

**ALASKA STATE LEGISLATURE
HOUSE LABOR AND COMMERCE STANDING COMMITTEE**

April 3, 2017

3:21 p.m.

MEMBERS PRESENT

Representative Sam Kito, Chair
Representative Adam Wool, Vice Chair
Representative Andy Josephson
Representative Chris Birch
Representative Gary Knopp
Representative Colleen Sullivan-Leonard

MEMBERS ABSENT

Representative Louise Stutes
Representative Mike Chenault (alternate)
Representative Bryce Edgmon (alternate)

OTHER MEMBERS PRESENT

Representative Zach Fansler
Representative Chris Tuck

COMMITTEE CALENDAR

CONFIRMATION HEARING(S)

Alcoholic Beverage Control Board

Rex Leath - Wasilla

- CONFIRMATION(S) ADVANCED

HOUSE BILL NO. 126

"An Act relating to workers' compensation benefits for members of the organized militia."

- MOVED CSHB 126 (MLV) OUT OF COMMITTEE

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 36

"An Act bearing the short title of the 'Fair Contribution by High Profit Businesses Act'; requiring certain persons in the business of oil and gas production or transportation to pay income tax; establishing a tax on the income of a sole

proprietorship, partnership, limited liability company, or an S corporation; relating to exemptions from the tax on corporations; and providing for an effective date."

- HEARD & HELD

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 14 (FIN) AM
"An Act relating to transportation network companies and transportation network company drivers; and providing for an effective date."

- BILL HEARING CANCELED

PREVIOUS COMMITTEE ACTION

BILL: HB 126

SHORT TITLE: ORGANIZED MILITIA: WORKERS COMPENSATION

SPONSOR(S): MILITARY & VETERANS' AFFAIRS

02/15/17	(H)	READ THE FIRST TIME - REFERRALS
02/15/17	(H)	MLV, L&C
02/21/17	(H)	MLV AT 1:30 PM GRUENBERG 120
02/21/17	(H)	Heard & Held
02/21/17	(H)	MINUTE (MLV)
02/23/17	(H)	MLV AT 1:00 PM GRUENBERG 120
02/23/17	(H)	Moved CSHB 126 (MLV) Out of Committee
02/23/17	(H)	MINUTE (MLV)
02/24/17	(H)	MLV RPT CS (MLV) 5DP 1NR
02/24/17	(H)	DP: LEDOUX, SADDLER, RAUSCHER, SPOHNHOLZ, TUCK
02/24/17	(H)	NR: REINBOLD
03/29/17	(H)	L&C AT 3:15 PM BARNES 124
03/29/17	(H)	Heard & Held
03/29/17	(H)	MINUTE (L&C)
04/03/17	(H)	L&C AT 3:15 PM BARNES 124

BILL: HB 36

SHORT TITLE: TAX: INCOME FROM NON C CORP ENTITIES

SPONSOR(S): GARA

01/18/17	(H)	PREFILE RELEASED 1/13/17
01/18/17	(H)	READ THE FIRST TIME - REFERRALS
01/18/17	(H)	L&C, FIN
02/27/17	(H)	SPONSOR SUBSTITUTE INTRODUCED-REFERRALS
02/27/17	(H)	READ THE FIRST TIME - REFERRALS
02/27/17	(H)	L&C, FIN
04/01/17	(H)	L&C AT 1:00 PM BARNES 124

04/01/17 (H) Heard & Held
04/01/17 (H) MINUTE (L&C)
04/03/17 (H) L&C AT 3:15 PM BARNES 124

WITNESS REGISTER

REX LEATH, Appointee
Alcoholic Beverage Control Board
Wasilla, Alaska

POSITION STATEMENT: Testified as appointee to the Alcoholic Beverage Control Board.

HEIDI HEINRICH, General Manager
Lucky Wish Bone Restaurant
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SSHB 36.

SILVIA VILLAMIDEN, Executive Director
Alaska Hospitality Retailers
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SSHB 36.

CAROLINA STACEY, Owner
Kindred Spirits
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SSHB 36.

LORI BREWER, Owner
Caffé D'arte Alaska
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to SSHB 36.

MATTHEW GARDNER, Senior Fellow
Institute on Taxation and Economic Policy
Washington, DC

POSITION STATEMENT: Reiterated some of the points from his previous invited testimony on SSHB 36 on 4/1/17.

REPRESENTATIVE LES GARA
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: As the sponsor answered questions regarding SSHB 36.

LAURA CHARTIER, Staff
Representative Les Gara
Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Answered questions related to SSHB 36.

ACTION NARRATIVE

[3:21:53 PM](#)

CHAIR SAM KITO called the House Labor and Commerce Standing Committee meeting to order at 3:21 p.m. Representatives Knopp, Sullivan-Leonard, Josephson, Wool, Birch, and Kito were present at the call to order. Representatives Fansler and Tuck were also present.

CONFIRMATION HEARING(S)
Alcoholic Beverage Control Board

[3:22:49 PM](#)

CHAIR KITO announced that the first order of business would be the confirmation hearing of one more of the governor's appointees to the various state boards and commissions.

[3:24:18 PM](#)

REPRESENTATIVE FANSLER asked Rex Leath to describe his views on the balance of power between the Alcoholic Beverage Control Board ("ABC Board") and municipal governments.

REX LEATH, Appointee, Alcoholic Beverage Control Board ("ABC Board"), stated his view that local communities have influence on ordinances and imposing local laws, which are mirrored against what regulations are in place based on input from the board. As long as those ordinances and/or laws are in compliance with state regulation, the ordinances and/or laws would be valid to enact. He said that if there is a conflict the community could bring it before the ABC Board for consideration as to whether the board needs to change something through regulation or statute.

REPRESENTATIVE FANSLER inquired where Mr. Leath thinks the line exists for municipalities that might protest a liquor license or give guidance on a liquor license. He asked what the ABC Board's duty is to listen to the protest.

MR. LEATH offered his understanding that the board's duty is to listen to concern. A community's concern may be a loophole or gap that needs to be adjusted in state law or regulation or in

Title 4 that infringes upon a community's ability to balance liquor laws and licenses within the community. "Or," he continued, "it may be something that we can't move on due to the statewide standard that we have to hold and so I think that's the balance respectfully that we have to ... find in that situation." He acknowledged that communities have the right to protest or bring up grievances and complaints, but the board must keep a statewide perspective and keep in mind that there could be some regulations or laws that may need to be adjusted, especially if they apply to Title 4.

[3:27:16 PM](#)

REPRESENTATIVE FANSLER stated that as a former city council member for Bethel, he was told that a municipality's protest would be given the highest regard and the ABC Board would follow that. He asked whether that is Mr. Leath's understanding of how it should work.

MR. LEATH offered his understanding that in the past it has been a priority of the ABC Board to entertain protests coming from municipalities, but said he is not aware of the current stance.

REPRESENTATIVE FANSLER asked Mr. Leath to speak to his experiences in rural Alaska and any developments he has been following in communities that are transitioning to new phases with alcohol.

MR. LEATH detailed his experiences. He said he grew up in Kodiak, has fished commercially throughout the state, joined the Alaska State Troopers in 1999, and was stationed in Kotzebue for four and a half years working in rural communities up the Kobuk and Noatak rivers and throughout the Yukon-Kuskokwim Delta region. He stated he was assigned to the alcohol and drug enforcement unit with the Department of Public Safety. He has worked with many "local option" communities that were dry, damp, or wet. He explained that he was in Kotzebue prior and during the establishment of the city-run packaging store there. He noted he is not intimately familiar with all the details and has not reviewed all the documents of the current stance in Bethel and Emmonak, but he is aware of the desires of communities to become damp or dry. "Each community," he added, "has a different dynamic that applies to it, as well as a different effect on the local communities that they may be a funnel to or a transportation hub to."

[3:29:46 PM](#)

REPRESENTATIVE FANSLER recalled that at a previous hearing with another appointee to the ABC Board there was discussion of reform issues underway with Title 4 and what might be a good change. He asked Mr. Leath what could be changed in Title 4 to empower local communities.

MR. LEATH responded that Title 4 covers many topics and regulations and the main issue with governance of liquor law license is communication between communities and state. The one area that can be improved, he stated, is the packaging store monthly list that documents how much alcohol has gone to a certain community for a certain person. That information, while held very close, is available for law enforcement and certain packaging store requests and helps prevent too much alcohol from going to a certain community. Communities that want to go damp or dry often ask how they can get hold of the information to make sure that they aren't allowing too much alcohol to go into the community. In the private sector/commerce side the packaging stores do not want to be part of the problem. He offered his belief that increasing education to the public and commercial sides of the alcohol industry, to increase awareness and fluid access to general, not personal, information, would prevent these violations before they take place.

[3:32:08 PM](#)

REPRESENTATIVE FANSLER thanked Mr. Leath for his comments. He related his concern that his region has communities that have chosen to go wet and many communities that are still dry. Unfortunately, one community's decision has a ripple effect to the other communities. He asked whether Mr. Leath has any ideas of ways to help the communities that wish be dry or damp but are near access to alcohol.

MR. LEATH replied that many times spot fires are being chased - local dry or damp communities with surrounding wet communities. Every wet community in the region becomes another access point for alcohol to influence the dry or damp community. He said he is currently the detachment commander for the Alaska Wildlife Troopers, managing the entire northern part of the state, and troopers deal with these things every day. He offered his belief that the best solution is to start with education, although he acknowledged the success might not be seen for a generation. A long-term effort must be invested for a long-term solution, he added. For many years [troopers] have chased bootleggers or importers into the damp communities from wet

communities. That works to catch a person with a backpack full of whisky, but it does not prevent the next generation in a community from knowing what the downside effect is of this problem. He continued:

If we truly are going to meet the need of that community that's voicing that desire to become dry or stay dry or damp, we need to get in and not just influence with enforcement, but we really need to influence at the base level with education to the young generation as to what the ramifications are of breaking the law, but also why those laws are in place by the local community members.

MR. LEATH acknowledged it's a lot of work and takes dedication, but the next generation of Alaskans is worth the investment today. To get ahead of this problem and not keep chasing the alcoholism nightmare in the state, he advised, [the state] needs to invest in the young generation on a case-by-case basis. Each community has a different message for its people and has the right to vote to be damp or dry. He noted the importance of talking to community leaders and finding out what education they want for giving to their local youth to prevent this from happening in the future. He added, "We're not going to change the activity, but we need to work on ... encouraging the change as a culture by the people there that want us to help them do that through education."

[3:35:38 PM](#)

REPRESENTATIVE FANSLER offered his appreciation for Mr. Leath's comments and said he hopes Mr. Leath continues to pursue the situation. He agreed every community is unique and has different needs, even within the same region. He told Mr. Leath: "I hope ... that if you're appointed to the ABC Board, that you fight for those things and I hope that you help us work towards education for our youth and help respect the sovereignty of our municipalities and their ability to choose self-determination."

CHAIR KITO concurred with Representative Fansler's comments.

[3:36:43 PM](#)

REPRESENTATIVE WOOL asked whether Mr. Leath was tracking the ABC Board at the time when it switched from the Department of Public Safety (DPS) to the Department of Commerce, Community & Economic Development (DCCED).

MR. LEATH replied he doesn't remember what year that was, but he recollected that he was working in the Alaska Bureau of Alcohol and Drug Enforcement when the switch occurred.

REPRESENTATIVE WOOL asked what Mr. Leath sees as the balance from the ABC Board between public safety and commerce.

MR. LEATH responded it is a sensitive balance. He said the ABC Board, particularly in regard to Title 4 issues, faces a hard line with communities wanting certain violators of Title 4, especially bootleggers, to be held accountable. Historically there has been a strong push to have law enforcement have a heavy voice through enforcement action to stop this problem from occurring. On the commerce side, he continued, he has found that packaging store and liquor licensed establishments are very willing to comply with the law. He offered his opinion that because the ABC Board is no longer under DPS, there's more of an opportunity for interjecting education as an element of prevention. Law enforcement is too busy pushing enforcement and catching up with offenders to have the time to focus on education, he explained. The industry, given civil liability, is often education minded. If appointed as the law enforcement element of the board, he said, he recognizes that he must keep an education option up front to prevent today's crimes and tomorrow's generation from involvement in crimes.

REPRESENTATIVE WOOL commented that education includes the education of license holders as far as following the rules and the education of responsible consumption.

[3:40:01 PM](#)

CHAIR KITO reminded committee members that signing the report regarding appointments to boards and commissions in no way reflects individual members' approval or disapproval of the appointees, and that the nomination is merely forwarded to the full legislature for confirmation or rejection.

REPRESENTATIVE WOOL moved to advance the appointment of Rex Leath to the Alcoholic Beverage Control Board to the joint session of the House and Senate for consideration. There being no objection, Mr. Leath's confirmation was advanced.

[3:40:55 PM](#)

The committee took an at-ease from 3:41 p.m. to 3:43 p.m.

HB 126-ORGANIZED MILITIA: WORKERS COMPENSATION

[3:42:55 PM](#)

CHAIR KITO announced that the next order of business would be HOUSE BILL NO. 126(MLV), "An Act relating to workers' compensation benefits for members of the organized militia." [Before the committee was CSHB 126(MLV).]

CHAIR KITO noted public testimony was still open on HB 126. He closed public testimony after ascertaining that no one wished to testify.

REPRESENTATIVE WOOL moved to report CSHB 126 (MLV) out of committee with individual recommendations and the accompanying zero fiscal notes. There being no objection, CSHB 126 (MLV) was reported from the House Labor and Commerce Standing Committee.

[3:44:43 PM](#)

The committee took an at-ease from 3:44 PM to 3:47 PM.

HB 36-TAX: INCOME FROM NON C CORP ENTITIES

[3:47:22 PM](#)

CHAIR KITO announced that the final order of business would be SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 36, "An Act bearing the short title of the 'Fair Contribution by High Profit Businesses Act'; requiring certain persons in the business of oil and gas production or transportation to pay income tax; establishing a tax on the income of a sole proprietorship, partnership, limited liability company, or an S corporation; relating to exemptions from the tax on corporations; and providing for an effective date." [Before the committee was the proposed committee substitute (CS) for SSHB 36, Version 30-LS0148\E, Nauman, 3/29/17, ("Version E"), which was adopted as the working document on 4/1/17.]

CHAIR KITO opened public testimony on SSHB 36.

[3:47:48 PM](#)

HEIDI HEINRICH, General Manager, Lucky Wish Bone Restaurant, testified in opposition to SSHB 36. She said she has been with the Lucky Wish Bone Restaurant for 38 years, most of that time

as the general manager, and she also owns a small coffee shop that is an active member of the community. She said the economic atmosphere that the Lucky Wish Bone is experiencing this year makes her fear SSHB 36 even more. The business is seeing a reduction in sales of 10-20 percent from the previous year, she advised, and in speaking with other business owners and vendors, it is apparent that it is an industry-wide problem. Alaska is facing a recession.

MS. HEINRICH stated that while titled "The Fair Contributions for High Profit Business Act", the bill begins with a list of \$25,000 as the first profit margin. A year-end profit of this amount is hardly a high profit operation, she said. Breaking those numbers down month to month would mean a profit of \$2,083 a month. As a businessperson she can say that overseeing a crew and maintaining overhead, plus all the other daily stresses, would certainly not be worth it at the end of the day. The formula used for SSHB 36 is not accounting for total sales, she continued, and more it is not accounting for (indisc.) profit. Despite Representative Gara's assurances, at the end of the day SSHB 36 is suggesting a legal form of double taxation.

MS. HEINRICH stated that a business like the Lucky Wish Bone Restaurant would not, at the end of the day, be able to see income as profit to owners. As a business with a small group of people, the restaurant pays its employees over minimum wage, has health benefits available, and shares with its employees the profit that there is at the end of the year. This last, she noted, is the only one that is not already mandated in some form by the government.

MS. HEINRICH pointed out the probability of the minimum wage being raised to possibly \$15 an hour this year, and the cost of worker's compensation going up. At some point, she said, it becomes too expensive to continue to maintain a small business and breaking points will come. She offered her belief that by this time next year, many businesses currently in operation will have closed their doors, unable to make the long hours and hard work pay the bills. And, she continued, this is without adding another hit to the bottom line with SSHB 36.

MS. HEINRICH maintained that fixing the mess state government has gotten Alaskans into should not be on the backs of just the business owners. She suggested that a sales tax could be a driving force to a better economy and would collect tax from all Alaskans and visitors alike. She has heard Representative Gara and others worry about a sales tax hurting low-income families,

but there is the blow that they will take if the businesses across the state that employ them begin to close. Business owners are hardworking people, she continued, often working many longer and harder hours than the people they employ. Business owners offer and provide employment for their fellow Alaskans and contribute to the economy. Without business owners Alaska's economy would be in even worse shape. There are more ways to deal with Alaska's government deficit than just SSHB 36, she said.

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REPRESENTATIVE WOOL understood Ms. Heinrich as having stated that the [proposed] minimum profit would be \$25,000.

MS. HEINRICH replied that the bill begins with a list of how the profits would be broken down and \$25,000 is considered as being a high profit business. She stated that \$25,000 at the end of the year is not a high-profit business.

CHAIR KITO pointed out that the aforementioned table is for oil and gas taxes that are separate from what would be a corporate tax. He explained that corporate tax begins in Section 4 on page 3 [of Version E] and would begin at \$250,000 subject to a 5 percent tax.

REPRESENTATIVE WOOL confirmed that for a small non-oil and gas business it would be \$250,000, not \$25,000.

MS. HEINRICH responded that a business would still be looking at paying almost a second percentage because the bill looks at paying 9.4 percent. She calculated that a couple owning a small business would pay almost \$19,000 more under this than two people would pay separately.

[3:53:43 PM](#)

SILVIA VILLAMIDEN, Executive Director, Alaska Hospitality Retailers, testified in opposition to SSHB 36 as written. She said she opposes the bill for many reasons, including those stated by Ms. Heinrich. She opined that the bill, as written, will hurt communities as far as jobs and the economy, and will hurt small business owners with yet another expense. She said her association has over 350 individual units of membership, which represent over 6,000 employees in the state. Alaska's economy is hurting and ultimately consumers will begin to feel

the impact of the higher cost of goods. Alaskans and tourists alike will have few places to dine or shop.

MS. VILLAMIDEN predicted that Alaska's high unemployment would only get worse. Businesses are already struggling to keep their doors open, she related, and adding more taxes will become an economic disaster. Businesses will have to cut down labor by laying people off and/or by cutting hours, she said, which will not help Alaska's workforce.

MS. VILLAMIDEN pointed out that merchants have the expense of freight, a cost that many people forget about. She advised that freight can run a business's expenses very high and that some businesses in Anchorage have already closed because they could no longer afford to pay the freight cost for bringing their merchandise to Alaska. She further pointed out that worker's compensation insurance, general and liability insurance, and health insurance are also extremely high and make it hard for any business to stay open. The proposed tax of 5 to 9.4 percent is another increase that could hurt a lot, she said.

MS. VILLAMIDEN urged committee members to take time, listen to the business owners in their own communities, and do homework to learn more before considering any more taxes and before any more businesses are driven out of Alaska.

[3:57:12 PM](#)

CAROLINA STACEY, Owner, Kindred Spirits, testified in opposition to SSHB 36. She said she and her husband own several businesses and are active members in their community. She expressed her hope for having a good future in Alaska for herself and her two children. She stated she is wary about SSHB 36 and noted Alaska's current economic atmosphere is not optimal. Her businesses are seeing a big reduction in sales, up to 20 percent from last year, she related. Her vendors and other businesses have also been concerned because they too are seeing reduced sales. Alaska is experiencing an economic downturn, she said.

MS. STACEY said SSHB 36 would affect every business making over \$200,000 in profits per year and has major flaws. Called "The Fair Contributions for High Profit Business Act", the bill would automatically consider any business with profits over \$200,000 to be a highly profitable business, regardless of its annual sales. The bill groups all businesses together under one criterion regardless of size, number of employees, or industry, she continued. The bill is aiming to tax only individuals that

are business owners instead of taxing all citizens, basically creating a legal form of double taxation. All individuals need to be invested in their communities, she stated, not just business owners.

MS. STACEY said she listened to the presentation that explained the bill. The presentation used businesses making \$10 million as examples and said that businesses needed to contribute to the community and the state. However, she pointed out, the reality is that all businesses are being grouped as highly profitable if they earn \$200,000, whether they are lawyers, doctors, a small coffee shop, or a grocery store. Small businesses are not the same as large ones, she said. Comparing a mom-and-pop shop to big corporations like Coca-Cola and Wal-Mart is unfair.

MS. STACEY explained how SSHB 36 would affect her small business. As a hands-on owner, she said, her hours are 24 hours a day, 7 days a week ("24/7"). When somebody calls in, she covers shifts even if she already worked hers. Plus, she must do ordering and shopping and must keep her business running no matter what. She must manage her personnel and do scheduling and hiring. If something breaks, she must fix it no matter how inconvenient or costly. These are the responsibilities of being an owner, she continued, but they are also the joys of being her own boss.

MS. STACEY said she pays most of her employees more than she pays herself. Her employees receive a guaranteed paycheck, they get paid before she does, and they get paid more than she does. This is because her income is tied to her business profitability regardless of how many hours she works, she explained. Sometimes she must work 60-80 hours to accomplish everything and keep her business running, but her employees do not, they get to go home. Grouping her small business with businesses that are earning \$10 million in profits is unfair and cannot be done, she argued. At the end of the day when her shop has profits it is the sum of her family's hard labor to make their business as profitable as possible. She said SSHB 36 is asking small business owners to pay themselves less at the end of the year.

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MS. STACY added that SSHB 36 is suggesting a legal form of double taxation. She stated that small businesses like hers will end up paying taxes on their profits and then the business owners will also have to pay taxes again on that income as the profits flow to owners. The income transfer from businesses to

owners is not exempt from taxes again, she pointed out. Page 3, line 23, [of Version E] clearly says that business owners will be able to deduct paid taxes from their personal income tax, and not apply payment to their tax bill. "In other words," she continued, "we will be taxed at a higher bracket based on the fact that we choose to work for ourselves versus working for someone else."

MS. STACEY asked why only business owners are being taxed and not every citizen. Businesses are being singled out, she said, rather than asking everybody to invest in their communities. A sales tax would make everyone take a bite of the pie, not just business owners. Business owners are hardworking people who are offering and providing employment to communities and are the driving force that promotes a healthy economic environment in Alaska, she continued. A friendly environment must be provided if businesses are to grow and flourish in Alaska. She urged committee members to realize that all the governmental regulations coming out are creating a hostile environment for doing business. She further urged members to take her concerns to heart and re-evaluate SSHB 36 because it will not work for people like her.

[4:03:30 PM](#)

REPRESENTATIVE BIRCH stated he shares Ms. Stacy's concerns. He said [Version E] has two components as he interprets it. Section 2 applies to persons engaged in oil or gas production and that tax would top out at 9.4 percent [on taxable income of \$222,000 or more]. [Section 4] applies to business income and would have a zero percent tax rate on taxable income of less than \$200,000 and a top rate of 9.4 percent on net income of \$1 million or more. He offered his understanding that taxable income is the gross less all expenses. He inquired whether this is Ms. Stacy's interpretation of the bill as well.

MS. STACY replied yes. She related that [a neighboring couple] works jobs and does not work nearly as many hours as she does. If these neighbors make \$220,000 in salaries, their taxable amount is going to be less than hers because she is a business owner. If she and her husband make more than \$220,000, they will be taxed first on their business and then on their income, which is not fair. Her neighbors use the roads and school district just as she and her husband do, she pointed out, but because she chooses to run a business and employ people and provide a service to her community, she is going to have to pay more than will her neighbors.

4:05:45 PM

LORI BREWER, Owner, Caffé D'arte Alaska, testified in opposition to SSHB 36. She stated that she and her husband have owned their business for over 25 years and currently employ 56 people. Like most small business owners, she noted, they have had many months where they work 10-12 hours a day, 6-7 days a week. They are on call 24 hours a day, 365 days a year. They started their business in a small shack in the Mountain View area in 1992. Owning a small business gives opportunity for people who work hard to accomplish big goals with little money or little education, and over time they can accomplish a lot. She said her company has helped to open hundreds of businesses in the community and works side-by-side with small business owners as they start from scratch. Her company employs students, parents returning to the job force, and second-chance employees who are transitioning from incarceration to become contributing members of society.

MS. BREWER said her biggest opposition to SSHB 36 is that it would double tax small business owners. The way the bill is written, if she and her husband were partners and together, they make \$222,000 they would pay a business income tax of almost \$21,000. After that is deducted, she and her husband would pay an additional \$19,000 on over \$200,000. It would be a double tax, she stated, because it is a deduction from their income, not applied to their taxes. She further noted that her neighbors aren't being taxed like that.

MS. BREWER recalled that in previous testimony, her small business was compared to Coca-Cola, not to just regular people working in Alaska. She further recalled it being said that her small business is a drain on the economy. She pointed out that her company employs many people and pays more in payroll taxes than she and her husband pay themselves in income. She and her husband pay property taxes, pay for permits, and pay taxes on everything they purchase. She and her husband support and are involved in their community, she continued, and give to many non-profits, such as the downtown soup kitchen, the March of Dimes, and the Fur Rendezvous, to name a few in just the last couple of months.

MS. BREWER added that the \$222,000 is quite often the total income of a partnership of three or four people in the business. She emphasized that the economy is tough right now and sales have decreased in retail and the food industry. In the last few

weeks, she related, three coffee shops have come to her wanting to put their shops up for sale, and one has actually closed its doors. As a wholesaler she sees 20-40 coffee shop owners each week and many are very nervous about what is going on in the economy and are talking about putting up their houses for sale.

MS. BREWER said SSHB 36 would take away the motivation for being a small business [owner] in Alaska. She urged that the legislature help businesses build a climate of growth and reinvestment in the state, rather than plans for downsizing.

[4:10:17 PM](#)

MATTHEW GARDNER, Senior Fellow, Institute on Taxation and Economic Policy, reiterated some of the points he made in his invited testimony on SSHB 36 on 4/1/17. Fairness is certainly a concern here, he said. From a multi-state perspective, the main inequity seen in looking at Alaska's current treatment of business income is that Alaska has a corporate tax with marginal rates up to 9.4 percent on traditional C corporations and a tax rate of zero on businesses that choose to incorporate in other ways. The main concern, he continued, is that that can create harmful incentives for businesses to shift their form of entity away from C corporations and toward these alternative forms.

MR. GARDNER recalled that several witnesses asked the question, "Why tax business income on the person's side and not tax other forms of personal income?" He noted that 42 states and the District of Columbia currently levy a broad-based personal income tax on all forms of income and advised that it is worth considering whether that might be a more equitable way of going forward. From a business tax perspective, he added, SSHB 36 takes an important step towards remedying a pretty clear inequity in how different types of businesses are created in Alaska.

[4:12:03 PM](#)

REPRESENTATIVE WOOL addressed Mr. Gardner's statement that if a company was a C corporation it may want to re-define itself as another kind of corporation to avoid the taxes. But, he said, that is the current situation and has been going on for a while, so someone would have done it already.

MR. GARDNER replied yes, there is some anecdotal evidence that that's been going on for a while. He recalled that 20 years ago a former Department of Revenue deputy commissioner said, in

effect, that a new business would be nuts not to form as a pass-through. Equalizing the tax treatment or taking a step towards equalizing the tax treatment of C corporations and pass-through businesses could take away that incentive and make it so that choice of entity would be based on purely economic considerations - what the market tells people to do - rather than what the tax system tells people to do. So, he continued, SSHB 36 is about trying to level the playing field going forward. He agreed with Representative Wool that the choices companies have made so far have probably in some cases been contingent on this tax differential for decades. The sensible role, he advised, is to try to mitigate that to reduce, not eliminate, that gap going forward.

[4:13:34 PM](#)

REPRESENTATIVE WOOL asked what Mr. Gardner would say to the mom-and-pop businesses who just testified that they are simply regular people doing their jobs who happen to have a small business that is categorized as, say, an S corporation, while their neighbors who are employees of a company and making the same amount of money would not have to pay the extra tax that the people who are small business owners would have to pay [under SSHB 36]. These small businesses are not Coca-Cola or Exxon, he continued, and they are asking why they would have to pay this tax while other people would not.

MR. GARDNER responded that that is an excellent question from the testifiers. He said the first point he would make is that the net income threshold of \$250,000 for paying any tax at all for non-oil and gas businesses would go a long way to making a clear distinction between the Coca-Colas and the mom-and-pop businesses. The \$250,000 of net income, which is income after all expenses, is the point at which tax would start to be paid. A net income of \$300,000, for example, would pay a tax of \$2,500 for an effective tax rate on that net income of 0.8 percent. A net income of \$500,000 would pay a tax rate of 2.5 percent. He said that makes a clear distinction, and from a multi-state perspective a bigger distinction, between more profitable businesses and less profitable businesses than exists in almost any other state with income taxes. Most states apply tax rates at a much lower level than \$250,000. So, he continued, there is an effort, more so than in most states, to try to distinguish between Exxon and Coca-Cola and the truly small business.

MR. GARDNER said the second point he would make is that the testifiers are correct that there is an inequity when taxing

some forms of personal income but not others. The most sensible long-term approach to taxing personal income, he advised, is to tax all types of income the same way. Alaska had a personal income tax and repealed it 30 years ago. The more comprehensive and sensible approach in the long run would be to apply a universal tax on personal income. In the short run, he continued, there is an inequity between different types of business incomes, and [SSHB 36] would try to level the playing field a bit between those different business forms. It is a good first step towards a more across-the-board level playing field for income taxation.

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REPRESENTATIVE KNOPP, in regard to making it a level playing field, observed that Section 2 provides graduated tax brackets. He questioned how that is equitable in that it seems the harder someone works, the more the person makes, and so the more the person pays. He asked why the scale is graduated in Section 2 rather than being a flat 5 or 10 percent.

REPRESENTATIVE LES GARA, Alaska State Legislature, sponsor of SSHB 36, answered that it was a policy choice. A flat 5 percent tax could have been chosen, he said, but that would probably have been higher for most businesses than what is proposed in the bill, which is that the first \$200,000 of any profits is exempt from any tax whatsoever. It is a [policy] call for legislators as to whether that is the right amount. He explained the bill tries to recognize that the lower the profit, the less tax should be paid. Alaska's current corporate tax rate of 9.4 percent kicks in at \$222,000. The bill does not reach 9.4 percent until \$1 million [in profit]. The bill tries to make the tax much fairer to smaller businesses by not having any tax for profit below \$200,000 and it provides for a lower tax than the current corporate tax. Those are legitimate policy calls for members of the legislature, he reiterated.

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CHAIR KITO noted the talk has been about "net profits" but the bill talks about "taxable income." He inquired whether these two terms are different or the same thing.

MR. GARDNER replied that, in general from this perspective, "net income" and "taxable profits" are basically equivalent terms. They are just different ways of describing the same concept, which is that all the expenses incurred during the year are

subtracted from all the revenues that are received from sales and service during the year. In this bill, that income after expenses is called taxable income, but a net profit is basically the same concept.

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REPRESENTATIVE WOOL drew attention to language [on page 1, line 12, through page 2, line 2, of Section 2, which read:

(e) There is imposed for each taxable year upon the entire taxable income of every corporation or person engaged in the production of oil or gas from a lease or property in this state or engaged in the transportation of oil or gas by pipeline in the state derived from sources within the state a tax computed as follows:"

REPRESENTATIVE WOOL further observed [that the tax rate would be zero percent for taxable income of less than \$25,000] and remarked that \$25,000 is a low number. He inquired whether this is a certain aspect of the oil and gas industry that he is unfamiliar with, given that \$25,000 profit in the industry seems small.

REPRESENTATIVE GARA responded that the lower tax rate is applied to all non-C corporations. Except, he pointed out, Alaska has a separate and complex definition of income for oil and gas and pipeline companies. Under this definition, called worldwide accounting, a company's barrels from around the world are divided by the barrels from Alaska, so what oil and gas companies pay is not truly Alaska income. This schedule is the exact same schedule paid by every oil and gas company that pays a corporate tax, he said. It is the exact one that Exxon pays, that BP pays, that every C corporation that produces oil and gas taxes pays. Under the bill, he continued, an oil and gas company that files as an S corporation would use the same tax schedule as an oil company that files as a C corporation - they are both doing the same exact activity. The bill uses the same definition as is used under the existing corporate tax, so it is profits and profits as defined by the oil and gas corporate tax.

REPRESENTATIVE WOOL asked why the sponsor chose to exempt Native corporations that are not C corporations. He recalled the sponsor stating that most Native corporations are C corporations and that if they are C corporations the bill would not apply.

REPRESENTATIVE GARA answered that according to information from the Department of Commerce, Community, and Economic Development (DCCED), all Native and village corporations currently are covered by the C corporation tax due to the number of shareholders they have. However, he explained, in case there are some that are treated differently, he didn't want to enter into the issue of the Alaska Native Claims Settlement Act (ANCSA) and so wanted to leave all ANCSA corporations the way they currently are. If there are any that aren't covered because they don't have enough shareholders, he added, they probably don't have the income that would have them pay any tax under this bill anyway.

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REPRESENTATIVE BIRCH inquired whether fishermen are included in the bill.

REPRESENTATIVE GARA responded that SSHB 36 uses the same rule that is used under the corporate tax, so a fisher or fishing company, such as a processor, that pays a fishing tax would get to deduct that from the corporate tax. He explained that any company that paid the fishing tax would get to deduct those payments from its income under the [proposed] new tax if the company is an S corporation or a limited liability company (LLC). So, they are treated the same as C corporations - C corporations that pay a fishing tax get to deduct their tax payment from their income before they pay the corporate tax.

REPRESENTATIVE BIRCH noted there are two sponsor statements. One states that SSHB 36 would hit 9,000 S corporations and the other states 6,000 S corporations as well as other business types. He asked which number is correct.

REPRESENTATIVE GARA replied that there are 9,000 S corporations that DCCED knows about in the state. However, it is unknown whether they would be touched by this tax because \$200,000 in profit must be made before this tax would kick in, and a company making under \$200,000 would not pay any tax. So, 9,000 would not be hit by this tax, but the portion of them that make profits over \$200,000 would be taxed.

REPRESENTATIVE BIRCH again noted that one of the two sponsor statements says an estimated 6,000 S corporations and the other says 9,000.

LAURA CHARTIER, Staff, Representative Les Gara, Alaska State Legislature, answered that the bigger number of 9,000 is the correct number and reflects better information. The sponsor received an updated number from the Department of Revenue (DOR) and that number is reflected in the updated sponsor statement.

REPRESENTATIVE BIRCH observed the fiscal note states there will be a collection cost of \$2.8 million. He inquired as to whether there is an estimate on how much revenue would be generated from the 9,000 S corporations, LLCs, partnerships, and other profitable businesses under the bill's definition.

REPRESENTATIVE GARA advised that [Ken Alper, Director, Tax Division, Department of Revenue,] would be the best person to answer this question. He relayed that Director Alper told him the state doesn't know what any of these 9,000 S corporations, LLCs, or 40,000 other businesses earn because none of them are required to file a tax return. However, he continued, Director Alper's very rough estimate is \$50 million. This estimate is based on what is known about what fishing and mining companies make and on what Hilcorp, an oil and gas producer, makes as an S corporation.

REPRESENTATIVE BIRCH asked whether the administration supports this proposal.

REPRESENTATIVE GARA replied he has not asked the administration if it supports this exact proposal. He said he knows the administration has discussed possibly doing a corporate tax and when the administration saw that a corporate tax bill was filed it may or may not have impacted whether the administration filed one. He added that he is unable to say whether the administration was going to file in any case.

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CHAIR KITO observed Section 2 of Version E states the "person" engaged in the production of oil and gas. He posed a scenario in which Company A has 20 shareholders and each shareholder is a person; the company is not a person. He recalled the sponsor stating that the tax would be on the overall company and said he therefore doesn't understand whether the bill is considering a company to be a person. He asked whether those individual persons each 20 would have to engage for the company if the company made more than \$250,000 in profit.

REPRESENTATIVE GARA responded that the statutes define "person" to mean person, business, or corporation. He said a statutory definition of "person" is at the beginning of Alaska's statutory code and it includes a corporation. The way the bill is written, the tax would go on the entity so that 500 shareholders would not each have to do their own separate tax return - only the business would do the tax return and would apportion to the shareholders so that they would know their portion.

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CHAIR KITO offered his understanding that a "person" could be defined as a corporation as well as an individual. He asked whether there is something in the bill that designates for the oil and gas tax where person is identified that those don't imply to individual shareholders.

REPRESENTATIVE GARA answered that Section 4 puts the tax on a qualified entity. He drew attention to page 3, line 8, of Version E, which states, "For each calendar year, a qualified entity shall pay a tax". He explained that "qualified entity" is defined as the various business forms that are defined in the bill, which is anything from a non-corporate business up to an S corporation; the whole class of 49,000 businesses that DCCED lists.

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CHAIR KITO clarified the definition explains the qualified entity for tax on \$200,000 and above. However, he said, he was referring to Section 2 which talks about tax on an oil and gas pipeline or oil and gas entity and provides a tax schedule. Section 2 only mentions "person" and doesn't mention "qualified entity".

REPRESENTATIVE GARA replied that, according to Legislative Legal Services, the language in Section 2 is the same language that is used in the current oil and gas corporate tax. The tax goes on the business. He offered his belief that "person" is used in the existing oil and gas corporate tax and that "person" means business. He suggested this question be asked of the bill's drafter at the bill's next hearing.

CHAIR KITO said he would like to have this question answered given there is a distinct difference between Section 2 and Section 4.

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CHAIR KITO recalled the earlier public comment about there being no distinction between a company with gross earnings of \$500,000 and profits of \$200,000 and a company with gross earnings of \$1 million and a profit of \$200,000 - they are two different types of companies, yet they would be taxed the same. He inquired whether the type of company activity was considered when identifying the amount of profit for taxes.

REPRESENTATIVE GARA responded that whether a company has high overhead with a gross income of \$1 million and a profit of \$200,000 or low overhead with a gross income of \$300,000 and a profit of \$200,000 - the company's profit is its profit. He said he didn't want to go to the point of taxing a company's gross income because gross income has no relevance to actual profits. He agreed the testifiers are right that both companies would pay the same tax if they have the same amount of profit. The bill, he explained, follows the current corporate tax rule, the C corporation tax rule, which is that no matter how much a company's gross income it is the profit that matters.

CHAIR KITO said he is trying to imagine the way corporations might be set up. For example, a larger corporation with higher gross [income] and higher expenses might have a larger number of shareholders, which means that that \$200,000 would be spread out among individuals so that each individual is not making much. He recalled an earlier comment about a limitation on the number of shareholders for eligibility or requirements to become a C corporation. He asked how many shareholders or partners there could be in a partnership before it would be required to file as a C corporation regardless.

REPRESENTATIVE GARA answered that two individuals setting up a very small business could decide to become a C corporation on their own, but right now they wouldn't because they would be subject to the C corporation tax. He said he used to think that to be a C corporation, a company had to be publicly traded; however, he offered his belief that someone could set up a C corporation with one shareholder.

CHAIR KITO clarified that that was not the question he was asking. He said he understands that a C corporation can have a single shareholder. Rather, he said, he is asking what the limit is before a company must file as a C corporation. For example, whether a company with 20 shareholders would have to be a C corporation, or whether a company with 100 shareholders

would have to be a C corporation, or whether an S corporation could have 1,000 shareholders.

REPRESENTATIVE GARA replied there is a limitation, a certain number of shareholders where a company would have to file as a C corporation. He offered his belief that this is why Alaska Native corporations file as C corporations. It is permissive for anybody to file as a C corporation, he continued, but at a certain number of shareholders it must be a C corporation although he doesn't know what that number is.

MS. CHARTIER stated her belief that 100 shareholders is the cutoff point between S corporation and C corporation. She suggested the bill's drafter, Emily Nauman, be asked to provide a definite answer at a future hearing.

CHAIR KITO calculated that if \$200,000 [in profit] were divided between 100 shareholders each shareholder would receive \$2,000 that would be subject to tax.

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REPRESENTATIVE WOOL suggested that maybe the origin of the \$25,000 increments in Section 2 is because the net profit for a corporation is divided among the shareholders, given that the language says "person" and the increments go up every \$25,000, which seems small for an oil and gas company.

REPRESENTATIVE GARA responded that the \$25,000 for the current corporate tax for C corporations is for the business itself. Under current law, he continued, if a corporation had 1,000 shareholders and only \$25,000 of profits, no individual shareholder would get much of a share and would not pay much of a tax. He said he is confident that even though the language states "person" the \$25,000 is for the business and that is why it is a much lower tax.

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CHAIR KITO announced that SSHB 36 was held over.

[4:38:44 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 4:39 p.m.