

HOUSE FINANCE COMMITTEE
March 30, 2017
1:38 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:38 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative David Guttenberg

ALSO PRESENT

Ken Alper, Director, Tax Division, Department of Revenue; Brandon S. Spanos, Deputy Director, Tax Division, Department of Revenue; April Wilkerson, Director, Division of Administrative Services, Department of Corrections; Randall Hoffbeck, Commissioner, Department of Revenue; Kristin Kranendonk, Staff, Representative Harriet Drummond; Ben Brown, Chair, Alaska State Council on the Arts.

PRESENT VIA TELECONFERENCE

Kate Hudson, Executive Director, Violent Crimes Compensation Board, Juneau; Alice Bioff, Kawerak, Inc., Nome; Andrea Noble-Pelant, Executive Director, Alaska State Council on the Arts, Eagle River.

SUMMARY

HB 115 INCOME TAX; PFD CREDIT; PERM FUND INCOME

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

HB 137 ST. COUNCIL ON THE ARTS: PUBLIC CORP.

HB 137 was HEARD and HELD in committee for further consideration.

Co-Chair Foster addressed the meeting agenda. He indicated that the discussion focused around the Department of Revenue (DOR) fiscal notes for HB 115.

#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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Representative Wilson discovered that a consultant had been hired by the administration to work on tax issues. She stated that the individual had been hired through an \$85,000 contract. She wondered whether the committee would have the opportunity to hear testimony from the consultant in-person. She voiced the department's lack of knowledge regarding trusts.

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AT EASE

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RECONVENED

Co-Chair Foster asked the administration to address the question.

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, provided background information about the consultant. He informed the committee that Professor Rick Pomp's role with the administration related to the development of an income tax bill. He relayed that Prof. Pomp was an attorney and a professor at the University of Connecticut. He explained that during the prior session the governor had offered a similar income tax bill. He learned through the process, that the income tax language used in the governor's bill was obsolete and needed updating. He delineated that DOR placed a request for approval of a 2017 income tax bill to the governor's office "long before" it was determined whether the bill would be introduced. He wanted to update the language in the bill regarding using adjusted gross income rather than a share of federal liability. He shared that issues had arisen related to using federal liability such as, its elimination in every other state and the difficulty to apportion income between resident and non-resident among others. The Department of Law (DOL) alerted DOR that it did not have the in-house expertise to draft the updated language. He subsequently issued a RFP (request for proposal) that was awarded to Prof. Pomp in the amount of \$85 thousand to draft an income tax bill. He qualified that during the process, the governor had not approved introduction of the bill. When DOR learned that the House Finance Committee was introducing its own income tax bill DOR offered the language on the "structure" of the tax and technical language to the committee. He clarified that Prof. Pomp contributed the tax structure and technical language but the tax tables, personal exemption, and amount of revenue was directed by the Co-Chairs of House Finance in the committee substitute (CS) version. He communicated that Prof. Pomp completed the contract but would be available to testify although he was not a trust expert. He clarified that he was an expert on state and local taxation. The question on how trusts were taxed was "technical and complex." He believed it would be beneficial to the committee to hear how the bill was structured in regards to trusts but did not know whether Prof. Pomp was the appropriate person.

Representative Pruitt asked where the money had come from to pay for the contract. Mr. Alper replied that the money had come from the Tax Division's general fund (GF) budget due to the hiring freeze. Representative Pruitt asked whether the division followed the normal procurement process and why Prof. Pomp was chosen. Mr. Alper delineated

that the money was transferred through an RSA to DOL who "headed up the contract" due to its legal procurement expertise through a typical RFP process. He did not know the specific criteria DOL employed. Representative Pruitt asked whether the governor had intended to introduce income tax legislation if one had not been offered by the legislature. Mr. Alper replied that the issue was left undecided and his goal was to be prepared with a "good" bill containing attention to technical details that could be implemented and was enforceable. He did not know the governor's intention regarding introducing an income tax bill.

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Representative Pruitt spoke to the \$85 thousand contract. He believed that the cost was too high to spend on something that may or may not have action taken. He wondered how often DOR engaged in similar contracts for things that might not come to fruition and what the costs were. Mr. Alper did not have any specific example under his two years as tax director. He noted that the contract was the only outside contract the division funded. The division discussed the need for "better income tax language" and the contract seemed to be a "reasonable investment." He emphasized that the department was not in the habit of spending money on things that was not necessary. The tax language contained in last year's bill was incomplete and based on the repealed tax in 1979.

Vice-Chair Gara did not want members to think that Mr. Alper attempted to conceal the information regarding the contract. He shared that prior to session he asked Mr. Alper whether the governor planned to introduce income tax legislation. He emphasized that Mr. Alper had been completely forthright about the contract. He asked whether Mr. Alper would have provided the information about the contract to other members of the committee if they had the same conversation. Mr. Alper answered in the affirmative and furthered that he spoke to "many people" prior to session and it was well known that an outside contractor was helping the division with tax language. Vice-Chair Gara announced that he was a proponent of the state developing its own income tax rates because using a percentage of federal income tax prohibited the state from exempting the Permanent Fund Dividends (PFD). He inquired whether an exemption for the PFD was allowable if the state adopted a

percentage of federal income tax as a foundation for its income tax. Mr. Alper replied that the bill could be written however the legislature desired and that included a deduction. He recognized that an income tax tied to federal liability was vulnerable to changes in the federal tax code. He deduced that if federal taxes were lowered, Alaska's revenue from the income tax would be simultaneously lowered. A tax based on gross income created a more dependable and predictable revenue stream. Vice-Chair Gara had not spoken to Prof. Pomp. He concluded through his own analysis that a tax system tied to federal liability created instability due to probable changes in the tax code and felt that many others came to the same conclusion without the help of an outside consultant.

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Mr. Alper agreed that a consultant was not needed to recommend the type of tax; however, the bill was extremely technical. He reiterated that DOL did not have the expertise and requested outside council. He knew that the state hired outside council for a variety of reason, mostly for litigation but also for consulting reasons.

Representative Wilson clarified that she had asked about the consultant because she wanted answers that the committee had not yet received and believed her job was to find the answers and had no other motive for the request. She asked when the contract ended. Mr. Alper did not know if there was a specific end date or whether Prof. Pomp had been paid; the deliverable was the draft bill he produced and he "deserved to be paid." Representative Wilson agreed that Prof. Pomp should have been paid for his work. She asked when the "deliverable had been delivered." Mr. Alper replied that an early draft was received in December and a final draft had been delivered in January. He communicated that DOL used the draft to write a final bill version and the bill was received by DOR in the later part of January. Representative Wilson spoke to the cost of the contract. She spoke to deductions and exemptions that would be given to residents versus non-residents and heard from previous testimony that taxing them differently was prohibited. She asked whether Prof. Pomp had any information on how a residential versus non-resident tax would be treated. Mr. Alper explained that the technically complex provisions in an income tax bill was properly apportioning in-state versus out-of-state income and Prof. Pomp devised tightly

defined language that allowed the duality. He specified that a few provisions in the bill favored a resident over a non-resident. The \$4 thousand personal exemption was essentially prorated for a non-resident and was only able to exempt the portion of income earned in Alaska. He exemplified an individual non-resident with a seasonal business in Alaska earning \$50 thousand and another business in a different state earning \$200 thousand totaling \$250,000 in income. The tax payer would pay income tax from the \$250 thousand bracket but only 20 percent of the tax, since only 20 percent of total income was earned in the state. He noted that the pro rata was a small benefit but was a way to favor the Alaskan over the non-resident.

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Representative Wilson was uncomfortable that the committee members had been asked to provide amendments by the following day. She did not have the expertise to write an amendment. She hoped that Prof. Pomp would be able to answer some of the member's questions. She did not want the bill to have consequences in the future that were unintended. Co-Chair Foster noted that the committee would take an "at ease" later in the meeting to determine when it could hear from Prof. Pomp.

Representative Pruitt asserted that expert help for answers to questions was previously requested. He expressed concern that Prof. Pomp was not mentioned to the committee before. He was frustrated by the issue. He thought some time may have been wasted by not retaining Prof. Pomp to testify and answer questions before the committee.

Co-Chair Seaton recounted that trust attorneys had testified and expressed concern about problematic language in the bill. The co-chairs were taking the concerns into account. He was working with the attorneys on getting answers as best as possible and would put forward amendments. He presumed Representative Pruitt and Representative Wilson were also speaking to trust attorneys to get opinions about the bill's language. He maintained that inquiry was part of the committee process and the reason the trust attorneys were invited to testify to answer all of the committee member's questions.

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Representative Pruitt appreciated the response; however, he remarked that Mr. Alper had just stated there was no one in Alaska with the expertise on trusts. He reiterated his frustration that the person who wrote aspects of the bill was not available to testify before the committee.

Vice-Chair Gara knew the comments were not meant as accusations but the "rhetoric" bothered him. He wanted to clarify the record. He stated that the suggestion that Prof. Pomp "wrote the bill was patently untrue." He relayed that legislators were not "helpless" when dealing with legislation and could undertake their own research and utilize resources. He noted his own personal attempts to find answers for the trust issues.

Representative Pruitt clarified that he was not making accusations.

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Mr. Alper moved on to address the fiscal notes. He noted that four were from DOR. He turned to the new DOR fiscal note allocated to the tax division showing income tax revenues only. The fiscal note reported that the state would raise over \$700 million each year. He delineated that the first full year of income tax collected was FY 20. The income tax provisions in the bill had an effective date of January 1, 2019. The first withholdings from paychecks was subsequent to January 2019; hence, the figure for FY 2019 represented half a year's worth of revenue. The first actual tax filings would not happen until April 15, 2020. Mr. Alper explained the capital costs reported in the fiscal note analysis of \$14 million; 2 percent of one year's amount of projected revenues. The division would embark on four short term projects if the legislation passed. A very "aggressive, lengthy, and extensive" regulations writing project was necessary to clean up details and address specifics and "gray areas." He expected that outside contractors would be required. A database would need to be built in order to collect and administer the tax costing approximately \$10 million. He highlighted that DOR recently completed a \$25 million contract to rebuild the tax management system. He noted that the results were very successful; the department expected to employ the same contractor for the income tax database. The department would provide outreach to the public about the tax and how it was structured. Finally, the division would

also need to hire new staff to administer the tax. The division estimated that about 60 individuals were required to administer the tax by the time it was fully implemented in FY 2020. He delineated that the department currently operated 25 tax programs. The largest was the corporate income tax that had 18 thousand tax payers; most were S corporations filing zero tax returns. The income tax would add 400 thousand Alaskan households as "customers" to the division's customer base. The division would need auditors, technical expertise, appeals officers, programmers, accounting technicians, and supervisors. The fiscal note contained a table listing the staff needs on page 4. The ramp up would be gradual. He included four staff in the FY 18 budget for a leadership team; supervisor, technical expert, programmer, and regulations staff.

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Mr. Alper shared the cost of the staff was a little over \$6.4 million per year plus the associated costs of personnel. He reported that currently the division had 110 employees and an income tax would increase the staff and costs half again as much as current expenses. He remarked that implementing the tax took substantial effort, but the department was up for the challenge. Mr. Alper continued that the analysis on pages 2 through 4 described the specific provisions in the bill such as tax brackets and withholding in "plain English." He cited the two tables contained in the analysis: one summarized the revenue and the other summarized the anticipated staffing needs.

Representative Wilson asked whether any analysis had been done on the cost to businesses to fill out the paperwork. Mr. Alper deferred the question to his colleague. He remarked that businesses were already doing the work at the federal level and felt that the state's forms did not create an extra burden.

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BRANDON S. SPANOS, DEPUTY DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, expected that the largest cost to businesses was related to the withholding tax that was specific to the state. The other forms required would be the same forms the IRS received, therefore the administration did not anticipate additional costs to businesses for other forms. Representative Wilson

ascertained that businesses needed to purchase some type of programming in order to comply. She pointed to the \$14 million cost for the state and assumed the tax would add costs to businesses too. Mr. Alper answered that most small business typically used a commercially available computer program like Quick Books that automatically downloaded a state's updated tax tables. He offered that the division would ensure the national accounting software programs internalized the Alaska's tax tables. A business owner would be able to rely on a program to withhold the income tax from their employees and the business could send their monthly reports and checks.

Representative Wilson contended that there would be costs to businesses and wanted to determine the amount. She listed S corporations, trusts, estates, and individual tax payers and wanted a breakdown of the amount of revenue that would be generated from each group. She requested better analysis of where the funds would be coming from. She wondered whether certain groups would be "hit" more than others. Mr. Alper clarified that "all of the revenue would be coming from individuals." He voiced that earnings from the various entities she listed were passed through to the owners who filed as an individual tax payer. He indicated that the tax division was not aware of the source of the income but obtained information on the complete set of IRS (Internal Revenue Service) data for the population of Alaska, the various income levels, and how many types (e.g. filing jointly) of filers there were. The IRS did not break out the type of income. He reiterated that the tax was specifically for individuals and the various sorts of income they earn.

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Co-Chair Seaton clarified that the CS included another category of non-grantor resident trusts that would file a distribution if one was retained. Grants or trusts were also attributed to the individual.

Representative Wilson asked whether any analysis had been done related to the loss of jobs in the private sector in the last 2 prior years. Mr. Alper answered that the income tax was modeled using a complete set of calendar year 2014 IRS data. The 2015 data had recently become available and the model would be updated. The division was working on breaking down the tax liability in fifths. He explained

that the model was straight forward and was based on types of filer and the various income levels. The calculation then used the tax tables and made certain estimates on averages, added up the data to determine the total revenue impact. Representative Wilson stated she understood how to do taxes. She noted that the information was based on data from 2014. She believed that the economic impact from low oil prices impacted the economy and job losses in 2016. She surmised that the fiscal notes did not reflect the current level of unemployment. She believed the committee received information based on older data and was not accurate. She advised integrating DOL statistics on employment data into the forecasted revenue projections for a better estimate than what was included in the fiscal notes. Mr. Alper stressed that it was not possible to know exactly what the numbers were in the future and the figures reflected in 2020 were forecasted.

Mr. Spanos relayed that the division's economists were listening during the previous meetings to Representative Wilson's questions and confirmed that the fiscal notes did factor in the Department of Labor and Workforce Development (DOL) statistics for the current years, but not specifically job losses on the North Slope. However, the DOL data did include job losses in the entire state. He elucidated that the economists determined that the total job loss figure was a better indicator on what the total revenue was versus just looking at the North Slope numbers.

Representative Thompson stated that the fiscal note analysis was based on Montana's tax agency to determine the number of new staff that would be necessary in Alaska. He asked how the state could do the work with half as many staff as Montana had. He wondered who would be auditing the companies to ensure they properly withheld taxes. He questioned the employment numbers of 60 staff by 2020.

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Mr. Alper replied that the question was fair. He explained the rationale used to calculate the fiscal note. He indicated that the department had rounded down a bit due to the fact that Montana had a specific department built around administering an income tax. Alaska's tax division was embedded in a department that already employed administrative, IT (information technology), accounting, and etc. staff. He presumed the increase could be added on

top of a "pretty robust framework" of employees that already existed within the tax division and the division could administer the tax for less. He deemed that the information about the number of staff precisely necessary was not yet known and was impossible to determine accurately before any tax was collected. He communicated that the costs embedded in the bill divided by the anticipated revenue equaled about 1.5 percent of expected revenue. He opined that 1.5 percent on startup costs and staffing "was a pretty good overhead" figure.

Representative Thompson referred to specialized tax accounting software that would need to be reprogrammed. He asked whether tax accountants and tax preparers were consulted about the costs to reprogram their software to accommodate a state income tax. Mr. Spanos replied that the administration had not specifically reached out to those companies. He knew that many of the accounting firms used either proprietary software or customized off the shelf software that would need to be reprogrammed. The department understood there would be a cost for the software but anticipated a new stream of revenue for tax accountants due to the tax. He shared the concern about administering an income tax without enough staff. He consulted with Vermont that had a similar population to Alaska; Vermont officials thought the number was too high. He delineated that Vermont had a more complicated tax structure than the one proposed and their tax officials recommended that fewer than 60 employees were necessary to administer Alaska's income tax. He envisioned hiring a base staff along with some outside expertise to guide the division until it was fully staffed. Representative Thompson asked how much more money it would cost an individual to have their taxes prepared. He stressed that a large number of people had their taxes done by a Certified Public Accountant (CPA) or accounting firm. Mr. Spanos replied that off-the-shelf systems cost about the same in many states. An additional \$10 to \$20 electronic filing fee was typically added on or embedded in the cost of the software for state's that prohibited the filing fee. He remarked that business accounting typically costs more than individual tax preparation.

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Representative Pruitt asked about the staffing needs listed on the fiscal note. He referenced the money spent on the contractor utilized from DOR vacancies. He wondered whether

the funding request was "above and beyond" the savings from the vacancy rates and other additional funding. Mr. Alper responded that the vacancy rates were "relatively high" in the current year due to the partial hiring freeze, which slowed the recruitment process. The contract cost \$85 thousand and the tax division's budget was \$15 million. The division was losing 8 positions in the FY 18 budget. The staffing request included all new positions. He hoped that current DOR employees losing their current positions were able to fill some of the 60 new positions. He spoke to the benefits of experienced workers. He pointed to page 4 of the fiscal note that contained a chart of necessary positions and drew attention to imaging operators and office assistants. He explained that the positions were half-year positions that scanned paper tax returns and did data entry. The fiscal note assumed that 80 percent to 85 percent of Alaskans filed electronically. Representative Pruitt inquired whether any additional money left over in FY 19 would be returned to GF or used for other things in the division. Mr. Alper responded that he was prudent by nature and would lapse money back into the general fund.

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Vice-Chair Gara related, in response to the previous discussion, that according to the Institute of Taxation and Economic Policy (ITEP) from a March 24, 2017 memo (copy on file) approximately 40 percent of Alaska's lowest wage earners would pay roughly half of one percent of their total income and the top 1 percent would pay about 3 percent of their income under the CS version of the legislation.

Representative Wilson emphasized that she requested numbers rather than percentages.

Mr. Alper continued to address the fiscal notes. He reviewed the new Alaska Permanent Fund Corporation (APFC) zero fiscal note allocated to its Investment Management Fees. He noted that the bill would not affect its investment policy therefore the fee structure would remain the same. Mr. Alper explained that the new PFD fiscal note reported the amount for dividends in FY 18 under the bill in the amount of \$833 million. He reported that the legislation altered the existing dividend calculation. In FY 18 and FY 19, a certain percentage of the Earnings Reserve Account (ERA) would be drawn and one-third would be

dedicated to dividend distribution. Alternatively, a minimum dividend amount was set at \$1250 if the calculation was below that amount. Subsequently, beginning in 2020, the draw was reduced to a percent of market value (POMV).

Representative Wilson pointed to the PFD funds appropriations listed on the fiscal note. She noted the \$881 million in FY 19 and the drop to \$874 in FY 20 and began to increase in the out-years. She wondered why the amount fluctuated. Mr. Alper was uncertain why the drop off occurred and deferred the question.

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Co-Chair Seaton referred to the chart on the second page. The percent of market value draw dropped from 5.25 percent to 5 percent in FY 20. The drop also reflected that a full year of income tax was not expected until FY 21.

Representative Wilson asked why there was such a large disparity from FY 20 to FY 21. Mr. Alper replied that the state anticipated average earnings on the Permanent Fund of 6.95 percent per year. The larger figure represented the inherent growth or the "underlying real growth of the fund." Additionally, a POMV "allowed for self-inflation proofing of the fund" along with the royalties from oil production. Representative Wilson thought that the stock market would be performing well for several years and expected different "average" figures. Mr. Alper explained that the legislation provided a larger dividend than what was included in the governor's budget. The fiscal note shows an additional \$181 million appropriation over the \$652 million included in the governor's request to total \$833 million. The \$652 million included in the Governor's budget covered a dividend of \$1000. The \$181 million in the "FY18 Appropriation Requested" column is the additional amount needed to cover a dividend of \$1,250 as proposed by this legislation.

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Mr. Alper moved to the new fiscal note from Permanent Fund ERA Appropriations allocated to the General Fund. He offered that the fiscal note reflected the 5.25 percent POMV amount decreasing to 5 percent in FY 20. In FY 18 the amount was \$2.526 billion and reflected the full draw from the ERA. The amount was split between two-thirds

appropriated to GF and one-third appropriated to the PFD. The amount remaining for GF was \$181 million. He noted the small decrease when the POMV dipped to 5 percent in FY 20 to \$2.650 billion from \$2.669 billion in FY 2019. Representative Wilson asked how the number would compare if the bill used a "fifty/fifty" split for the complete draw from the ERA in FY 19 and only realized earnings were taken out. Mr. Alper answered that he knew of two different 50/50 bills. The bill utilizing a POMV was the exact same number but with a different split. He expounded that he did not remember the number for the one tied to using 50 percent of the "historic lookback of statutory net earnings." He offered to provide the information upon Representative Wilson's request.

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Mr. Alper addressed the new Various (for fiscal notes only) fiscal note allocated to All Branches. He pointed to the analysis relating to the transfer of "Other" funds to GF and noted the \$54.9 million figure in FY 18 and \$62.2 million in FY 19. He explained that the bill contained a provision that changed certain deposits from mineral royalty from new oil to the corpus of the PF. The fiscal note reflected the reduction of royalty deposits to the permanent fund to the constitutionally mandated 25 percent with the remainder deposited into GF. The provision meant that an additional \$55 million in additional GF revenue the following year, which would grow to \$75.3 million by FY 23. He moved to the new Department of Administration fiscal note allocated to the Office of Administrative Hearings (OAH) that handled tax appeals. He reported that the allocation was a duplication of funding from the DOR fiscal note. The fiscal note changed the funding source from general funds to interagency receipts. He elucidated that the OAH would attain jurisdiction over appeals from the final tax division's informal appeals process as well as other disputes relating to the new tax. The OAH estimated that additional staff was necessary. He emphasized that the cost was covered in the Tax Division's fiscal note and DOA would send DOR an interagency bill for its services.

Representative Wilson referred to page 2 of the fiscal note analysis and posed a question regarding trusts. She stated that a trust was "almost like a person;" assets and "property and everything else" comprised a trust "entity." She ascertained that if the trust made money in the state,

regardless of where the trustee lived, the trust would be taxed under the bill. She asked whether she was correct. Mr. Alper responded that it was his understanding that if the earnings were derived from an Alaskan source they would be taxed.

Mr. Spanos agreed with Mr. Alper's answer.

Co-Chair Seaton clarified that "grantor trusts," which involved a person as the beneficiary, passed all assets to an individual and were taxed as an individual. The only thing under discussion was non-grantor trusts.

Representative Wilson opined that any money removed from the trust should be taxed versus taxing any earnings the trust made. She referenced the 400,000 new tax payers and inquired about the origin of the number. Mr. Alper answered that the figure was the estimate of the number of households in the state.

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Representative Wilson asked for a breakdown of the number of out-of-state households represented in the 400,000. Mr. Spanos replied that an estimated 13 percent of the filers would be non-resident. Mr. Alper detailed that the number of Alaskans filing federal taxes were 128,000 joint filers, 184 thousand single filers, 37 thousand head of household filers and 9 thousand "other" filers adding up to 358,000 income tax filers in Alaska. He furthered that non-residents were added to total 400,000. He acknowledged that the figure was a rough estimate, but believed it was "reasonable." Representative Wilson asked how many of the 42,000 out-of-state were seasonal workers or employed full-time by the state. Mr. Alper deferred the answer to DOL data. Representative Wilson deduced that not all of the 358,000 Alaskan taxpayers worked full-time. Mr. Alper clarified that the tax filers from the 358,000 data he cited identified themselves as Alaska residents. Representative Wilson surmised that trusts, estates, and all S corporations was not included in the 400,000 number. Mr. Alper agreed with the statement.

Vice-Chair Gara voiced that it would be desirable to "tax as many out-of-state individuals as possible" within the constraints of statute. He asked whether a person from another state would pay taxes on a trust managed in Alaska.

Mr. Spanos answered that the bill carved out an exemption. He deemed that the intent of the original drafter was to capture income from trusts to the constitutional limits that included the corpus of the trust. Assets that would not be taxed were ones managed from Alaska but were trading in another state. He added that the amount of the trust's corpus that was managed from an Alaskan bank would be taxed.

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Representative Thompson asked how educational savings from PFDs were factored in to the income tax. Mr. Spanos thought that it might be taxed if the account was part of a non-grantor trust, but an educational savings account was "potentially exempt." Representative Thompson spoke to putting half of the PFD into the college savings account and wondered what was taxed. Mr. Alper replied that if half of the dividend was deposited into the educational account then the amount of the dividend would be cut in half.

Representative Wilson surmised that the interest made off of an educational savings account would be taxed as soon as a child was ready to go to school and the same would happen when it was removed from a trust. Mr. Spanos replied that whether the interest was taxed depended on whether it was taxable at the federal level. Therefore, if it was subject to a federal tax it would be taxed in Alaska and if a distribution was made from a non-grantor trust, the trust received a deduction.

Vice-Chair Gara stated that the dividend was not taxed under the bill, therefore if a dividend was placed into a trust, the dividend amount would not be taxed. He asked whether his statement was accurate. Mr. Spanos replied in the affirmative. He mentioned that only the interest earned on the dividend would be taxed.

Representative Pruitt remarked that the discussion bounced between two different topics, 529 accounts and trusts, which were separate and strayed away from the original question. He hoped to obtain a correct answer.

Mr. Alper turned to the new zero DOA fiscal note allocated to the Violent Crimes Compensation Board (VCCB). He delineated that the VCCB currently received an annual appropriation from the dividend fund based in part by the

number of individuals who were ineligible to receive a permanent fund dividend because they were incarcerated felons.

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KATE HUDSON, EXECUTIVE DIRECTOR, VIOLENT CRIMES COMPENSATION BOARD, JUNEAU (via teleconference), spoke to the zero fiscal note. She explained that the board received the dividend appropriation calculated annually from the Office of Management and Budget (OMB) and the remaining portion went to the Department of Corrections (DOC). She understood the current funding method would continue and any shortfall due to lowering the PFD payout would be covered through DOC using GF. She voiced that the board's state funding was entirely derived from the criminal fund and did not receive any GF.

Vice-Chair Gara asked whether the zero fiscal note was not affected by the amount of the dividend and would remain zero. Ms. Hudson answered in the affirmative. The board's budget had been flat for the past couple of years and may take a reduction in the current year.

Mr. Alper addressed the new fiscal note from DOC allocated to Physical Health Care. He deferred to the department for the explanation.

APRIL WILKERSON, DIRECTOR, DIVISION OF ADMINISTRATIVE SERVICES, DEPARTMENT OF CORRECTIONS, explicated that PFD Criminal Funds were a portion of the funds that supported the physical healthcare component within the department. The funds were calculated based on the number of ineligible applicants who would not receive a PFD due to a felony conviction and incarceration. The department anticipated fund changes in FY 18 due to the reduction in the FY 16 PFD. The criminal funds allocated were reduced by \$9.1 million and were proposed from another fund source; the Alaska Capital Income Fund.

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Vice-Chair Gara did not understand the fiscal note. He noted that if the bill passed, the dividend in the current year would be larger than the past year. He wondered why an increase was necessary. Ms. Wilkerson responded that the calculation was based on the previous fiscal year and the

amount allocated was a year behind. She offered that the FY 18 budget was based on the \$1,022 PFD that was reduced from \$2,072 and reduced the PFD amount available by \$9.1 million. She furthered that an increase in the PFD to \$1250 anticipated in FY 19 reflected an increase into the criminal fund by \$2.8 million and reduced the amount necessary to \$6.289 million that would carry over to FY 20. She added that the PFD was anticipated to increase further in FY 21 by \$1.3 million and further reducing the Alaska Capital Fund request to \$4.95 million and in FY 22. She anticipated close to a \$400 thousand increase in the PFD and \$410 thousand in FY 23 and FY 25.

Representative Wilson asked whether the Alaska Capital Fund source had been the same in past years. Ms. Wilkerson replied in the negative. She stated that in previous years the department had used GF. Representative Wilson asked about the purpose of moving the money from one fund to another when it was not the original purpose of the fund. Ms. Wilkerson did not know the answer and would provide the answer for why the funding source was changed when she investigated the issue. Representative Wilson was concerned that if the funding remained in the 1171 fund source code it counted as an undesignated general fund (UGF) spend. She added that if the funding changed to the 1197 fund source code for the Alaska Capital Fund the appropriation appeared as designated general fund (DGF) but was still being utilized for the original purpose; healthcare. Ms. Wilkerson replied in the affirmative. Representative Wilson thought that the funding source change "looked like a shell game." She thought that the fiscal note looked like a reduction in UGF but state money was still being spent.

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Representative Pruitt asked whether the state filed for PFD's for felons in order to obtain the money. Ms. Wilkerson replied that typically DOC, the Department of Public Safety and the Permanent Fund Dividend Division collaborated and identified the number of incarcerated individuals who were ineligible. Representative Pruitt believed there was about \$91 million in the Alaska Capital Fund account and asked how much was appropriated to the fund in the current fiscal year. Ms. Wilkerson replied that she did not know. Representative Pruitt stated that typically the fund had been used for capital projects. He wondered why the decision was made to cover the shortfall

with the fund. He stated that it appeared that Capital fund funding source was utilized instead of UGF to avoid "growing the budget." He disagreed with using Capital Budget funds since the Capital budget was drastically reduced. Ms. Wilkerson replied that she was not the person to speak to the decision. She would have to provide the answer to the committee at a later date. Representative Pruitt understood why the administration did not want the funds to be classified as UGF, but warned that the appropriation significantly reduced available capital budget funds.

3:19:23 PM

Representative Thompson noted that in regards to incarcerated individuals PFD's, some of the funding was for a prisoner's health care and a portion of the funds were appropriated to the Violent Crimes Compensation Board. He asked whether there was a formula that specified how much went to each use. Ms. Wilkerson answered that the number of ineligible individuals identified was calculated based on the amount of the PFD to determine the amount available. She noted that \$1.4 million was appropriated to the VCCB. Representative Thompson thought he had recently heard that the VCCB board's fund presently contained \$20 million.

Ms. Hudson clarified that the VCCB fund did not contain \$20 million. Representative Thompson remarked that he did not have any direct knowledge of the actual amount.

Co-Chair Seaton offered that the \$9.103.6 million had been included in the governor's budget from the Alaska Capital Fund source. He indicated that during the operating budget process he had requested that committee members look for GF instead of UGF and make comparisons in order to avoid "crossovers" when working on the budget. He commented that following GF in the budget included both sources of funds and eliminated any confusions or problems with fund sources. He relayed that the item would be taken up in conference committee on the operating budget item because the Senate funded the item through UGF.

Representative Wilson understood that the PFD Criminal Fund was included under GF and the Alaska Capital Fund was in the "other" fund category and was not considered UGF or DGF, which made it appear that GF was decreased in the budget, "when in reality it was a fund switch."

Representative Pruitt agreed with Co-Chair Seaton and disagreed with the focus on UGF during the prior fiscal year. He reminded the committee that much of the money in the Alaska Capital Fund was "swept" into the fund through reappropriation money by the Senate a "couple years ago". He spoke to the sustainability of drawing the criminal fund amount out of the account without knowing how much was added every year.

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Mr. Alper relayed that the sweep of the funds into the Alaska Capital Fund was an unusual circumstance. He indicated that typically each year money was deposited and expended in the same year. He referred to the Amerada Hess lawsuit from the 1990s and instructed the committee that much of the revenue deposited into the fund was from the Amerada Hess lawsuit. He explained that the judgement from a dispute over royalties stipulated that a portion of Permanent Fund earnings were excluded from the dividend calculation in the amount of approximately \$23 million per year. The Alaska Capital Fund received a total of roughly \$40 million per year with additional earnings from other state funds.

Co-Chair Seaton asked for the administration's position on the bill.

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, voiced that the administration believed a draw limit was an important component to include in the bill and that a 5.25 percent draw was sustainable over time without the reduction to 5 percent. The administration disagreed with the increase to a \$1,200 dividend and deemed that the increase placed additional burden on the budget that would have to be achieved with cuts; the administration was more comfortable with a \$1,000 PFD.

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

#hb137

HOUSE BILL NO. 137

"An Act redesignating the Alaska State Council on the Arts as a public corporation and governmental instrumentality of the state; defining the powers and

duties of the Alaska State Council on the Arts; providing exemptions from certain statutes for the Alaska State Council on the Arts; making conforming amendments; and providing for an effective date."

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KRISTIN KRANENDONK, STAFF, REPRESENTATIVE HARRIET DRUMMOND, read from prepared remarks.

House Bill 137 quasi-privatizes the Alaska State Council on the Arts (ASCA) by restructuring it as a public corporation in order to help the ASCA to continue its work with self-employed Alaskan artists and art businesses during these challenging fiscal times. This new status will allow the ASCA to increase its ability to leverage funds from non-governmental contributors and better adapt to the shifting economic future.

This bill adds Alaska State Council on the Arts employees to exempt employee status. Currently the ASCA has 4 full time employees, and Rep Drummond's office reached out to those employees and they were all supportive of this change. This section makes those employees exempt from the State Personnel Act.

The bill adds artists' submission made in response to an inquiry initiated by the ASCA to the list of records that are exempt from public inspection. This does not include artists awarded a commission however.

The bill adds appropriate board member language needed to create "trustees" since the corporation will be governed by a board of trustees. And it replaces language that entitles trustees to be reimbursed for travel expenses at the same rate as members of other state boards.

HB137 also adds "literary arts" as a field represented within the board and replaces "educational" objectives with "strategic" objections as it relates to the councils ability to enter into contracts.

Other changes include exemption from the State Procurement Code, while still providing for formal, appropriate procurement protocols for ASCA.

Restructuring will keep ASCA's operating budget under the Executive Budget Act for openness and transparency. Transition language will allow ASCA's advisory committees, and the public process will remain in place as ASCA administers grants, programs, and services.

Finally there is transition language in the bill that will also allow Council members to remain on the board until their term is over and allow current employees to remain on staff.

The effective date for this legislation is July 1, 2017.

The State Council on the Arts wants to ensure that it is in a position to expand its important work to serve all Alaskans. Private funders across the nation are increasingly approaching ASCA to offer support. Carefully considered restructuring efforts have the potential to allow the Council to advance the opportunity to grow the development base, as well as reduce its reliance on State funds.

HB137 will improve the ability of the Council to leverage non-state funding and represents a real opportunity to realign ASCA to better perform in the environment which exists in Alaska today.

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BEN BROWN, CHAIR, ALASKA STATE COUNCIL ON THE ARTS, agreed with Ms. Kranendonk's remarks. He elaborated that the bill represented over a year's efforts by all of the members of the council and staff, and partners at Rasmussen Foundation and other foundation partners. He believed the legislation was carefully crafted.

Co-Chair Foster OPENED public testimony.

ALICE BIOFF, KAWERAK, INC., NOME (via teleconference), spoke in support of the legislation. She read from a prepared statement:

Dear Honorable Committee Chair and Committee members,

My name is Alice Bioff, resident of Nome, Alaska, currently employed at Kawerak, Inc. and an Alaska

State Council on the Arts (ASCA) council member. Thank you all for the opportunity to testify in support of HB137. I am testifying today in my capacity as an ASCA council member. I am a tribal member of the Native Village of Koyuk, and grew up there and in Nome. My family and I have lived in Nome for the last 17 years. For much of that time, I have been employed by Kawerak, Inc., the regional Native non-profit consortium of tribes for the Bering Strait region, as a Business Planning Specialist.

Through our work here at Kawerak, I am honored and privileged to work with artist entrepreneurs within our communities. We provide direct technical assistance offering tools and resources to assist artists continue their work so that they can sustain themselves, their families and their communities. It is through this work that I have seen firsthand how important it is for these artists who live in communities with very few resources and infrastructure, to grow their businesses through opportunities such as those that become available through ASCA and others.

Artist Entrepreneurs are economic development drivers in their communities and the Alaska State Council on the Arts supports these communities through their work and advocacy. With their partnerships, resources and programs, we see a bright future and growth opportunity to support all artists across the State.

Through the restructuring initiative, we see ASCA services continued and strengthened to support the artists through improved ability to react to funding opportunities and better represent, support and advance the artists by offering the tools and services needed to strengthen an already existing and important economy. This is critical to strengthening and sustaining our rural communities in this fiscally challenging time.

HB137 streamlines the process ASCA will use to present opportunities to artists all over Alaska, including those artists we have worked with for years here in the Bering Strait region. From my perspective, this will be a great benefit for all artists including those in rural Alaska.

3:36:09 PM

ANDREA NOBLE-PELANT, EXECUTIVE DIRECTOR, ALASKA STATE COUNCIL ON THE ARTS, EAGLE RIVER (via teleconference), testified in support of the legislation. She shared that she was a council member for 11 years. She offered that the council's purpose was to support and advance Alaska's creative industries and its cultural infrastructure. She believed a thriving arts community created a ripple effect around the state and connected the population. The council was in existence for 51 years and was ready for organizational change. She noted that Alaska's creative industries was growing due to targeted public and private investment in the state's cultural infrastructure over the past 10 years, experiencing rapid growth in grants programs, and public private partnerships. The council worked on national and international levels on projects, initiatives, and policies through arts organizations. In addition, the council provided professional development throughout the state. She commented that the bill enabled the council's staff to manage projects in a timely manner and increased its work across sectors such as transportation, healthcare, economic development, and tourism. She mentioned that the council's mission evolved to "expand access to arts experiences;" art as a process versus art as a product. The council's programs reached military service members for treatment of PTSD (Post Traumatic Stress Disorder) and incarcerated individuals learning how to create art for post-release success. The council assisted teachers who wanted to live and teach in rural communities and provided children and youth opportunities to learn through arts and culture. She related that HB 137 allowed the council to be responsive in implementing projects that affected its performance and the ability to seek and secure private funding. She emphasized that the council worked with partners and all of the revenues from the funders was funneled back into Alaskan communities in the form of grants, programs, and resources.

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Ms. Noble-Pelant provided the list of partners including the Rasmussen Foundation, the Alaska Arts and Culture Foundation, Atwood Foundation, National Endowment for the Arts, Margaret A Cargill Philanthropy, the SERI Foundation, SeaAlaska Heritage Institute, Alaska Humanities Forum,

Western States Arts Federation, and the American for the Arts.

Co-Chair Foster CLOSED public testimony.

Representative Wilson asked about required matching funds. She asked for evidence on whether matching funds had to be GF. Mr. Brown answered in the affirmative and emphasized that the provision was laid out in federal code. He termed it as "black letter law." He relayed that the state of Kansas eliminated their state match and ultimately lost their entire federal grant. He reported that the council discussed ways to increase its earned income that qualified as a state match. He exemplified a license plate bill from the previous session that included a provision for the arts license plates. The council currently had a design contest for Alaskans to design license plates and then sell them, although he did not anticipate a large revenue stream from the venture. However, it was an example of program receipts that can offset the state matching funds. He maintained that private match money will not work. Representative Wilson had asked the question because she thought that some additional federal dollars were available that the state was not receiving. Mr. Brown replied that the partnership agreement was for a three-year period and the amount was determined by the National Endowment for the Arts. In addition, the council sought merit-based competitive funds. He specified that programs like Poetry Out Loud and Creative Forces did not require matching funds. He assured the committee that the council had done very well in attaining funding of all types and that the council "would never leave a federal dollar on the table."

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Representative Pruitt asked whether the council was able to utilize private funds to receive more federal funds. Mr. Brown responded that over half of the council's budget was derived from private foundation money and the rest was state appropriation and NEA match. Any private money was used over and above the funding to support its mission.

Representative Kawasaki asked whether the council was at the maximum federal match. Mr. Brown answered that the council was at "the right amount." He elucidated that some states appropriated more than necessary. Representative Kawasaki asked for verification that the bill would not

jeopardize any of the National Endowment for the Arts match. Mr. Brown replied that the funds were not in jeopardy and assured the committee that he confirmed the matter with the NEA.

Representative Kawasaki asked whether it was typical or necessary for states to have a council or committee to receive NEA funding. Mr. Brown answered in the affirmative. He elaborated that the state had to have some sort of council containing public members and within the larger mandate, states did it differently. Alaska would be the first state with a quasi-private corporation. He reported that other states were watching Alaska with interest in adopting the idea. He thought that the bill could set a positive example for the rest of country.

HB 137 was HEARD and HELD in committee for further consideration.

Co-Chair Seaton addressed the schedule for the following day.

ADJOURNMENT

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The meeting was adjourned at 3:49 p.m.