes unless part of a C corporation. He requested confirmation. Ms. Hansen responded in the affirmative. Vice-Chair Gara defined that the multi state tax compact prevented double taxing tax payers. He asked whether the statement was correct. Ms. Hansen responded in the affirmative. He wondered whether a corporation would be taxed in Alaska if the state did not follow the multi state compact. Ms. Hansen deferred her answer to Mr. Spanos. Vice-Chair Gara inquired whether an individual was a laborer, legislator, doctor, or individual business owner the tax rate was the exact same based on their income under the CS. Ms. Hansen answered in the affirmative. She added that the tax was based on income regardless of the source.

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Representative Wilson asked where non-profits stood under the CS. She wondered about native corporations that issued dividends. Ms. Hansen answered that Mr. Spanos was preparing a more detailed answer. She noted that the native corporations were not non-profits and paid taxes. The dividends were paid out to beneficiaries and were deducted from what the corporation paid and were taxed at the individual level. Representative Wilson wondered whether the beneficiary dividend was included in taxable income. Ms. Hansen offered to double check the federal tax status. She related that if the dividends were included in the adjusted gross income the amount was taxed at the individual level. Representative Wilson wondered what other category the dividends could be included under. Ms. Hansen replied that there was a category for tax exempt dividends, but she needed to research what dividends were included.

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Representative Pruitt remarked that an S corporation was simply passing through money earned to the applicable individual. He surmised that the income tax and tax on an S corporation "cancelled each other out" since the money was automatically passed through to a shareholder. The individual receiving the money would have to pay a personal income tax under the bill. He wondered about the tax being duplicative.

Co-Chair Seaton understood that Representative Pruitt referred to the "normal functioning" of an S corporation. He qualified that alternately, an S corporation could pay some of the distributed taxes and the provision in the CS ensured that the amount paid in taxes was not double taxed. He declared that no provision in the bill double taxed anyone or entity, which was why the provisions were very detailed. The details guaranteed that loopholes were not left open to be interpreted to offer loopholes or double tax anyone.

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Vice-Chair Gara observed that there was no double taxation in the bill. He provided an example of an architect who made \$1 million in wages that would be subject to the income tax unless the income was earned as a shareholder in an S corporation; then the architect paid nothing. He surmised that a continued exemption created the scenario. Ms. Hansen deferred the details of the amounts that could be passed through at the corporate level to Mr. Spanos. She relayed that if the shares were directly passed through to the shareholder individual income taxes applied.

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BRANDON S. SPANOS, DEPUTY DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, commented on the discussion. He offered that S corporations and partnerships were pass through entities and were not taxed separately in the CS. A provision allowed a partnership or an S corporation to pay on behalf of nonresidents. A credit was available to the individual to indicate that the S corporation paid the taxes. He summarized that S corporations and partnerships were pass through entities and taxes due were owed by the individual unless the tax payer elected to pay via the corporation or entity.

Vice-Chair Gara wanted to confirm that an S corporation shareholder paid the same tax as a wage earner making the same amount and that no one was double taxed. Mr. Spanos answered that ultimately the bill treated all income the same other things being equal, "regardless of the structure of the entity the individual belonged to."

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Ms. Hansen turned to the final slide numbered 13. The slide depicted a current 1040 federal tax form. She pointed to line 37 that specified the amount of adjusted gross income and the \$4 thousand exemption was based on the federal exemption on line 6 d of the 1040.

Representative Wilson wanted to know the reason for choosing the federal exemptions. Ms. Hansen responded that most states used an adjusted gross income. She relayed that it was determined that the federal exemptions were "a good place to start," were consistently used, and "leveled the playing field." Representative Wilson contended that the deductions were arbitrary and "at the end of the day," the exemptions did not even the playing field. She had understood that the discussion was income tax and was based off line 22, total income. She thought that \$4 thousand was the only deduction allowed, but by using the federal exemptions 13 other items were deductible. She asked whether what was being proposed was based on what certain states had done. Ms. Hansen replied that she could not speak to all the decisions that were made regarding the CS. Representative Wilson was not trying to place Ms. Hansen on the spot. She asked Co-Chair Seaton who made the decision to include the exemptions.

Co-Chair Seaton relayed that the decision was made based on testimony that listed problems with using tax liability. He shared that the administration had hired a tax consultant to develop an income tax. The tax was based on adjusted gross income that was used in many other states. He suggested she offer an amendment to tax all income without deductions. He remarked that a starting point had to be chosen and the federal adjusted gross income was a "logical" choice because it included sensible exemptions.

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Representative Wilson stressed that her questions were not indicators of whether she agreed or disagreed with the bill

but were an attempt to understand the bill. She thought there were many things in the bill that were complicated and wanted to better understand all the parts and pieces. She hoped to receive answers to all the questions asked by committee members.

Representative Pruitt inquired whether landlords could deduct expenses from their rental income before paying taxes. Ms. Hansen did not know enough about the specific issue. Co-Chair Seaton responded that line 12 reported business expenses from the federal Schedule C form and would be subtracted from total income.

Representative Wilson corrected Co-Chair Seaton that the accurate form was Schedule D, line 17. She continued to explain that Schedule C was for small businesses.

Ms. Hansen relayed that Mr. Spanos would present the following day.

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Co-Chair Foster introduced Mr. Davis and noted that a document dated March 24, 2017 titled "Assessing the Distributional Consequences of Alaska's House Bill 115 (Version L)" (copy on file) was distributed to members.

CARL DAVIS, RESEARCH DIRECTOR, INSTITUTE ON TAXATION AND ECONOMIC POLICY (ITEP), ANCHORAGE (via teleconference), spoke to the memo. He relayed that the information primarily contained a "distributional analysis" on how the bill impacted Alaskan families at different income levels. He commented that the two core findings were that the income tax was progressive, and the amount of tax paid increased with income. He continued that the cuts to the PFD were regressive and impacted lower income families more than middle or higher income families. He pointed to figures 2 and 3 of the analysis [pages 4 to 5] that compared the changes and the impact on federal taxes. He reported that the net impact of the progressive income tax and regressive PFD cut was "proportional overall." Figure 3 portrayed that family's income from all levels would be reduced by 1.8 percent to 2.8 percent. The plan relied more heavily on larger PFD cuts in the initial years therefore, the plan was more regressive overall and impacted families at the bottom income levels by 8.6 percent relative to their income.

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Representative Wilson pointed to page 1 of an ITEP document and read bullet point two and three:

Most states with personal income taxes offset some of the impact of regressive fiscal policies on their low-income taxpayers by offering a refundable Earned Income Tax Credit (EITC) patterned after the federal EITC. In Alaska, a state credit calculated at 25 percent of the federal EITC could reduce the impact of the bill on the state's low-income taxpayers by 1 percent of their income. Such a credit would reduce Alaska income tax revenues by roughly \$25 million per year.

Low-income families, for whom the PFD represents a major source of income, would be impacted more heavily in the years immediately following implementation of this bill. This is because reductions in the PFD payout are forecast to be largest in the short-term. If the PFD payout is reduced by \$950 per person, the bottom 20 percent of earners could expect to see an impact from this bill equal to 8.6 percent of their incomes. This far exceeds the 2.9 to 4.1 percent impact felt by other groups under this scenario. (See Figure 2 and Table A.)

Representative Wilson asked for further clarification. Mr. Davis replied that the analysis was not based on provisions in the CS. He offered the information after examining the results from the data used in figure 2: "Impact of Alaska House Bill 115 (Version L)." He discovered that the impacts in the early years of implementing HB 115 was steady across income groups except for a PFD reduction of \$950 which had an "outsized" impact on low income groups; an income reduction of roughly one percent for the lowest 20 percent. He furthered that the bill did not offer an earned income tax credit, unlike most states with a personal income tax. He elucidated that the intent of an earned income tax credit was to offset the impact of changes in fiscal policy on low income groups.

Representative Wilson referred to the chart on pages 4 or 5 of the document. She asked where the category data was derived from and whether it reflected the loss of jobs due to the economy. Mr. Davis answered that he utilized the most recent reporting by the Internal Revenue Service (IRS), which was

from 2014, and the data was "aged forward" to 2016 using other sources of economic analysis including the Congressional Budget Office. He shared that ITEP attempted to gather state specific forecasting data to include analysis for future years but was unable due to the imprecise nature of the data. He furthered that the number of people in each income group was based on IRS returns. He reported that each income quintile represented roughly 70 thousand units or tax returns. The number of individuals in each quintile differed due to family size; families at the top tended to be larger than families in the bottom quintiles. Representative Wilson asked if the lowest number of returns reflected children. Mr. Davis reiterated that the families in the lower quintiles "tended to have fewer children on average." He delineated that the number of people was not the same in each income group, but the number of tax units remained constant at 70 thousand tax returns per quintile.

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Representative Wilson mentioned that she was not requesting forecasted data. She wondered how he would have shown the adjustment for lost jobs due to the economic downturn. She also questioned how he determined the 78 percent to 22 percent split between residents and nonresidents. Mr. Davis responded that the information was not as detailed as he would have liked. He had obtained information on how the Alaskan economy had changed but did not have sector specific information. He elaborated that if a dramatic shift had occurred over the last year or two within one sector, the affects could not be reflected in the current data. The company relied on the ISER figure of income tax revenue to determine the nonresident's percentage and had to rely on outside sources since ITEP did not have data on nonresident income tax contributions. The income quintiles only included Alaskan residents and the nonresident data was included as an addition to the residential data. He added that ITEP was able to model the federal income tax in Alaska and an alternative scenario included in HB 115 where Alaskans can write-off the \$660 million of state income tax, which triggered a federal income tax cut of approximately \$102 million. Therefore, the combined impact of federal tax cuts and income tax payments by nonresidents would raise an estimated 22 percent of the revenue in HB 115 and reflected reliable data. Representative Wilson was very concerned with not having the correct data. She asked whether only those tax payers with itemized reductions could write the state's income off their federal

taxes. Mr. Davis confirmed that Representative Wilson was correct and had "an important point" but his analysis did account for that scenario. Representative Wilson opined that her point made her question the analysis regarding the write-off impact on federal taxes. She reiterated her doubt about the accuracy of the data and projected revenue.

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Vice-Chair Gara asked him to explain the \$4 thousand exemption per person. He referenced the provision that exempted a single filer from the income tax who earned under \$10.3 thousand dollars. He asked whether someone who earned less than \$14.3 thousand would also be exempted due to the \$4 thousand exemption. Mr. Davis responded that he was correct. Vice-Chair Gara wondered whether the amount was doubled for joint filers. Mr. Davis responded in the affirmative. He furthered that the additional exemption for the PFD dividend was equally "significant." Vice-Chair Gara wanted to clear up confusion. He relayed that the bill did not impose a tax for a single filer who earned \$14.3 thousand or less and under \$28.6 thousand for joint filers (after the PFD exemption). He asked whether the two percent tax only applied to income above the figures he quoted and if the tax due totaled \$25. Mr. Davis answered in the affirmative and confirmed Vice-Chair Gara's statements.

Representative Guttenberg asked how he performed the modeling and whether most of the figures were "aggregate." Mr. Davis affirmed that the distribution charts were based on averages and represented aggregate tax payer groups. He mentioned that every tax payer would be impacted differently depending on their specific situation. Representative Guttenberg wondered when more accurate figures would be available to upgrade the model to 2017. Mr. Davis answered that the annual update from the IRS was the "fundamental" basis for the model due to its detailed data on income levels and sources. He reported that updated figures would be released later in the year for 2015. He incorporated any other new usable economic data or projections when released. Representative Guttenberg referred to the population and job loss projections from DOL. He wondered how appropriate it was for ITEP to incorporate the data into their model. Mr. Davis relayed that ITEP examined the DOL data and adjusted the model downward. He noted the dramatic differences in each states' economy and tried to incorporate state data when it contained enough details. Representative Guttenberg inquired whether the quintile data

was adjusted downward and included the loss of children in the economy in terms of their effect on school district counts or PFD loss of family income. Mr. Davis confirmed that he adjusted the PFD data for 2016. The information on the number of recipients was rooted in 2016 data. He detailed that the income tax data was less concerned with employment but focused on income levels. The employment data was less of a priority than the correct income levels which to some extent reflected the employment levels.

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Representative Grenn recalled a prior year ITEP report that indicated 70 or 80 percent of Alaskans would pay less via a sales tax than last year's proposed income tax. He wondered whether the same applied to the current income tax proposal. Mr. Davis answered that the number that ITEP used in the previous year came from an ISER report finding that approximately 80 percent of Alaskan taxpayers would pay less under an income tax linked to federal liability than under a general sales tax designed to raise the same amount. [Mr. Davis' teleconference call was dropped.]

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RECONVENED

Co-Chair Foster indicated Mr. Teal would be presenting to the committee.

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DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, referred to documents in the member packets titled: "HB 115 Amended OMB Budget" and "HB 115 Amended Flat Budget" (copy on file). He indicated that the models reflected HB 115 updated numbers and the bill's impact on the operating budget and PFD. He began with the data on the "HB 115 Amended OMB Budget" slide that contained four graphs depicting the model results based on the Office of Management and Budget's (OMB) Ten Year Plan. He relayed that the data portrayed a balanced budget beginning in FY 20 and draws off the Constitutional Budget Reserve (CBR) ceased. He noted that in FY 19, the income tax revenue "kicked in" halfway through the year and was flat at roughly \$700 million in the out years. He pointed out that the CBR balance

was rising from interest and settlements because the balanced budget ended the need for CBR draws. The Earnings Reserve Account (ERA) was steady at roughly \$9 billion due to the increasing payout of \$50 million to the general fund (GF) with the remainder appropriated to PFD's. He highlighted that in FY 2018 dividends were \$1250 and would remain steady rising slightly to \$1400 by FY 2026.

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Representative Wilson ascertained that trusts, S Corporations, and LLC's were currently taxed in the CS and was a new provision. She assumed that the additional revenue was included in the model and wondered how it impacted the model. Mr. Teal deferred the answer to DOR. He commented that he only received the \$700 million in revenue estimated number from the department. Representative Wilson asked whether the figures were the same as the previous version's estimates. Mr. Teal answered that the income tax revenue estimates were roughly \$30 million annually higher in the new CS. Representative Wilson asked, "what part of the bill" the \$30 million in increased revenue impacted. Mr. Teal remarked that the CS contained a major change in the income tax provisions and presently, the tax was based on adjusted gross income. He was unable to answer the question without detailed information. He received a single number from DOR. Representative Wilson asked whether a fair conclusion was that the revenue in the CS increased by \$30 million but the source of the increase was unknown. Mr. Teal responded that Representative Wilson was correct.

Vice-Chair Gara remarked that the CS did not add income from S corporations and LLC's. The previous version of the bill and the state's prior income tax taxed the individual owners of the entities. He asked whether the statement was correct. Mr. Teal responded that he was correct. He added that the entities were "pass throughs" and the distributions to individuals was taxed. Any version of an income tax based on the individual income that included the entities would tax the income.

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Representative Wilson interjected that the CS title was changed to include the entities in the new version of the bill and she presumed that a change occurred from the original version of HB 115.

3:16:16 PM

Co-Chair Seaton affirmed that the entities were taxed under the previous version of the bill. He explained that when the bill changed to adjusted gross income more detailed provisions were included to avoid loopholes. The CS was a more detailed construction of the bill. The intent was to include "some balanced progressive tax rates." He reported that the goal was to raise approximately \$650 million to \$700 million in revenue from an income tax as part of a balanced sustainable fiscal plan that worked under OMB's 10-year projection. He furthered that the previous version of the income tax based on a percentage of federal tax liability and the new CS were "relatively" the same in terms of revenue generation and progressivity. The difference between the versions was that the volatility from basing the tax on federal liability was eliminated. The change occurred based on advice from previous testimony. Representative Wilson did not understand how the bill impacted trusts for individuals who live in the state versus those who did not and how it affected the economy. Co-Chair Seaton replied that nonresident trusts that do not derive income from within the state were not taxed under the bill. He surmised that her desired outcome regarding trusts were integrated into the bill. He elucidated that individuals would only be affected if the trust's income came from a source within the state. A trust manager would likely use diversified investments. However, if there was a trust with large investments in the state generating revenue the income would be taxed under the bill.

Representative Wilson appreciated his reply. She deduced that the bill would not impact nonresidents but thought the provision would impact residents who therefore, might set up their trusts in other states instead.

3:21:03 PM

Representative Ortiz attempted to summarize the impact of HB 115 with an income tax versus without an income tax. He did not believe any one was excited about paying an income tax. He was aware of the potential impact the income tax had on people in the state. He wondered whether an income tax helped solve the fiscal problem in the state, created a stable fiscal climate, supported the state's bond rating, created a more certain business environment, and if the state's savings would grow. He asked if there was a "net positive" with the legislation. Mr. Teal explained that bond ratings were tough

to deal with and the "raters had their own black box." However, it was likely safe to say that "with a balanced budget the bond rating would be higher." He reiterated that the model demonstrated that with HB 115 the budget was balanced, and reserves grew. He voiced that without an income tax, deficits of roughly \$600 million to \$700 million would continue and reserves declined, which offered a plan without a solution and created uncertainty because at some point the deficit had to be addressed. A plan that balanced the budget provided more certainty than a plan that contained a deficit and did not offer assurance on how the deficit would be filled; either by budget cuts or revenue generation.

[3:25:08 PM](#)

Vice-Chair Gara asked Mr. Teal to display a model based on SB 26 (APPROP LIMIT & PER FUND: DIVIDEND; EARNINGS). He wondered how much revenue would be generated beginning in FY 18 and FY 19 for public services. Mr. Teal responded that SB 26 did not include revenue generation and lacked approximately \$700 million per year. He noted that the bill offered a different PFD amount that remained flat at \$1000. He noted that a provision in SB 26 payed out 25 percent of the Percent of Market Value (POMV) appropriated to dividends versus 33 percent in HB 115 and was the difference in the deficit of \$500 million because the additional \$200 million paid dividends. The bills were very similar except for the income tax. Vice-Chair Gara guessed that the FY 18 deficit was roughly \$2.8 billion. Mr. Teal answered in the affirmative. Vice-Chair Gara deduced that SB 26 had an estimated \$560 million deficit in FY 19. He reported that some had referred to SB 26 as a "95 percent solution" and wondered why.

[3:28:19 PM](#)

Representative Pruitt interjected that the Senate had a different philosophy about the actual "spend" for government and wanted higher budget cuts, which should be part of the discussion about SB 26 and the 95 percent.

Co-Chair Foster indicated that there would be a more detailed discussion when the committee would hear SB 26 the following morning.

Representative Wilson thought that the discussion should include the top graph on the left of the slide that depicted the budget cuts of \$300 million in the current year and \$250

million for the following two years and compare the entire plan contained in SB 26.

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

[3:29:48 PM](#)

Co-Chair Foster reviewed the agenda for the following morning.

ADJOURNMENT

[3:30:42 PM](#)

The meeting was adjourned at 3:30 p.m.