

HOUSE FINANCE COMMITTEE
FOURTH SPECIAL SESSION
November 8, 2017
1:04 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:04 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

Ken Alper, Director, Tax Division, Department of Revenue;
Brandon S. Spanos, Deputy Director, Tax Division,
Department of Revenue; Representative Dave Talerico;
Representative Andy Josephson; Representative Geran Tarr.

SUMMARY

HB 4001 EMPLOYMENT TAX

HB 4001 was HEARD and HELD in committee for further consideration.

Co-Chair Foster addressed the meeting agenda.

#hb4001

HOUSE BILL NO. 4001

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

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KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE (DOR), addressed a PowerPoint presentation titled "Capped Payroll Tax - Responses to Questions; HB 4001 by Governor Walker" dated November 8, 2017 (copy on file). He was present primarily to answer questions that arose during his presentation with Commissioner Sheldon Fisher on October 26. He referenced the revenue forecast Commissioner Fisher had presented with DOR chief economist Dan Stickel. He noted that DOR had responded to committee questions from that meeting with a letter addressed to the committee co-chairs dated November 2 (copy on file).

Mr. Alper began on slide 2 with a table of contents. He planned to address questions pertaining to labor force, relative impact and progressive-regressive issues, the combination of state and municipal taxes and where the state ranked nationally, and technical questions on profit distribution and tax implementation. He anticipated he would be joined by his colleague who could answer technical questions.

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Mr. Alper moved to slide 4 related to the letter dated November 2, 2017, which answered four questions. He addressed the oil and gas tax credit appropriation formula (10 or 15 percent; \$175 million for FY 19) and relayed that based on statute the most recent spring revenue forecast applied, which was the most recent official price forecast prior to the passage of the budget. He referenced the transition of motor fuel tax from unrestricted general fund (UGF) to designated general fund (DGF). He detailed that the issue first reached the committee's attention the previous session with the administration's motor fuel tax bill, which had not yet passed. He furthered that the Legislative Finance Division (LFD) had decided it may be a more appropriate use of the fund given existing statutory

language and the way it was used; therefore, LFD had made an internal determination it would be considered DGF regardless of what happened with any new revenue bills. The Office of Management and Budget, DOR, and LFD were all in agreement that going forward the motor fuel tax should be considered DGF

Mr. Alper spoke to the third question pertaining to negative revenue from the oil and gas corporate income tax. He explained that it primarily came from the time lag between estimated tax payments. He stated that the tax year was a calendar year for the tax. In 2015 companies were paying estimated taxes after the first, second, and third quarter of 2015, but by the time they paid their taxes and trued up, it was the end of calendar year 2016 (October was the payment due date). He furthered that FY 17 was when any refunds for overpayments of 2015 taxes would have been paid back. He expounded that because there were relatively high estimated payments in 2014 and 2015 (based on the lower prices not working their way through the system yet), DOR ended up paying back substantial refunds.

Mr. Alper specified that additionally, Legislative Audit had determined that certain additional revenue coming in that went to the General Fund, should have been considered Constitutional Budget Reserve (CBR) revenue - it had been the result of an audit or administrative proceeding. Subsequently, an internal transfer had been made from the General Fund to the CBR, which had shown up in the year it was made (FY 17) as negative General Fund revenue, although practically speaking it was revenue neutral.

Mr. Alper continued to address slide 4. The table showed how negative revenue balances had occurred in FY 16 and FY 17. The fourth question related to the impact of \$1 on the price of oil. At current oil prices in the \$40s, \$50s, and \$60s per barrel range, \$1 in the price of oil was roughly \$30 million UGF over the course of one year. For example, if the price was \$10 higher than anticipated, it was possible to estimate building \$300 million into thoughts on the state's projected deficit.

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Co-Chair Foster recognized Representatives Dave Talerico and Andy Josephson in the audience.

Representative Pruitt asked if the \$30 million was tax and royalty revenue. He asked for detail.

Mr. Alper responded that the \$30 million was all unrestricted revenue - it included production tax and the unrestricted portion of oil and gas royalties (the half to three-quarters not dedicated to the Permanent Fund); if Permanent Fund money was added back in, the number would be \$35 million to \$37 million. He noted that portion belonged to the corpus of the Permanent Fund and was not spendable.

Representative Guttenberg stated that the \$1 rise in price did not account for fluctuations, mid-year, or partial year. He believed it was as if the prices went up \$1 on January 1 and remained there until December 31. He asked for verification that the scenario represented a simplistic approach to illustrate the impact.

Mr. Alper answered in the affirmative. The scenario assumed the \$1 shift for the entire year. At the lower price range, it assumed the production tax change was based on the 4 percent gross minimum tax. At higher prices it became more complicated - once producers were able to get into the net profit structure, the number would increase closer to \$80 million per \$1 at higher oil prices. The department of revenue produced a document after every forecast showing the detail that it could provide to the committee.

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Co-Chair Seaton spoke to question 1 on slide 4. He read an excerpt from the answer to question 1 in DOR's November 2 letter to the committee:

However, the statute is not entirely clear whether the 10 or 15 percent should be applied to tax before or after application of credits. The alternate mechanism, calculating the percentage after application of credits, would result in smaller annual appropriations. Based on the preliminary fall forecast, the \$175 million for tax credits would be reduced to about \$46 million.

Co-Chair Seaton asked if there was any further legal clarification on the subject. He wondered if there were two alternative mechanisms that were viable.

Mr. Alper answered that DOR had not asked for a formal legal opinion. The issue had not been germane until the current year. The way the department had interpreted the statutory language going back to the FY 16 budget cycle - when the state first contemplated using the funding formula as opposed to the previous open-ended language - statute specified 10 or 15 percent of the amount received from AS 43.55.011. He elaborated it was the production tax - 35 percent of the net calculation. The department interpreted it to mean the tax calculation without any of the credits (including credits against liabilities, primarily the per barrel sliding scale credit under AS 43.55.024(j)). Based on the statute it was a larger number the state was taking 15 percent of, which accounted for the \$30 million in the FY 17 appropriation, the \$77 million FY 18 appropriation, and the \$175 million forecast. If the amount was tied to the amount received from AS 43.55.011, meaning accounting for the subtraction of the credits, it would be the smaller number.

Mr. Alper continued that the per barrel credit had been very low for the past couple of years due to the lower price in oil. The difference between the two calculations may have been \$10 million. Now suddenly, if the alternative calculation was used - meaning use of the amount received after the subtraction - the 15 percent calculation derived at \$46 million. The appropriation language was a guideline to the legislature and the legislature would ultimately appropriate what it felt was suitable in next year's budget. The department's intention was to point out there was another interpretation to the language.

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Mr. Alper moved to slide 6 that included a line graph showing FY 10 to FY 18 state revenue and expenditures (without the Permanent Fund Dividend (PFD)). The slide demonstrated how General Fund revenues had declined beginning with the peak in FY 12 and how expenditures had declined to react to the decrease in revenue. He detailed that although expenditures had dropped 44 percent from the peak in FY 13, the revenue decline of 80 percent had led to the structural deficit going forward. The situation was the reason for the proposed revenue bill. The expectation was the bulk of the deficit would be met by some form of Permanent Fund restructuring and HB 4001 would be the last

piece towards reaching a structurally sustainable balanced budget in future years.

Mr. Alper addressed what the bill would do on slide 7. The bill included a 1.5 percent flat rate tax on wages and self-employment income; it was a subset of what people generally think of as income. He elaborated that the bill did not tax investments, retirement income, dividends, interest, and other related items. The tax would be paid by individuals earning income in Alaska and did not distinguish between resident and nonresident. He noted that if a household contained more than one working person, each would pay separately. He specified that individuals with a job would generally not file - employers would take the 1.5 percent from paychecks just as federal social security taxes were withheld. The payment would be remitted [to the state] directly from the employer, which would be sufficient for DOR. The department would only receive direct individual filings from self-employed people.

Mr. Alper continued to explain the bill on slide 7. A cap had been added to the tax to the greater of \$2,200 adjusted for inflation or twice the previous year's PFD, whichever is greater. He detailed that at slightly over \$147,000 a 1.5 percent tax equaled \$2,200. At lower income levels it would be a 1.5 percent tax and at higher incomes it would be the capped tax - the cap would impact about 5 percent of earners. The foregone revenue resulting from the cap was around \$10 million to \$20 million. He explained that the \$320 million bill would become \$330 million or \$340 million if the cap were moved and the same basic structure was maintained.

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Vice-Chair Gara spoke to some of his concerns that the bill would tax middle and lower income individuals as opposed to wealthier people who had a lower tax rate. He addressed that the bill did not tax investment income. He referenced statements by Warren Buffett that because he made his money off investments he paid a lower tax rate than his secretary. Vice-Chair Gara remarked that investment income typically pertained to much wealthier people who received dividends and capital gains. He thought it was a second area wealthier people were being treated more favorably than lower and middle-income people. He asked about the reasoning behind the decisions.

Mr. Alper responded that the federal income tax rate on capital gains was lower than the income tax rate on general income - this accounted for Mr. Buffett's observation he was paying at a lower rate than his secretary. Mr. Alper noted that in his presentation two weeks earlier he had discussed some of the administration's thinking behind the cap. He detailed the cap was a way of distinguishing the tax from a true income tax. The person who was highly productive and earned a significant amount of money was not penalized for their additional income. He detailed it was part of the pushback from the Senate that was strongly opposed to an income tax. The bill's structure (although based on wages) fell short of being a true income tax due to the cap. He agreed that by eliminating capital gains and similar unearned income, it tended to make the tax lower on the higher income individuals.

Mr. Alper continued that he would address an upcoming slide showing the effective tax rates on different income levels. A similar analysis of a true income tax was much more progressive - there was a higher take at higher rates - largely because of the inclusion of capital gains. The bill's tax structure was more flat - the 1.5 percent held across the board and effective rates fell at high levels in part due to the exclusion of unearned income and in part due to the cap.

Vice-Chair Gara understood the bill structure was an effort to bring members of the Senate on board. He stated that under federal law Warren Buffett would pay a lower tax rate and under HB 4001 he would pay no tax. Vice-Chair Gara disputed the idea that wealthier people were more productive. He noted that nurses and laborers were just as productive as someone making a large income.

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Mr. Alper answered there was a philosophy held by many that an income tax was fundamentally wrong, and they may prefer taxing on consumption. A full income tax took its highest amount from people who earned the most. He explained the bill represented a compromise because it did not appear possible to pass such a tax and because the administration strongly believed a viable revenue measure was necessary to ensure the operation of a viable government into the future.

Vice-Chair Gara understood. He explained he was not pushing an income tax and was also aiming for something the legislature could agree on.

Representative Ortiz asked if lifting the tax cap or including capital gains in the tax would mean retiree pensions would also have to be included in the tax.

Mr. Alper answered that the bill could be written in any way. He detailed that the bill language could limit the inclusion to capital gains, interest, retirement, or dividends. He noted that the PFD was not income under the bill and would not be taxed; if the broad category of dividends was included, it would mean the inclusion of the PFD. He was reluctant to mention the Institute on Taxation and Economic Policy (ITEP) based on a reaction by Representative Pruitt a couple of weeks earlier. The organization conducted state level analysis nationwide and had done some work for the committee; it had a series of charts showing the effective tax rates and a comparison between income tax, sales tax, and a head tax. The organization had also done an analysis of a head tax with the inclusion of capital gains that was mildly progressive. He knew members of the committee had contemplated similar structures. The administration's overarching preference was for the agreement on a fiscal solution in the current special session.

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Representative Ortiz asked how much additional revenue would be generated if capital gains were included in the bill.

Mr. Alper answered that he did not know the number, but he guessed another \$50 million or so without the inclusion of a cap. He noted the information was available in the model. He mentioned how it fell out in scale to the other income factors and that it was limited to a relatively small subset of the population. He furthered that if a cap was maintained, most people living off capital gains would still pay at the \$2,200 and there may not be a substantial amount of additional revenue generated.

Representative Wilson asked about an analysis regarding a single mother of three working at a minimum wage job who the state had already taken over \$4,000 from due to the cut

to the PFD. She believed under the scenario the tax would be an income tax if it was the only money the family had coming in.

Mr. Alper answered it was a tax on income but did not meet the strict definition of income tax because it only taxed certain portions of income. He agreed that under the scenario provided by Representative Wilson the tax would be 1.5 percent of the individual's income. He stated that reasonable people disagreed on how to characterize the reduction in the PFD.

Representative Wilson reasoned that a cut to the PFD was a loss to the individual's income. She stated it was possible to argue about terminology, but the tax still resulted in a loss in income. She reasoned it was an income tax under the scenario she had provided. She noted it was the same in a middle-class family that had no other income put away. She asked how the administration justified the percentage an individual would pay to government compared to a person making \$100,000 who had been able to put money into IRAs and other savings. She stated the loss would be much less for higher wage earners. She wondered why the bill would hit the lower and middle-class individuals at a much higher level.

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Mr. Alper explained that the bill had evolved from the school head tax bills. The old school head tax that had been in place since territorial times through the late 1970s was a flat rate of the first check earned and it had gone towards the school system. There had been a couple of different variants on the bill brought forward in the past couple of years as a potential revenue measure. He elaborated that Representative Matt Claman had introduced a bill in the House and Senator Click Bishop's bill in the Senate had been used in many ways as the model for HB 4001. He detailed that the definitions in those bills included wages and self-employment income, meaning it was a payroll tax versus an income tax. The purpose was to "scoop a little bit" from regular labor - it was a simpler bill and did not go as deep into the economy. Senator Bishop's bill had a series of stair steps. He elaborated that one income bracket paid \$100, the next income level paid \$200, with a cap at \$500.

Mr. Alper continued that the issue with the stair step was what happened at the transition where a very high marginal tax rate occurred. By changing it from a stair step to a flat percentage, the net effect was the same, but the weird transitions when people stepped from one bracket to another were eliminated. The next decision was how big to make the tax. He estimated that the percentage would be closer to 0.25 to 0.5 percent because Senator Bishop's bill would have raised \$70 million, whereas Representative Claman's bill would be closer to 3 percent because it had raised over \$500 million. The administration had selected \$300 million as a revenue target, which required a 1.5 percent tax. He reiterated that the foundation of the bill came from the school head tax bill, not the income tax bill.

Representative Wilson replied that she did not care where the bill structure came from. She was concerned about hitting lower and middle-class households harder. She stated it was necessary to factor the PFD cut into the equation because it impacted income going into residents' households. She understood the logic of a flat rate because it was easier; however, teenagers would pay, whereas, people living off other revenue would pay nothing. She spoke about individuals trying to get off welfare and stated they would be hit harder. She thought there had to have been something in the modeling that made the administration okay with hitting the lower and middle-class harder. She was trying to determine where the philosophy came from.

Mr. Alper answered that the bill was viewed in a vacuum and not as combined with changes to the PFD. As a standalone bill, it was truly a flat tax to 95 percent of the population - everyone would pay the same 1.5 percent. For the most part the people in that 95 percent, probably with the exception of retired people (retirement income was exempted), everyone would pay the same piece of their income. The regressivity kicked in at the higher end. He continued that if someone was aiming to meld a tax with a PFD reduction in a way that levelized the impact across the board, a progressive income tax exempting some of the lowest income people would be the cleanest method. He noted that the bill passed by the House had roughly accomplished that - it had exempted the first \$20,000 in income and had stepped up to a higher rate. As an overlay with PFD cuts it had come out fairly close to a flat combined tax impact. The bill had not been acceptable to the legislature at

large. The administration was not trying to reopen that debate. The current bill contained a flat tax as a standalone item that seemed to be a reasonable solution. The alternative - a sales tax worked in the other direction and had an even greater impact on the lowest income people and less impact on the higher income people. The current bill's impact fell somewhere in between an income and a sales tax.

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Representative Wilson believed Mr. Alper had made her argument. She was concerned the administration was looking at the concept in a vacuum. She noted that Anchorage was increasing its gas tax and had a different property tax level than other areas of the state. She noted that some parts of the state had no tax because they were not in a borough. She believed that when the state began looking at options in a vacuum it would hit people hard during a recession. She wondered if the impact could mean some people would determine it was not worth going to work at a minimum wage job. She understood that the other option had not passed the legislature. She thought perhaps the philosophy was to try the current bill because nothing else had worked. She remarked that Alaska was the lowest taxing state, but only when talking about certain taxes; it did not account for other taxes and the high cost of living. She had grave concerns over impacts the bill would have. She remarked on a comment by Pat Pitney [Director, Office of Management and Budget, Office of the Governor] that the administration was only looking at increases to the budget, not decreases.

Mr. Alper shared that later in the presentation there were a number of slides pertaining to municipal taxation levels. He communicated that the issue had arisen in his previous presentation to the committee. He believed seeing Alaska's city taxes layered with state taxes compared to other states was illuminating.

Representative Tilton referenced Mr. Alper's testimony that it was possible to include other modules in the tax including capital gains, investment income, and other. She thought there was an associated cost of increasing government. She asked for an estimate.

Mr. Alper answered that the fiscal note to HB 115, which had passed the House in May had included about 60 additional staff, which may have been on the low side. He noted that DOR may have needed a bit more staff for a complicated statewide income tax. The current bill included 40 staff in the fiscal note and he believed the estimate was on the high side because most of the population would not have to file. The paperwork load was dramatically reduced because employers would file on behalf of their employees. He estimated the department could probably make due with 30 additional staff. If the complexity of the tax increased to something more like an income tax, DOR would need additional staff somewhere in between.

Mr. Alper identified the cap as the biggest variable - if no one was paying more than \$2,000 there was not much utility in having an entire team of auditors at the individual level to ensure everyone was paying the right amount (the role of the auditors tended to be to go after the larger numbers). If the tax contained no cap it would result in high payers, which would add more people to the mix (it would also add more revenue). The cost to the administration represented a tiny fraction of the revenue that would come in. Hiring 40 new state workers and the cost to build new software would be 2.5 percent of the bill's revenue.

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Mr. Alper turned to slide 8 and continued to provide a bill summary. The bill was projected to bring in about \$320 million in revenue; approximately 15 percent of the revenue would come from nonresidents (people working in Alaska who earn wages or with self-employment income in Alaska). In the case of wage earners, the tax would be remitted by employers just like resident wage earners. For self-employed individuals there was a state equivalent of the federal 1099 form (contract employment form) that employers would be required to send to the state, so it was aware of who was earning money. He elaborated that it may require a bit of effort chasing small business owners, but eventually, the department believed it would get everyone on the tax rolls.

Mr. Alper furthered that the bill would require a \$10 million one-time cost to procure software, programming, and basic startup needs of administering a new tax. The

projected operating cost was \$5.2 million for 40 new employees; DOR hoped to do the work with fewer than 40 new employees, which would drop the cost of running the tax to about \$4 million per year. He reiterated his earlier testimony that about 2.5 percent of projected revenue would go to administration over the six-years in the fiscal note period.

Co-Chair Seaton asked if the department anticipated that identification of self-employed would be by business licenses - anyone with a business license would receive an inquiry.

BRANDON S. SPANOS, DEPUTY DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, answered there were a couple of different methods to identify who was self-employed. One would be a business license and the other was the Internal Revenue Service (IRS). He detailed that the IRS would share information with the state and the department would have the ability to see who had filed with self-employment income under an Alaska address. Nonresidents working part of their business in Alaska would be more difficult - the state could get the information if they had a business license, but if someone was doing business in Alaska without a license it became more difficult. Typically, in other states people called to determine if someone had paid a tax. The state could not respond to the question, but it could look into the question.

Mr. Alper moved to slide 10 pertaining to labor force and population. He reported that based on information provided by the Department of Labor and Workforce Development (DLWD), the state had not suffered a population decline. The state's population growth had been very small at less than 1 percent over the past four years. As of July 2016, the estimated population was slightly under 740,000 people. He shared that 2017 numbers would be available in January [2018]. Currently, DLWD forecasted modest growth through 2045. There had only been three years since statehood with negative population growth, after the completion of the pipeline when numerous temporary migratory laborers left the state. Another decline had been in the 1980s during the large oil price decline. Nonresident wages were about 16 percent - the number was updated from the 15 percent figure used by the administration pertaining to the bill. He explained it was also necessary to subtract people with Alaskan addresses who earn all their income out of state.

Mr. Alper continued to address slide 10. The total statewide job loss was 11,600 (3.2 percent) through September 2017. He reported that the number of people employed by the state as of the previous month was down 2,800 from the peak (12 percent reduction).

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Representative Wilson extrapolated that 2,800 government employees had been lost and the private sector had lost 8,800.

Mr. Alper saw no reason the numbers reported on the slide should not be additive. He agreed that her summation seemed correct.

Vice-Chair Gara stated that the committee had received information from DLWD three months earlier that over the last two years the state had lost closer to 14,000 private and public-sector jobs. He asked if a difference in time periods accounted for the difference in the numbers.

Mr. Alper answered that DOR had not been able to identify the source of the 13,000 number. He reported that the numbers had been relatively steady in the past several months. The 11,600 was the most current job loss number from DLWD.

Mr. Alper turned to slide 12 titled "ITEP analyzed multiple tax options that each would raise \$500 million." The slide included a chart from an April 2017 ITEP report. He noted that the 1.5 percent tax was the baseline. He remarked the seven bars did not represent equal quadrants of the population; the first four bars were the income level quintiles (zero to \$20,000, \$20,000 to \$40,000, \$40,000 to \$60,000, and \$60,000 to \$80,000). The top 20 percent of the analysis broke up into three subgroups (\$81,000 to \$95,000, \$96,000 to \$99,000, and \$100,000). The portion of the bar above the crosshatch showed what the share of income would be without a cap, whereas the crosshatch accounted for the cap. The people in the top two levels would be paying less than what they would have without a cap.

Mr. Alper explained that to get into the top 5 percent of household income in Alaska, income was about \$210,000. The analysis assumed 1.5 working people per joint filer in a

household and kept the income around the \$140,000 cutoff point for the cap. There was a partial drawback of the group's effective tax rate from 1.5 to around 1 percent. There were some individuals earning more than \$365,000 and over \$1 million - the rate would be variable depending on how high their income level was, but the effective tax rate dropped down some. He focused on the bottom 95 percent of income earners where there was relative flatness to mild progressivity (1.2 percent effective tax rate for the lowest earners to a 1.8 percent tax rate at the 80 to 95 percentile of people). The ITEP analysis tried to come up with \$500 million tax schemes for Alaska, which was where the 2.43 percent payroll tax figure had come from (slide 12). He noted that the 2.43 percent tax was arbitrary, and it would be an unusual legislative solution to pick a number that precise.

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Vice-Chair Gara asked if the bars on slide 12 only showed payroll tax income. He wondered if the regressivity on benefit to the wealthier sector be higher if their investment income (that was not being taxed) was counted.

Mr. Alper answered that the chart presumed what Vice-Chair Gara had stated. He detailed that because it was a wage tax and the higher income people tended to have more unearned income, it was the reason the 1.5 percent and 0.7 percent bars were included on the chart. He furthered it was a wage tax on all income; if it was 2.4 percent of all income and three-quarters of a person's income was unearned, it would be about one-quarter of the rate. He furthered it was where the 0.7 percent bar came from and the cap reduced the bar further.

Representative Guttenberg pointed out that the ITEP report was from April 2017. However, the most recent analytical data on DLWD's website was from 2015. He observed there was a lag on information regarding job loss and other.

Mr. Alper believed the DLWD employment numbers were only a couple of months old. The department received numbers at least quarterly from employers through the employment security tax. He was uncertain about the department's other data sources.

Representative Guttenberg responded that DLWD could have more current numbers, but the recent information was not on the department's website. He stated that the nonresident workforce in the oil and gas industry was at an all time high of 36.4 percent, which represented over \$700 million in lost income to the state. There was no more recent data on the specific webpage.

Mr. Alper responded that since the peak the industry had lost about 5,000 jobs in Alaska. He referred to Representative Wilson's mention of a loss of 8,800 private sector jobs. He explained that the 5,000 jobs did not represent two-thirds of the 8,800 because many of those 5,000 were nonresidents who were no longer coming to Alaska to work. He continued that because of the industry's high nonresident workforce, the impact of its job losses on the state tended to be a bit overstated.

Representative Guttenberg stated that one of his concerns was about who was getting laid off in terms of Alaskans or nonresidents. He stated that unfortunately it appeared that Alaskans were getting laid off at a higher rate. He reasoned it could just reflect subcontractors because there was not a breakdown between the three major communities (North Slope, Kenai, and Valdez). As far as he could tell there was a disparity on who was getting laid off and it was not working in the favor of Alaskans.

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Mr. Alper advanced to slide 14 and showed a bar chart of the comparable tax burden by state. The chart showed state-level taxation (all taxes paid by individuals to a state including sales and income taxes, license fees, etcetera). The yellow portion of the bars titled "select sales taxes" represented taxes on motor fuel, alcoholic beverages, and other related items. The black portion of Alaska's bar represented the \$320 million from the proposed capped payroll tax in HB 4001. He directed attention to New Hampshire were outliers compared to the rest of the county in terms of their low taxes. Florida was the third lowest state, but its taxes were quite a bit higher than those in Alaska and New Hampshire. The proposed tax would bring Alaska's taxes above New Hampshire.

Mr. Alper moved to slide 15 and addressed a bar chart showing the comparable municipal tax burden. He referenced

questions about local government taxation being high in Alaska. The light blue segment of the bars represented property tax, which did not typically exist at the state-level. The slide factored in property taxes, sales taxes, license fees, and other. He pointed to Alaska's position on the chart - the average Alaskan was paying \$2,300 in municipal taxes; the bulk was property tax. New Hampshire had higher municipal taxes and appeared farther to the right on the chart. He detailed that New Hampshire managed to survive with a relatively small state government because they had relatively large local governments.

Mr. Alper pointed out that in Alaska about \$600 per capita of the \$2,300 was not really an individual tax, it was the oil and gas property tax collected by the state and shared with municipalities (approximately \$450 million). He continued that it was an oil and gas industry tax, which was not really paid by locals, but it was difficult to parse it out from the dataset of municipal property taxes. Other oil and gas states had something similar, but not to the scale of the tax in Alaska. If approximately \$600 per capita came out of the property tax, Alaska's municipal tax burden would put Alaska closer to the middle of the states (indicated with a green arrow on the chart).

Mr. Alper agreed that Alaskan had a substantial property tax burden, which was higher due to higher property values and incomes, but it was not out of scale with the rest of the country. He communicated that much of the data used for the chart had come from the District of Columbia that had the highest local government taxes in the country (shown on the far right of the chart).

Representative Wilson addressed the oil and gas property component on slide 15. As an example, she stated if a person had a property tax of 13 mills that 7 mills went to the state. She asked when the statute had last been considered as a possibility for revenue. She wondered if there was another oil and gas property [tax] pertaining to the North Slope (outside the value of the pipeline).

Mr. Alper answered that the idea of sharing the oil and gas property tax with the local government at their own mill rate was part of the oil and gas property statute (AS 43.56); it was more or less unchanged since the 1970s, although there were issues regarding the tax cap and treatment of debt that modified things - there had been a

few minor changes made to the statute. He continued that Trans-Alaska Pipeline System (TAPS) assessments were considered in court for many years; there had been a settlement a year or two back where the state, producers, and local governments had determined TAPS would be worth \$8 billion for property tax purposes. He added that it was a five-year settlement, meaning the state would not have to revisit the issue for some time. The total property tax portfolio was around \$28 billion (the majority of the additional \$20 billion was in the North Slope Borough and included pads, wells, rigs, warehouses, trucks, and other; other locations included were Kenai and Valdez). The state received a full 20 mills for portions of TAPS that ran through unorganized boroughs. The North Slope property tax rate for its own property was 18 mills - 90 percent of the collected taxes in North Slope were shared with the borough. He continued that over \$300 million per year went to the North Slope Borough for its share of the oil and gas property tax. He noted that all those factors distorted the dataset on slide 15.

Representative Wilson asked if DOR had considered whether the method in statute since the 1970s was still the fair way to split the taxes. She asked if the department had considered looking at the issue as it was considering various revenue options.

Mr. Alper replied it was not up to DOR to decide. The department's job was to collect and administer the taxes. He furthered that if the legislature or the governor wanted to revisit the sharing of oil and gas property taxes it would be a big conversation that would require significant work. He noted there would be some vested interests with strong opinions on the matter.

Representative Wilson appreciated that the subject was administrative and not for DOR.

Mr. Alper added that the oil and gas property tax that went to the different jurisdictions was public knowledge and was published annually in the DOR Revenue Sources Book. He detailed the tax was 20 mills and \$560 million was collected (2 percent); about \$120 million was kept by the state and \$440 million was divided between the various municipalities.

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Mr. Alper moved to slide 16 and addressed the state and local comparable tax burden. The purple arrow to the pointing to the far left on the chart represented Alaska as-is and the second purple arrow to the right of the first showed Alaska with \$320 million revenue from the proposed capped payroll tax. With combined state and municipal taxes Alabama and Tennessee both paid lower taxes than Alaska, which moved to the tenth lowest state. He elaborated that if the \$440 million oil and gas property tax was backed out, the state would be the lowest to the fourth lowest taxed state (Alabama, Tennessee, and Florida would be the lowest). He stated it was difficult to determine exactly how much discount should be taken for the oil and gas property tax. He pointed out that New Hampshire was slightly below the national average with combined state and local taxes; its higher municipal taxes put the state close to the average taxation level.

Representative Guttenberg discussed that other states had counties, but Alaska did not. He remarked that Alaska's constitutional convention had outlawed counties in the state. He spoke to adding the Permanent Fund to the combined state and local tax burdens. He remarked that no other state had a similar fund, which made the comparison difficult. He remarked that adding the Permanent Fund would significantly change the picture. He understood it was not a tax burden, but it was a benefit to living in Alaska, as were the state's tax levels and services provided.

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Mr. Alper clarified that the term local included county-type government (slides 15 and 16). He did not know the reasoning behind the decision to use the word "borough" rather than "county" or what the differences were between Alaska's boroughs, and counties in other states. He addressed the PFD and reasoned that on one hand it was possible to say that all Alaskans were receiving an \$1,000 dividend, which could be considered a negative tax. He explained that the inclusion of the PFD would put Alaska dramatically below other states. Others argued that the PFD was not a negative tax, but entitlement or underlying income for residents and any reduction to the PFD should be considered a tax that should make Alaska's tax bar increase. The administration was not accepting either scenario and was simply saying a tax was a tax and the PFD

was a calculation the people received - there was no "supposed to" it just is what it is, which was a decision the courts had made several months back as well.

Representative Guttenberg responded that the characterization of the PFD as an entitlement was strongly debatable. He made further remarks about the historic nature of the conversations. He reiterated that no other state had a similar fund.

Vice-Chair Gara considered individual tax burdens in Alaska. He stated that the oil and gas property tax was not paid by individuals, but largely by businesses. He asked about a scenario that put Alaska's taxes at the lowest in the nation (where the oil and gas property tax was not included).

Mr. Alper answered that the light blue segment of the bars on slide 15 represented property tax. The chart did not distinguish between commercial and residential. Ultimately everything was paid by an individual, but the chart included office buildings and all property tax; only some fraction of the amount was borne by individuals and the state did not have the data to carve out the information. In addition to the underlying increase to the property tax from commercial property, came the increase in Alaska from a large amount of commercial property that was out of scale with the state's population base and other economic activity (oil and gas property tax).

Mr. Alper moved to slide 16 and directed attention to the left purple arrow pointing at Alaska current law. He explained if the oil and gas portion of the property tax was backed out of the light blue segment of the bar, Alaska would be the lowest taxing state. The right purple arrow showed Alaska current law with HB 4001 layered on top. The right green arrow reflected Alaska current law with the oil and gas property tax backed out and the new wage tax layered on top. The difference between the two green arrows was the addition of the \$320 million tax.

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Co-Chair Seaton spoke to the difference between the purple and green arrows on slide 16. He asked why there was no black segment (HB 4001 estimated payroll tax) on either of

the bars reflecting Alaska's taxes without oil and gas property tax.

Mr. Alper clarified there was no bar for Alaska without the property tax. The green arrows were pointing in between existing bars. He furthered that a bar would need to be added to the left of Alabama (reflecting how Alaska would look with the property tax correction) and a bar in between Florida and South Carolina (reflecting how Alaska would look with the property tax collection and the addition of the new tax).

Mr. Alper moved to slide 17 and addressed a state comparison of the combined tax burden based on the largest cities per state. He reported that Anchorage was different than 107 other communities in the state because it had no sales tax. When considering the state and local combined tax burden, Anchorage was the lowest taxed jurisdiction in the country. He noted that there was not a material amount of oil and gas property tax collected in Anchorage; therefore, no adjustments or corrections were necessary. When considering property taxes, vehicle registration fees, and other, the average Anchorage resident paid approximately \$1,800 in state and local tax burden - less than the largest cities in all other states. Bridgeport, Connecticut had the largest taxes at about \$7,000, followed by Newark, New Jersey, and Detroit, Michigan. The comparison used a cohort of the largest cities in all states. With the HB 4001 proposal, Anchorage would move to the second lowest rank and Cheyenne, Wyoming would become the lowest taxed city on the list. He pointed out that the chart used a \$50,000 income analysis.

Mr. Alper moved to slide 18 reflecting an average income of \$100,000. Anchorage remained the lowest taxed city when compared to the peer group of states. He pointed to the red bars to the right of the slide representing state income taxes, which tended to bring taxes up significantly. The dark blue portion of the bars reflected state and local sales taxes - there was no sales tax in Anchorage. He explained that adding a 1.5 percent wage tax on households with \$100,000 income would move Anchorage to the third lowest taxed city (Cheyenne, Wyoming, and Sioux Falls, South Dakota would rank lowest and second lowest).

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Representative Wilson remarked that Anchorage also had more affordable energy than most of the state. She wondered how a community like Dillingham that had property and sales taxes would fit within the overall picture. She thought most of the other communities in Alaska would be much higher up on the scale.

Mr. Alper returned to slide 15 to answer the question. There was a presumption of the weighted average sales tax, which was 1.7 percent in Alaska. He clarified that no one was actually paying 1.7 percent - the number was an average. He suggested that if Anchorage was removed from the mix, the number on the chart would be higher across the board. He explained that the dark blue portion of the bar reflecting property tax would get bigger. Consequently, the non-Anchorage areas would probably be higher than Anchorage.

Representative Wilson thought the numbers would also be skewed because there were parts of the state without property or sales taxes. She wondered if the charts only factored in organized areas in the state. Alternatively, she wondered if the data included the entire state.

Mr. Alper answered that the charts included the total aggregate tax collected divided by the total population. Individuals living in untaxed areas would bring down the average.

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Representative Wilson thought the graph was not helpful because she believed areas without taxation should be excluded (those areas represented a large portion of Alaska). Additionally, using Anchorage skewed the numbers because there were other areas with sales and property tax (e.g. North Pole) with higher energy costs. She asked to get a better idea what the chart would look like with the removal of Anchorage and areas that did not have any taxes. She thought it would be a more accurate portrayal of what the residents would pay.

Mr. Alper responded that her suggestion would take quite a bit of effort to parse the information out at the municipal level. He explained that Representative Wilson was talking about two different things. He elaborated that Fairbanks and Dillingham (high energy costs notwithstanding) were

organized municipalities paying property taxes, which fell into the calculations. Although people in unorganized areas without property taxes may cover a substantial part of the map, they accounted for about 10 percent of the state's population. He furthered that 90 percent of Alaskans had the type of taxation of those living in urban areas. He acknowledged the 10 percent may skew things a bit, but it was not a game breaker.

Representative Wilson recalled a former classmate who never understood that three or four zeros brought down an average significantly. She stated thought that combining areas without taxation and Anchorage with its low taxation made it more difficult. She did not like the chart that tried to make it appear the state would not be taxing much. She believed the components she was pointing out made the chart almost irrelevant.

Mr. Alper responded that Alaska was different in many ways. He believed the state's Congressional delegation struggled to explain to peers what was different about Alaska. He noted challenges of logistics and higher energy costs. He added that Alaska also had higher incomes. There was only so much that could be corrected for and every state had its own unusual features. The best the department could do was come up with averages and caveat them to the best of its ability. He continued that Alaskans did pay lower taxes than people in other locations; the state had been able to rely on the oil industry to cover the vast majority of government operations for four decades and it would not be possible into the future. He furthered that the price of oil no longer supported the state's population and governmental needs. He continued that layering a tax on residents would hurt, but it would not be the destroyer of the economy as one may think, because Alaska was mostly below average on the scale compared to other states. He underscored that no one wanted to tax for the sake of taxing; the goal was adding a tax in order to provide essential services to Alaskans.

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Representative Wilson spoke to the importance of legislators having the most accurate information to go home with because the issue was about how the tax would impact Alaskans. She stated the issue was not only about taxation. She spoke to the option of reducing government - the state

had a population of slightly over 700,000 with a government larger than most other states. She stated that even with a tax, the current government was too big to support. She wanted to stick to what the charts did or did not show in order for people to have a better understanding of whether the information was reflective of the area they live in.

Representative Thompson realized the biggest population section of the state was the Railbelt. He asked if it was fair to say that upwards of 80 percent of the taxes collected on HB 4001 would come from the Railbelt.

Mr. Alper replied that he believed so, but he did not have the data on hand. Roughly 80 percent of the state's population was located in the Railbelt region; therefore, roughly 80 percent of the taxes would come from that area.

Vice-Chair Gara remarked that the state was rearranging the chairs on the Titanic as it sank. He remarked that the governor had been public that he saw the state sinking. He remarked that the governor had not proposed the bill for fun. He furthered that after \$3.5 billion in cuts, there was evidence that continued cuts would deepen the recession. He referenced the \$2.5 billion budget gap and explained the governor was trying to right the state and prevent a deeper recession. He asked if his remarks were fair. He reasoned the governor was not being illogical about his proposal, even if the legislature did not agree with him on everything.

Mr. Alper believed there was a consistent message from the administration and LFD about the facts. The budget had been reduced, revenue had declined, the state had deficits, and savings were declining. There was an expectation that government would continue to do certain things; more could always be cut, but the easy cuts were gone. He reasoned it was a worthwhile conversation to find a way to bring in another couple hundred million dollars. He remarked that finding another \$1 billion would make Alaska a very different state and one that he speculated most legislators would not want to administer.

Mr. Alper continued and spoke to the goal of reducing the deficit as much as possible with the materials at hand, followed by looking to the Permanent Fund. He stated that the fund was a wonderful asset and was a centerpiece of the state's ability to live a successful future if the fund was

treated right. He spoke to the importance of using the fund sustainably, wisely, and within its own limitations - meaning there was a finite amount that could be taken out per year. The committee had more or less agreed to that number. There was also the factor of the appropriate split of the amount between the government and the people in the form of the PFD, which there was still debate over. After all of those actions were taken a gap in the hundreds of millions of dollars would still exist. He referenced Ms. Pitney's testimony from the prior day of \$600 million to \$900 million. He explained that the gap could be addressed in three or four ways: 1) cuts (which may or may not be possible), 2) the implementation of a new tax (such as HB 4001), 3) the elimination of the PFD (which he did not believe was advisable), or 4) extra money could be spent from the Permanent Fund annually in addition to the sustainable amount (which could lead to catastrophic long-term outcomes).

Mr. Alper communicated it was the administration's position that a small tax covering part of the deficit and cuts were probably the best way forward. The most important thing was to stay within the boundaries of a sustainable draw from the Permanent Fund. He furthered that the fund would most likely not have the ability to balance the budget on its own combined with existing revenues in years to come; therefore, another option was necessary. The bill was about that additional option.

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Mr. Alper asked his colleague to address the remaining slides.

Mr. Spanos addressed slide 20 pertaining to partnership distributions:

- This bill would tax a partner's distributive share of the partnership's net taxable income
- Does not matter whether or not a partnership actually pays a partner a distribution
- Partner share is reported to him/her on Schedule K-1 of federal Form 1065
- If both spouses are partners, they will each receive a separate Sch. K-1 reporting their individual share - there is no such thing as a joint K-1

- If they file jointly, K-1s would be combined on their federal Form 1040
- Federal 1040 is not used to prepare a state tax return under this bill. Each spouse would use their individual Sch. K-1 to prepare their separate state returns

Mr. Spanos elaborated on the slide. He referenced a prior question by Co-Chair Seaton asking how a married couple who were partners in a partnership reporting income on a 1040 would report the information to the state. He explained that each individual would receive a Schedule K-1; there was no such thing as a joint Schedule K-1.

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Co-Chair Seaton stated that distributions from partnerships would be taxed under the bill. He asked if a distribution from a sub S corporation would be the same.

Mr. Spanos replied that the distributive share would be taxed under the bill, but the actual distribution would have been taxed already; there would be no additional tax on the distribution. He explained that the distributive share reported on the K-1 would be taxed under the bill. There was no change for S corporations, which under current law were exempt from corporate tax. He elaborated there was no individual tax, which would normally be taxed as passthrough income in another state with income tax.

Co-Chair Seaton asked for verification that there would be tax on the distributive share of a profit from an S corporation.

Mr. Spanos replied that the distributive share of a partnership would be taxed because partnerships fell under self-employed income under the bill's definition. S corporations were a corporation just like a C corporation and were not taxed under the bill because they were not defined as self-employment income.

Co-Chair Seaton asked for verification that it was merely a matter of definition of a distributive share that was or could be in the bill.

Mr. Spanos answered that the definition used in the bill came from the Internal Revenue Code where partnership

income was defined as self-employment income. Ownership in an S corporation was viewed as investment - the owner was viewed as an investor, not a partner in a corporation; therefore, the distributive share did not flow to the investor the same way as a partnership distributive share. The bill could be rewritten to include S corporation passthrough income, but it would be a bit more complicated.

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Vice-Chair Gara shared that he was a part owner of a small LLC. He explained that what was actually distributed was not all of the company's profits (the management decided what to distribute). He asked if the distributive share would be a person's share of the profits whether they were distributed or not.

Mr. Spanos answered in the affirmative. He elaborated that the distributive share was the portion of the income representing a person's ownership in the partnership or LLC and their portion of expenses.

Vice-Chair Gara asked if his LLC decided it wanted to avoid taxes by not distributing the companies profits and it distributed zero, there would still be a distributive share even without a distribution.

Mr. Spanos agreed.

Co-Chair Seaton asked if LLCs would be taxed as partnerships. Mr. Spanos stated it depended how an entity chose to be taxed federally. For federal tax purposes an LLC could choose to be taxed as an S corporation or a partnership. If an entity chose to be taxed as a partnership federally, the partners would receive a K-1; however, if it chose to be taxed as an S corporation they would not.

Co-Chair Seaton asked if the bill's definition that would tax LLCs as partnerships was problematic or prohibitive.

Mr. Spanos answered that the question would be about how a distributive share would be calculated because a K-1 would not be received. He reiterated his earlier statement that taxing an S corporation could be done in the bill, but it would be more complicated.

Co-Chair Seaton did not want to create holes with the bill. He asked if the bill could specify that an S corporation could choose whether its income would be taxed as corporate income tax under the state or under a distributive share partnership. Under either scenario it would mean S corporations would fall into one of the state's tax systems and would be taxed in Alaska like C corporations.

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Mr. Spanos answered that the bill could be structured that way, but if an LLC chose to be taxed as a partnership for state purposes, yet it was taxed as an S corporation for federal purposes, it would be very complicated to determine how much the entity would owe because it would not receive a K-1. He noted that it would be possible to specify that an S corporation would be taxed as a C corporation, which would be simple because the language was already in statute. He furthered that S corporations were already required to file with the state as a corporation, but currently they were exempt from a tax.

Co-Chair Seaton asked whether there was anything preventing an S corporation from generating a K-1 form for the state (whether it was submitted to the federal government or not) if the corporation wanted to be taxed under the provision in the bill.

Mr. Spanos answered that nothing would prevent them, but the tax structure for an S corporation was different. He was sure a CPA could figure out how to prepare documents as if the entity was an S corporation and as if it were a partnership. He explained that federal returns were audited by the IRS, which DOR relied on for broader coverage. He elaborated that if an entity was preparing its own documents, DOR would need in-house experts for partnership K-1 preparation, which was doable, but more complicated.

[2:31:47 PM](#)

Mr. Alper addressed the PFD tax status and voluntarily donating their PFD on slide 21:

- From a federal tax perspective, what matters is if someone is issued a PFD
- All recipients get a 1099 which is also sent to the IRS

- PFD is a dividend (Sch. B) for federal tax purposes. Dividends are taxed at filer's regular tax rate
- For federal purposes, if someone doesn't want to be taxed on their PFD, they would need to not file for (or receive) it
- Alternatively, someone could make a tax deductible charitable donation to the state of their PFD
- However, that would only make a taxable difference if they itemized their deductions (Sch. A) on their federal tax return
- Plausible work-around, establishing a GF designation for the share of the state population that does not apply for a PFD
- No way to "donate" an individual's dividend without it first being received and considered taxable income

Mr. Alper elaborated on the slide. He explained that if a person chose to donate their PFD and wanted to receive a tax deduction for the donation, the person had to actually receive their PFD (it would have to be income and a deduction). He stated that did not want to accept their dividend they could choose not to apply. The department had considered possible workarounds where if a person chose not to apply it would trigger a donation to the state. The closest the department had come was to take the number of Alaskans who applied for their PFD and the number who did not apply; the department could set aside a revenue flow for individuals who did not apply, but there would be no donation associated with the action. It would merely be a mechanism to account for individuals who chose not to apply or were not eligible. The dividend was classified as Schedule B and was federally taxable at the regular rate. The donations of dividends were deductible, but only if itemized. He noted that approximately 30 percent of Alaskans itemized.

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Representative Ortiz asked if the state established a workaround, the state would have information about who qualified for a dividend versus who actually applied. Alternatively, he wondered if Mr. Alper was talking about basing the calculation on a total number of Alaskans who may or may not qualify.

Mr. Alper answered that eligibility determinations were a key issue. There was no way to involve donations or write-offs without going through an eligibility determination, so someone knew they were getting something before they gave it away (at that point it would be income). For individuals who did not apply, the concept he had mentioned would be a blanket calculation of the rest of the population. The presentation listed Alaska's population at slightly below 740,000 and approximately 670,000 applied for the dividend in the current year. He believed about 20,000 had been disqualified, but it was a separate issue. about 70,000 Alaskans did not apply for one reason or another. He speculated at reasons.

Representative Ortiz asked if the impact of a workaround would potentially mean a higher dividend for other people. He reasoned that the higher dividend would go away if the workaround was applied.

Mr. Alper replied that it depended on the starting point. He explained the current dividend distribution process - the legislature made an appropriation, which in the past had been a lump sum. He noted that the past year was unusual because it had been a reverse engineered lump sum to equal \$1,000. He used \$1 billion as an example amount going into the fund. Currently the number was divided by the number of eligible applicants. If the non-applicants were built in to the calculation it would reduce dividends because it would be divided by a lower number and a portion would be carved out to go into the appropriation. He clarified he was not providing a policy proposal, but a theoretical exercise. Alternatively, an amount could be appropriated to dividends and in addition there would be a separate number based on individuals who did not apply that could be appropriated to the General Fund on a pro-rata level.

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Representative Tilton stated that if a person did not apply for their dividend it impacted other things like a person's eligibility for fishing licenses and other. She believed there was an array of issues the state would need to figure out how to deal with.

Mr. Alper answered that eligibility for the PFD was seen as de facto proof of Alaska residency for certain things like

fishing licenses; however, he did not believe the lack of receiving a dividend was necessarily proof of ineligibility. He was certain a person could go to the Department of Fish and Game with their mortgage statement, electric bill, driver's license, or other in order to prove residency. The PFD was one of many mechanisms to prove residency.

Representative Guttenberg stated that he went through the conversation annually with a couple of people. The individuals were lifelong Alaskans and had received the PFD every year they were eligible, but they no longer wanted to receive it. Instead, they did not want to have to apply for it and wanted the money to either stay in the General Fund or the principal of the Permanent Fund, or to donate it to a school or the borough. He observed that the issue was difficult for many Alaskans and the problem was unique to the state. He believed keeping things simple worked.

Mr. Alper imagined another theoretical workaround where a resident checked a box specifying they were electing not to apply for the PFD and they would like to donate it to the General Fund or school district. He explained that it would still be necessary to prove the individual's eligibility. He questioned how the IRS would treat the situation if the eligibility process was bypassed and an individual was given a de facto dividend (a share of the total). He guessed that the IRS would need to consider it income, meaning the benefit the Alaskan was trying to gain from not receiving the dividend would be lost. He highlighted a scenario of a person who itemized and was in the top bracket (39 percent). If the person received a \$1,000 dividend, the donation of the dividend would save the individual only at a 40 percent rate and would end up even at best and probably owing a bit of tax on the difference.

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Mr. Alper was happy to address additional questions.

Co-Chair Seaton remarked there had been discussion on parameters of the cap, looking at S corporation or partnership distributions. Another issue that had been mentioned was the prospect of not increasing the actual rate, but if the voters approved a bond issue, there could be an automatic mechanism to amortize the repayment of the bonds through a temporary increase in the tax in the bill.

If there was a general obligation bond it would mean the legislature was not sitting there trying to determine what cuts to make or other options to pay for the amortized payments. He wondered whether the issue had been considered by the administration. He asked if the calculation authority for a temporary increase could be put in DOR's lap.

Mr. Alper answered that he had spoken with the state's debt manager Deven Mitchell [Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue], but he did not have a legal opinion on the subject, so he was unable to say anything concrete. He answered that the scenario was plausible; it would involve delegating a rate-setting authority to DOR. He furthered the method was seen at the municipal level frequently. He provided examples. He furthered that voters would approve the authorization and DOR would have the ability to set the rate higher and change the withholding tables in subsequent years. There was nothing to make it inherently impossible; it was a bit complicated and no one else was using the method. He noted that Juneau had a sales tax that voters approved every several years, which supported a specific list of capital projects. Deferring "this sort of thing" to voter approval in order to change the tax rate was not unheard of. If the proposal became real, DOR would reach out to the Department of Law to ensure there were no holes.

Mr. Alper relayed that DOR was already trying to come up with language if there was the desire by the committee to include an amendment in the bill. Practically speaking it would not work well within the cap; it should be included outside the cap. He explained it was much harder to predict who was and was not going to be paying at that number and it was hard to predict the revenue. He summarized that the department could try to make it work, but it did not have enough information at present to specify how it would be done.

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Co-Chair Seaton stated that another idea floating around was a rebate or exemption for income below the federal government's \$10,300 or other. He asked if it would be difficult for the department to issue a refund if a person had paid the 1.5 percent tax but was below the federal government income level.

Mr. Alper answered there were a couple of different ways to do it. He detailed that to not tax the first "x" dollars of income was more difficult because especially at lower income levels many people had multiple jobs throughout the year and they ended up "tripping over the minimum" and the state would have to go after the individuals to pay taxes. Administratively, it would be much easier to pay a flat rebate to people who come below a certain income level, although it would have unfairness right at the edge. He explained that the individual making \$100 than the cutoff would not receive a rebate, while the person making below the cutoff would; it would mean the creation of a staircase in the tax rate. Alternatively, if a rebate of \$150 was given to everyone off the first \$10,000, it would be the simplest administratively, but it would be expensive.

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Mr. Spanos agreed that it could be done. The major concern that most states had with refunds was fraud, especially with some of the larger data breaches (if someone stole a person's information they could file for a refund claim under that person's name). There was an administrative burden on verifying the person was who they claimed to be before the refund was sent. He explained the method was simpler than putting the burden on an employer to verify someone had already paid the tax somewhere else or that they were below a given income level. He furthered that it could be done and DOR could give employers the ability to register employees its system, but it would put the burden on the employer. The department believed that having the taxpayer file directly with it and having a refund sent was manageable.

Co-Chair Seaton asked about the fiscal note. He wondered if the intention was to have a capital and operating fiscal note if the bill passed.

Mr. Alper answered that if the bill passed during the current special session and there was no accompanying appropriation, the state did not need to start spending the money in the next few months. The department could wait for the next budget cycle or ideally a supplemental budget that would pass early in the coming regular session. For operating and staff needs the department would reach out to a contractor for was in the hundreds of thousands of

dollars. The department would find a way to locate the funds elsewhere and would then backfill it later in the year. He addressed a capital appropriation and explained the contractor would take time to gear up for it anyway - as long as the contractor knew the state would have the money in the coming year, there should not be a problem.

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Vice-Chair Gara surmised the items under discussion were feasible. He reasoned that other states and the federal government exempted certain amounts of income. He spoke to the concept of stair stepping and provided a scenario where the state wanted to exempt the first \$20,000 of income or to exempt anyone earning \$20,000 or less. He supposed a person could specify they wanted less withheld on their employer withholding form and if they underestimated they could pay the tax at the end of the year. He asked for verification that it was all feasible.

Mr. Spanos replied that it was feasible. He noted that an issue when contemplating the method was that an individual with multiple jobs that would easily exceed the line could not pay the tax; if the individual was a nonresident it was nearly impossible to track it down and get the money back. For residents, the state had a dataset showing the person was a resident and it should receive W-2 forms from employers, which would allow DOR to determine the individual exceeded the limit and to send them a bill or ask them to file a return. He spoke to the expense of chasing down filers and sending out paper documents. From a wage tax perspective, it was not typically a voluntary compliance issue because the tax was withheld from wages. However, with self-employed individuals it was a voluntary return that needed to be filed. What Vice-Chair Gara was proposing was that an individual not meeting the income level would have to file their own return if they exceeded the specified income level. The department suspected that under the scenario many people would not file and DOR would have to seek out individuals.

Vice-Chair Gara assumed there were other states that exempted income for lower income people. He asked for the issue to be kept in mind because it was a concern for some.

Mr. Alper answered that the bill that the House had passed [the prior session] had exempted income below a given

level. He confirmed that the concept was not unusual. Some form of a standard deduction was standard operating procedure in income taxes. The key was it exempted everyone, which could be built into the withholding tables and standard formulas. He furthered that if the state wanted to exempt the first \$20,000, close to one-third of all the income fell off the tax roll; therefore, if the state wanted to raise the same money proposed by the bill it would mean raising the rates. Nonetheless, it would be easy to implement. However, exempting those earning less than \$20,000 became more complicated; a cleaner way to do it would be by refund rather than by a tax.

Vice-Chair Gara asked if administering the refund process would be feasible for DOR.

Mr. Alper answered that the key issue was fraud. When dealing with potentially hundreds of thousands of transactions, many systems automated the process. There had been a problem with Russian hackers applying for refunds on behalf of thousands of citizens and getting electronic wire transfers in the hundreds of thousands to millions of dollars before anyone caught what was happening because everything was automated. He explained that was they type of thing the state needed to protect itself from.

Representative Wilson asked when amendments on the bill would be due.

Co-Chair Seaton replied that a date had not yet been determined.

Representative Wilson remarked that she did not want to overload Legislative Legal Services.

Co-Chair Seaton stated that it would be helpful for committee members to bring the ideas forward for discussion. At present they were still considering which ideas were feasible and what there was agreement on.

HB 4001 was HEARD and HELD in committee for further consideration.

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

#

ADJOURNMENT

2:56:13 PM

The meeting was adjourned at 2:56 p.m.