

HOUSE FINANCE COMMITTEE
FIRST SPECIAL SESSION
June 12, 2017
1:33 p.m.

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CALL TO ORDER

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

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

Arnold Liebelt, Staff, Representative Paul Seaton; Taneeka Hansen, Staff, Representative Paul Seaton; Ken Alper, Director, Tax Division, Department of Revenue; Randall Hoffbeck, Commissioner, Department of Revenue; Representative Dan Saddler; Representative Andy Josephson; Representative Matt Claman; Representative Louise Stutes; Representative Justin Parish; Representative Geran Tarr.

SUMMARY

PRESENTATION: CONCEPTS and REVENUE IMPACTS OF EMPLOYMENT and SELF-EMPLOYMENT TAX

[NOTE: The following presentation contains content relating to SB 12. The bill was not in the committee's possession.]

Co-Chair Seaton indicated that the agenda would cover the concepts in the governor's fiscal package. He had asked his staff to put together a presentation on employment and self-employment tax and how that could generate revenue.

^PRESENTATION: CONCEPTS and REVENUE IMPACTS OF EMPLOYMENT and SELF-EMPLOYMENT TAX

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Co-Chair Seaton recognized Representatives Dan Saddler, Matt Claman, and Andy Josephson.

#sb12

SENATE BILL NO. 12

"An Act imposing a limited educational facilities, maintenance, and construction tax on net earnings from self-employment and wages; relating to the administration and enforcement of the educational facilities, maintenance, and construction tax; and providing for an effective date."

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ARNOLD LIEBELT, STAFF, REPRESENTATIVE PAUL SEATON, explained he had been asked to put together a presentation of the concepts embedded in SB 12, which had been part of the governor's request. In the current meeting, the intention was to look at the fiscal impacts of SB 12, thought to create \$100 million in additional annual revenue.

Vice-Chair Gara clarified the legislation had been put forward by Senator Click Bishop.

Mr. Liebelt replied in the affirmative.

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Mr. Liebelt provided a PowerPoint presentation titled "Concepts and Revenue Impacts of Employment and Self Employment Tax" dated June 12, 2017 (copy on file).

Mr. Liebelt began by reviewing slide 3 titled "SB 12 - Employment Tax for Educational Facilities":

"An Act imposing a limited educational facilities, maintenance, and construction tax on net earnings from self-employment and wages; relating to the administration and enforcement of the educational facilities, maintenance, and construction tax; and providing for an effective date."

- The bill as written does the following:
- Imposes a tax on wages and net earnings from self-employment (payroll tax)
- Estimated to generate \$60 million annually, with \$5 million from non-residents
- Intent is to designate the funds to the Educational Facilities, Maintenance and Construction Fund (AS 37.05.560)
- Creates tax brackets with corresponding flat tax (not percentages)
- Applies to residents and non-residents with income from a source in the state
- Does not apply to capital gains, investment income, retirement or other unearned income

Mr. Liebelt clarified he was just looking at the framework of the bill as it was currently written.

Co-chair Seaton recognized Representative Louise Stutes in the audience.

Representative Wilson asked about how much money was in the Educational Facilities, Maintenance and Construction Fund. Mr. Liebelt did not know the amount but the amount available for appropriation was zero.

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Representative Wilson asked how much was taken out of the fund for those projects each year. Mr. Liebelt did not know the answer to her question.

Representative Wilson requested that Co-Chair Seaton's staff get that information for the committee.

Vice-Chair Gara asked about which forms of income would be counted. He surmised that income from stocks would not be counted. Mr. Liebelt answered in the affirmative.

Vice-Chair Gara asked about S corporation income from profits. Mr. Liebelt thought it would depend on how that income would be defined.

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TANEEKA HANSEN, STAFF, REPRESENTATIVE PAUL SEATON, responded that SB 12 had been written using the Internal Revenue Service (IRS) definitions of net earnings from self-employment. There was some mention of partnership income and some partners were S corporations but there were a lot of specific exemptions for that type of income. It was difficult to fully answer the question without closer analysis.

Co-Chair Seaton reminded members the hearing was not on SB 12, but on the concepts therein.

Representative Thompson commented that he had been an owner of a corporation. He spoke of a bonus check, rather than a dividend payment as a stockholder, which was included in the W-2 tax form. He remarked there were a lot of grey areas.

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Mr. Liebelt addressed a graph on slide 4 titled "Impact of Tax in Alaska Senate Bill 12." He pointed to the blue table, which showed the tax that would be owed based on income. The far left of the graph showed the percentage of impact on one's income, from 0.0 percent to 0.6 percent. Anyone making less than \$20,000 per year would pay \$50. Anyone earning between \$20,000 and \$50,000 would pay \$100. Anyone earning \$50,000 to \$100,000 would pay \$200. Those earning \$100,000 to \$500,000 would pay \$300, and those earning over \$500,000 would pay \$500. He pointed to the table showing the percentage of impact on wages, salaries and self-employment income. The high impact was at 0.5 percent. He noted the increments listed at the bottom of the graph. He pointed to spikes at \$20,000, \$50,000, \$100,000 and \$500,000. Additionally, someone earning \$99,000 then crosses over into the threshold of \$100,000,

they would go from paying from \$200 to \$300. The impact at the \$20,000 to \$30,000 level would be greater than for those at the \$100,000 level. In general, it was a regressive tax as it would have a higher impact at the lower end than at the higher end of income.

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Representative Wilson referred to wages and income. She wondered if everyone would be paying at least \$50. She wondered if the Permanent Fund Dividend (PFD) was considered taxable income.

Mr. Liebelt responded that the PFD would not be considered earned income. The taxable income in the legislation was only concerned with wages or income from self-employment.

Representative Wilson asked about those receiving dividends from corporations. She asked whether any of those would be considered earned income.

Ms. Hansen responded that publicly traded corporations would not be included. The IRS [Internal Revenue Service] definition did mention partnership distributions, but it contained several exemptions. It was her understand was that the IRS was attempting to narrow the definition to include specifically self-employment. It was a more detailed answer than she could provide presently.

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Representative Wilson asked where military personnel would fall in the graph. Mr. Liebelt did not have the data on hand.

Representative Ortiz referred to slide 3. He asked about the proportion of revenue coming from nonresidents compared to a House bill passed earlier in the session.

Mr. Liebelt thought the percentage was similar.

Co-Chair Seaton clarified that most nonresidents would be earning wages. Essentially the proportionality would be comparable.

Vice-Chair Gara commented that the wealthiest would pay the lowest per income versus the lowest earners would be paying the highest tax. Mr. Liebelt answered in the affirmative.

Vice-Chair Gara would want to see that factor changed.

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Mr. Liebelt reported that the sponsor had put forward the bill in order to have some options for broad-based taxes. He noted that there could be different brackets looking to make things more equitable. The amount of tax in those brackets could be changed. There were many ways the legislation could be sliced and diced. The legislation was devised in order to address a specific fund.

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Co-Chair Seaton received a question from Representative Saddler in the audience. They had asked if the legislation could be repealed it through a referendum. He responded that every action by the legislature could be addressed in a referendum. He reported that Representative Justin Parish and Representative Geran Tarr were in the audience. He added that the bill could be changed within the committee. His office had not calculated the comparison. The analysis had been carried out by Institute on Taxation and Economic Policy (ITEP) ["Comparing the Distributional Impact of Revenue Options in Alaska" by Carl Davis and Aidan Russell Davis, dated April 2017 (copy on file)].

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Representative Wilson wondered what the group was comparing.

Co-Chair Seaton indicated that a number of tax structures had been compared, including a self-employment tax and a flat tax mechanism. It was based on the same set of criteria. He reiterated that SB 12 was one way an employment tax could be structured.

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Vice-Chair Gara thought it was obvious that the legislature was "stuck on high center" on the issue of generating revenue.

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Mr. Liebelt highlighted a bar graph on slide 5 also titled "Impact of Tax in Alaska Senate Bill 12." He explained that the slide was looking at the impact of a tax on various income brackets. The income range included impacts at the lowest 20 percent, and so on. There was no limit on the right side. Everything above \$115,000 was broken down to between \$115,000 and \$228,000, between \$228,000 and \$556,000, and above \$566,000. This was done for comparative purposes. The lowest 40 percent earners were impacted at a higher level than those at the higher end of the spectrum.

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Representative Wilson thought it would be helpful to include the dividend on the graph which would have an impact only on residents. She wanted to see how lopsided it became if the \$1,000 decrease in the PFD was included. She thought it was important to compare apples-to-apples by including what was on the table. She wanted to know the total impact of each range.

Co-Chair Seaton commented that the ITEP report did show the impact on each range. It had it for the Permanent Fund reduction. That chart had been distributed and could be put on top of the current chart to show the impact. The lower income ranges showed a great effect on their income. He referred to her query about military personnel and pointed to the \$40,000 to \$73,000 in the middle range under SB 12.

Representative Wilson was asking in order for the public to understand.

Co-Chair Seaton noted the ITEP report from April was on the legislative website. He noted it did not contain SB 12, but did address the other tax proposals.

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Ms. Hansen clarified ITEP had analyzed how much money would come from nonresidents but the chart showing impact only spoke to Alaska residents. Showing both categories would greatly distort the chart.

Representative Wilson commented that when talking about the out-of-state workers, it was important to recognize that the PFD did not affect those taxpayers.

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Mr. Liebelt discussed options for increasing revenue on slide 6:

1. Increase the number of brackets and tax rate per bracket
2. Change from flat tax rate to percentage
3. Include earnings from capital gains and other investment income

Mr. Liebelt elaborated on some of the concepts from the bill that could be implemented. He pointed to the small table in blue. If there was a 2.43 percent rate on wages and self-employment earnings, it would generate about \$500 million per year. At 1.82 percent, it would generate about \$375 million, and at 3.65 percent it would generate about \$750 million per year. It was important to note that the rate was not progressive and would impact everyone at the same percentage amount. It only applied to sources of income within the state, for both residents and nonresidents.

Representative Ortiz asked if it was a flat tax. Mr. Liebelt answered as long as it was understood that it only applied to wages from self-employment.

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Mr. Liebelt reviewed a graph on slide 7 titled "Figure 14: Comparing the Impact of a Payroll Tax to an Income Tax in Alaska." He reported that 95 percent of wage earners would be impacted to a greater extent by a payroll tax than by a personal income tax. He pointed to the middle bar. An income tax impacted the middle class more than others.

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Mr. Liebelt addressed a graph on slide 8 also titled "Figure 14: Comparing the Impact of a Payroll Tax to an Income Tax in Alaska." He reported that the slide included payroll tax, investment gains, and capital gains as well as other unearned income. Once the payroll and investment tax

rate was applied to the personal income tax, the impact levelled out. There was an impact at 1.2 percent for the lowest 20 percent tax bracket, up to 1.3 percent, to 1.7 percent and 1.6 percent in the middle ranges, then to 1.5 percent and 1.4 percent at the highest tax bracket.

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Co-Chair Seaton reported that the tax rate dropped from 2.43 percent [flat tax shown in the payroll tax scenario in figure 14] to 2.1 percent [flat tax shown in the payroll/investment tax scenario in figure 15] as the flat tax between slides [figures] 14 and 15 [slides 7 and 8]. He stated it broadened across income - it was not what had been included in the governor's bill. He noted the scenarios reflected an effort to make things more equitable among various groups. This led to a flat tax across all incomes.

Representative Wilson asked about using \$2,200 per person as a dividend payment. She asked whether people would get money back [from the reduced dividend in the previous year through gubernatorial action].

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Ms. Hansen replied that for the ITEP report each revenue generating option had been examined separately. The analysis had used the projected dividend payment, rather than rely on the unknown amount of payments to be determined.

Co-Chair Seaton added that the report was based on the statutory rate dividend of \$2,200.

Representative Wilson thought the actual versus the statutory dividend amount would impact the bars in the graph.

Ms. Hansen responded that the tax amount would appear on slide 8. The bar from the reduction of the dividend bar onto the bar from tax and the combined effect would be shown how much income would change if there were a tax and there was a reduction in the dividend amount.

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Representative Wilson mentioned the PFD would be taxed in HB 115.

Vice-chair Gara corrected that a PFD tax was not in the legislation.

Ms. Hansen replied in the previous slide regarding tax on wages and self-employment income, it would not affect the bars at all. In the present slide, there would be some effect depending on how the bill was written.

Vice-Chair Gara asked Ms. Hansen to speak to the disproportional impact on lower income taxpayers from a reduction in dividend payments, and how that compared to Senator Click Bishop's bill [SB 12] and to the Senate proposal for a \$1,000 dividend.

Ms. Hansen responded that each would have to be equalized to compare them, and it would be too abstract to present orally.

Co-Chair Seaton reported that Figure 15 was based on the ITEP report which kept all analyses comparable in generating \$500 million. He commented that the committee was looking at the comparisons rather than specific numbers. He thanked Representative Wilson for her emphasis on the impact of taxes on taxpayers. He mentioned the difficulty in determining the range of incomes within the state. The information on the slide showed the impact on different segments of the population. He encouraged people to examine the report on the website. The report was only 20 pages long and contained information on how different economic segments of the population were impacted.

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Representative Guttenberg mentioned that in SB 12 there are five brackets. Most of the analysis in the presentation contained seven brackets. He wondered how many brackets were in the IRS codes to get up to \$500,000 income.

Co-Chair Seaton clarified that the brackets shown were looking at segments of the Alaska economy rather than taxes. He specified that they were flat taxes and not brackets at all.

Representative Guttenberg recognized that there were many ways the calculations were arrived at. He wondered how many brackets were involved.

Ms. Hansen offered that from memory she believed the IRS had eight or nine brackets. Many states had many more than that. She spoke of unemployment insurance that cut off at a certain income. At the federal level there were layers in curves and steps, and at state levels they differed.

Co-Chair Seaton reminded members that not all of the income was taxed and that the impact on the lower income levels would be higher if there were a \$1,000 or \$2,000 dividend and not the proposed changes at present.

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Mr. Liebelt concluded with slide 9 pertaining to options available to close the state's budget gap:

There are many options available to close the state's budget fiscal gap using a broad based tax. Each option will impact families at different income levels in very different ways.

Examples:

- Personal Income Tax: More progressive. Higher payments from higher income families
- Sales Tax: More regressive. Impacts lower income families to a greater extent.
- Reduction to PFD: Most regressive. Greatest impact to lower income, least impact to highest income
- Payroll Tax: Impacts middle class more than the lowest or highest income brackets.
- Payroll and Investment Income Tax: Most equitable across income brackets. Will impact lower income earners more on their income, and higher income earners more on their investments

Co-chair Seaton reiterated that the concepts within the bill were what was being examined.

Vice-Chair Gara asked what it would take to write another bill containing some of the concepts in the presentation.

Co-Chair Seaton thought it was possible.

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KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, responded that if the desire was to draft a bill similar to SB 12 but which would reflect some of the concepts in the presentation, it would not be a big lift for either the Department of Law or Legislative Legal Services. The concern regarding SB 12 was in the need to write the necessary regulations in order to implement the bill.

Representative Gara asked whether S corporation owners' income would count under the definitions of the bill, or whether it would continue to be exempt.

Mr. Alper relayed he thought those categories would not be included in the bill as written.

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Representative Ortiz stated he did not like to talk about taxes. He asked whether, based on current information on the stock market and on oil prices and production, the state could adjourn the current session with the prospect of a fiscal plan without adding revenue.

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, responded that following examination it was concluded that, if all components were perfect, as in high oil prices and production, perfect stock activity, there could be a balanced plan within four or five years without adding revenue. However, if things happened in a more consistent fashion, there would be a \$300,000 shortfall.

Representative Ortiz asked if PERS [Public Employees' Retirement System] and TRS [Teachers' Retirement System] and oil tax credit obligations were included. Commissioner Hoffbeck responded in the negative.

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Representative Wilson spoke to self-employment and asked whether the item appeared on the table in form C of the tax form.

Commissioner Hoffbeck deferred to Ms. Hansen.

Ms. Hansen was still getting familiarized with the net earnings deductions. There were several deductions and she thought it would likely be that line.

Representative Wilson filed self-employment taxes and knew what it looked like. She spoke to 20 deductions. She got taxed on her income to offset putting money into social security. It would be a very different calculation if she were an employee. Those people who were self-employed may pay less, but there were deductions to be calculated as well.

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Co-Chair Seaton drew Representative Wilson's attention to slide 3. He pointed to net earnings on self-employment. Those would be after a subtraction of business costs.

Representative Wilson thanked Co-Chair Seaton for making her point. As an employee she would not be able to deduct certain things, but as a self-employed taxpayer, she could.

Co-Chair Seaton stressed that the legislature was looking at the information at a high level and the bill structure was not formed. He thanked Mr. Liebelt for the presentation.

Co-Chair Seaton recessed the meeting to a call of the chair [Note: the meeting never reconvened].

#

ADJOURNMENT

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The meeting was adjourned at 2:30 p.m.