ALASKA STATE LEGISLATURE
SENATE LABOR AND COMMERCE STANDING COMMITTEE
April 25, 2017
9:03 a.m.

MEMBERS PRESENT

Senator Mia Costello, Chair
Senator Shelley Hughes, Vice Chair
Senator Kevin Meyer
Senator Gary Stevens
Senator Berta Gardner

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 115(FIN) AM(EFD FLD)
"An Act bearing the short title of the 'Education Funding Act'; relating to the taxation of income of individuals, partners, shareholders in S corporations, trusts, and estates; relating to a payment against the individual income tax from the permanent fund dividend disbursement; and repealing tax credits applied against the tax on individuals under the Alaska Net Income Tax Act."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 115
SHORT TITLE: INCOME TAX; PFD PAYMENT/CREDIT;
SPONSOR(s): FINANCE

02/10/17	(H)	READ THE FIRST TIME - REFERRALS
02/10/17	(H)	FIN
02/13/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
02/13/17	(H)	Heard & Held
02/13/17	(H)	MINUTE(FIN)
02/14/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
02/14/17	(H)	Heard & Held
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03/14/17	(H)	FIN AT 8:30 AM HOUSE FINANCE 519
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03/23/17	(H)	FIN AT 9:00 AM HOUSE FINANCE 519
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03/27/17	(H)	MINUTE(FIN)
03/28/17	(H)	FIN AT 9:00 AM HOUSE FINANCE 519
03/28/17	(H)	Heard & Held
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03/28/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
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04/04/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
04/04/17	(H)	-- MEETING CANCELED --
04/07/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
04/07/17	(H)	<Bill Hearing Canceled>
04/11/17	(H)	FIN AT 1:30 PM HOUSE FINANCE 519
04/11/17	(H)	Moved CSHB 115(FIN) Out of Committee
04/11/17	(H)	MINUTE(FIN)
04/12/17	(H)	FIN RPT CS(FIN) NT 4DP 4DNP 2NR 1AM
04/12/17	(H)	DP: GUTTENBERG, GARA, SEATON, FOSTER
04/12/17	(H)	DNP: TILTON, THOMPSON, PRUITT, WILSON
04/12/17	(H)	NR: GRENN, ORTIZ
04/12/17	(H)	AM: KAWASAKI
04/15/17	(H)	BEFORE HOUSE IN SECOND READING
04/16/17	(H)	TRANSMITTED TO (S)
04/16/17	(H)	VERSION: CSHB 115(FIN) AM(EFD FLD)
04/17/17	(S)	READ THE FIRST TIME - REFERRALS
04/17/17	(S)	L&C, FIN
04/24/17	(S)	L&C AT 1:30 PM BELTZ 105 (TSBldg)
04/24/17	(S)	-- MEETING CANCELED --
04/25/17	(S)	L&C AT 9:00 AM BELTZ 105 (TSBldg)

WITNESS REGISTER

REPRESENTATIVE PAUL SEATON
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: Sponsor of HB 115.

TANEEKA HANSEN, Staff
Representative Paul Seaton
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: Presented the sectional analysis for HB 115.

ACTION NARRATIVE

9:03:31 AM
CHAIR MIA COSTELLO called the Senate Labor and Commerce Standing Committee meeting to order at 9:03 a.m. Present at the call to order were Senators Gardner, Meyer, Stevens, Hughes, and Chair Costello. She said that during the economic hearings throughout the session the committee learned that Alaska is experiencing a recession and extensive job losses. Economists who presented information to the committee asked the legislature to help provide some certainty for moving forward. Using that presentation as a basis, the committee started asking what

impact each bill that was introduced would have on the state's economy.

HB 115-INCOME TAX; PFD PAYMENT/CREDIT;

9:05:08 AM
CHAIR COSTELLO announced the consideration of HB 115. She stated that the intent is to hear the introduction, walk through a sectional analysis, and hold the bill for further consideration. Public testimony will be heard during the 6:00 p.m. meeting. [CSHB 115(FIN)am(efd fld) was before the committee.]

9:05:48 AM
REPRESENTATIVE PAUL SEATON, Alaska State Legislature, sponsor of HB 115, explained that the bill creates a broad-based tax that is based on the adjusted gross income of residents and nonresidents. The revenue that is collected will flow into the Public Education Fund to fund the base student allocation (BSA) and pupil transportation. There is a $4,000 exemption for each resident filer and their dependents. Permanent fund income is also excluded from taxation. The tax brackets provide that each taxpayer pays the same tax rate on the first $50,000 of their adjusted gross income. Income from Sub S Corporations and partnerships is reported on the partner's or owner's individual return.

Withholding for the school tax would begin January 1, 2019 and the first return would be due in April 2020.

9:08:04 AM
REPRESENTATIVE SEATON stated that a broad-based tax is the last piece of a complete fiscal plan that will provide a stable and sustainable future. Uncertainty is bad for both the economy and Alaska's schools, but forward funding education eliminates some of that uncertainty. Adding a new revenue source also protects schools from uncertainty because diversifying revenues reduces volatility. Alaska has already experienced the growth and contractions that come from relying too heavily on one source of income. Drawing from multiple sources will help smooth the ups and downs.

The Education Funding Act is important for a fair and balanced plan. He pointed out that all fiscal plans before the legislature this session require some use of the Permanent Fund Earnings Reserve Fund and a reduction in the dividend. He noted that the latter is regressive and hurts the lowest-income Alaskans most. He opined that the school tax in HB 115 is the best broad-based tax to balance the reduction in the dividend. The sales tax option is also regressive and hits the lowest-income Alaskans twice. For example, a general sales tax would raise $500 million in revenue and Alaskans in the bottom 20 percent of income would feel a 2.2 percent impact on their overall income while the top 15 percent would contribute 0.9 percent and the top 1 percent would contribute just 0.4 percent.

REPRESENTATIVE SEATON posited that connecting Alaskans directly with state services through a broad-based tax will increase the awareness and participation in how state government revenues are used. A broad-based tax also directly connects the state with economic growth. There is currently no incentive for the state to encourage economic or population growth. One thousand new jobs means more students in the schools, more people driving on the roads, and more common state services. Without a broad-based tax, the state receives no revenue to help pay for the services needed for those additional people. That is a disincentive for economic growth, he said. If the state is connected to growth through a broad-based revenue source, the state will be incentivized to make choices that grow the economy. Most importantly, plans without a broad-based tax leaves a deficit of $500 million to be filled at some future time from new revenues, drastic budget cuts, or spending down our savings. Leaving this sort of uncertainty in place puts at risk the savings and services we would be preserving for future generations.

9:12:09 AM
REPRESENTATIVE SEATON spoke to the question of why the tax is based on the adjusted gross income. He pointed out that 29 other states use this as a starting point and Alaska did too from 1975 through 1980. Using a percentage of the federal tax liability as the starting point seemed like a good idea initially, but it is too volatile. Using the adjusted gross as the starting point avoids automatically adopting all the federal credits and deductions and allows Alaska to make those choices for itself. Also, all sources of income are treated equally in computing the adjusted gross income. This includes capital gains and wages. Calculating nonresident taxable income is simpler under adjusted gross income than under federal tax liability. This approach is Alaska specific. Specifically, the permanent fund dividend and Alaska municipal bonds are exempt from taxation. Most importantly, it is the purview of the legislature to define what is and is not taxable. That authority cannot be delegated to the administration. He said much of HB 115 is technical details telling the administration how to create regulations without imposing taxes.

REPRESENTATIVE SEATON discussed the history of tax in Alaska paraphrasing the following document:

> Before oil started flowing, Alaskans were accustomed to participating in their state economy through a structured tax program. The income and school taxes created stability for basic programs – education, health, public safety, infrastructure, and more.

- School tax implemented in 1949 during territorial days;
- Alaska Territorial Legislature also passed income tax in 1949 (in 11 days);
- Alaskans paid both taxes from 1949-1980;
- In 1975 the income tax had changed from 16 percent of federal tax liability to a tax with brackets from 3 to 14.5 percent;
- Alaska income tax provided 40 percent of all state revenue.

9:18:38 AM
REPRESENTATIVE SEATON stated that based on an effective date of January 1, 2019, the Department of Revenue estimates that the Education Funding Act will raise $341 million in FY2019 and $687 million in FY2020. Once the tax is fully implemented, approximately $80 million will be collected from nonresidents who work in Alaska. DOR estimates that administering the tax will cost between 1 percent and 1.5 percent of the total revenue raised.

He said the Education Funding Act is intended to be part of a larger fiscal plan that includes restructuring the permanent fund earnings and changing the calculation of the permanent fund dividend. Individuals and families in the lowest 20 percent of the income range will feel the reduction in the dividend the most, because it makes up a larger percentage of their income. Those in the higher income range will contribute a slightly higher percentage through the school tax, but will see a smaller impact through the change to the dividend. The higher income brackets will also see a larger offset in their federal tax liability. He directed attention to the chart on page 7 that illustrates that the lowest 20 percent of filers will feel about the same impact to their total income as the top 1 percent when the Education Funding Act is combined with HCS SB 26, the restructured PFD. Individuals in the lowest income brackets will be impacted more in the first few years because the dividend will change first, and the full year of income tax won’t be paid until 2020.

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REPRESENTATIVE SEATON highlighted that Alaska is the only state that doesn’t have some form of broad-based tax to support core state services. It is ranked 50 in state and local tax burden, but 10 in per capita income. Forty-one states have a statewide income tax and two have an income tax on interest and dividend income. The school tax in HB 115 would be the fourth lowest amount of tax revenue collected as a portion of total personal income. Alaska would rank 30 in the per capita revenue collected through this tax. The three states with lower tax rates than HB 115 proposes all have statewide sales taxes. North Dakota has a 5 percent state sales tax and a total state and local tax of 6.78 percent. Arizona has a 5.6 percent state sales tax and a total state and local tax of 8.25 percent. Louisiana has a 5.0 percent state sales tax and a total state and local tax of 9.98 percent. Alaska’s average local sales tax is 1.76 percent. Of the 6 other states with no income tax, all have a statewide sales tax. He reminded members that a sales tax is regressive and would disproportionately affect communities with a higher cost structure.

He said it’s difficult to quickly and accurately compare income taxes between states because of the differences in deductions, tax brackets, and credits. Some states also have income taxes at the local level. He directed attention to page 10 that shows that Hawaii does not adjust brackets for inflation, Ohio has additional income taxes at the local level that average 2.25 percent, Montana allows deductions for some federal taxes, and Kentucky does not adjust brackets for inflation but has additional income taxes at the local level that average 2 percent. He disputed the claim that the tax brackets proposed in HB 115 are the 12th highest marginal tax rate in the country. It ignores the fact that most states apply the top marginal rate after the first $10,000-$50,000. Thus, more people are paying the highest rate on a majority of their income leading to a higher effective tax rate.

REPRESENTATIVE SEATON offered more information on how different states create their brackets. Twenty-nine states use the federal adjusted gross, 14 states automatically adjust their brackets for inflation, 10 states double the bracket for joint filers, and 9 states increase but don't double joint filing. Nine states have a flat tax that applies to all taxable income between 3 percent and 5.5 percent. Most states start their tax brackets at zero and 30 states have a standard deduction. The proposed school tax in HB 115 does not have a standard deduction, but the first $10,300 is exempt and there is also a personal exemption. Four states have a tax benefit recapture that results in certain high-income taxpayers paying the top marginal rate on all their income. HB 115 has no such proposal.

9:30:24 AM
REPRESENTATIVE SEATON reported that Alaska Department of Labor and Workforce Development (DOLWD) 2015 statistics show that nonresidents comprised 21.3 percent of the total workforce and earned 16 percent of the total wages in the state. That means $2.7 billion in wages left the state that year. That doesn't include income from self-employed individuals and non-wage industries such as commercial fishing. DOR estimates that nonresidents will contribute about $80 million of the $687 million in revenue that is collected in FY2020.

He directed attention to a chart from Northern Economics that shows the projected job losses under three budget scenarios. He said the state has already lost jobs and any choice that is made to address the deficit will contribute to future job losses before state employment is forecast to recover. The question is how much. According to the analysis from Northern Economics, a cut to the permanent fund dividend or implementing a broad-based tax would have similar effects on the employment forecast. However, cutting the budget an additional $1 billion will have a far greater effect, even with the full projected dividend. Cutting the budget instead of using the dividend or a broad-based tax to fill the deficit would result in the loss of an additional 10,000 jobs before employment is projected to stabilize.

9:32:25 AM
REPRESENTATIVE SEATON displayed the chart on page 13 that shows the impact of different cuts on Alaska's workforce. He said that according to the Institute of Social and Economic Research (ISER), every $100,000 million of deficit reduction will have the following impact on jobs: initiating an income tax will result in the loss of 450-800 jobs; cutting the dividend will result in the loss of 558-892 jobs; cutting the budget will result in the loss of 980-1260 jobs; and cutting the state workforce will result in the loss of 1,400-1,600 jobs. The ISER report also indicates that 3 private sector jobs will be lost

for every 2 state employees that lose their job due to budget cuts.

He noted that the income losses are similar for each of the choices.

9:33:47 AM
REPRESENTATIVE SEATON displayed the IRS form 1040 on page 14 to illustrate how the Alaska tax would be calculated. Filers start with the adjusted gross income on line 37, deduct the $4,000 per person personal exemption, and enter the adjustments for taxable income or nontaxable municipal bonds on lines 8a and 8b.

REPRESENTATIVE SEATON concluded his presentation emphasizing the importance of adopting a complete fiscal plan this year, because failing to do so creates uncertainty. Until Alaska shows it has a balanced and sustainable budget, credit rating agencies may continue to downgrade the state's standing. The intended implementation date of HB 115 is January 1, 2019, which provides time for other parts of the fiscal plan to be put in place. "We cannot afford to wait one more year."

9:36:40 AM
CHAIR COSTELLO asked Ms. Hansen to walk through the sectional analysis for HB 115.

9:33:14 AM
TANEEKA HANSEN, Staff, Representative Paul Seaton, Alaska State Legislature, spoke to the following sectional analysis for CSHB 115:

> **Section 1** (page 1, line 7) – Clarifies that this Act may be known as the Education Funding Act.
>
> **Section 2** (page 1, line 10) – Legislative intent language outlining what income level for an individual or a couple is considered exempt from this income tax.
>
> **Section 3** (page 2, line 8) – AS 43.05.045(a) clarifies that there is a penalty if a state return is not filed electronically. However, individual filers are exempt from this penalty as noted later in AS 43.22.075(i) – (see page 19, line 25).
>
> **Section 4** (page 2, line 18) – Creates the Individual Income Tax within AS 43.22

Sec. 43.22.010 (page 2, line 20) **–** Imposes a progressive income tax on residents and nonresidents on their taxable income. Taxable income, defined later in this chapter, is based on federal adjusted gross income with some state specific modifications. Residents are taxed on all taxable income, while nonresident individuals will be taxed on income from a source within the state.

Subsection (b) outlines the income tax brackets for an individual.

Subsection (c) outlines the income tax brackets for two individuals who file jointly; those who are eligible to file a joint *federal* income tax return are eligible to file jointly in the state. Under subsection (d) and (e), those that are eligible to file a joint return federally but do not do so are directed how to file on the state level.

Subsection (f) describes how two individuals who filed a joint federal return but who are not both residents of Alaska shall file with the state. They may choose to file separately, as nonresidents, under the tax brackets described in (b) of this section, or they may elect to file jointly under the brackets in (c) but only if both choose to be taxed as residents.

Sec. 43.22.015 (page 4, line 4) – Describes how a nonresident individual will determine their Alaska state income tax due. Their tax is determined on all of their taxable income, using the brackets in 43.22.010(b). That tax is then reduced by a ratio based on how much of the nonresident's taxable income is from a source within the state. [Nonresidents who choose to file jointly are not eligible to use this allocation of income, and are instead considered as residents.]

9:39:56 AM

Sec. 43.22.020 (page 4, line 20) –Defines the tax on trusts and estates. Trusts are taxed at the same rates as an individual under the income tax brackets in 43.22.010(b), except that the first $10,300 is not exempt as it is for an individual. Nonresident trusts are taxed on Alaska source income. Alaska Native Settlement trusts receive alternative federal tax treatment and are taxed at 2.5% by this state income tax. Trusts that are not taxed federally, including union pension trusts and charity trusts, are not taxed under this chapter. Disability trusts are also exempt from state taxation.

Sec. 43.22.025 (page 5, line 31) – Provides a credit to residents for taxes paid to another state based on income earned in that other state (ensuring a resident is not taxed twice on the same income). A credit for income taxes paid in another state cannot reduce the tax due to Alaska below what it would have been if the out-of-state income was never included in the calculation of the tax due. This means that regardless of the amount of income tax the resident paid in other states, the credit cannot reduce the amount of income tax due to Alaska below what the resident individual would owe on just the income that is not taxed by other states.

9:45:34 AM

Sec. 43.22.030 (page 7, line 12) - Defines the income that is considered taxable income under this chapter. This is based on the federal adjusted gross income with a few specific items added and subtracted. Specific to Alaska, this section allows a per person exemption of $4000 and also allows the permanent fund dividend to be deducted from state tax. Alaska municipal bonds will also not be taxed.

Items added into federal adjusted gross income include: interest and income from state and municipal bonds and certain United States bonds which are not taxed by the federal government but which are taxable by the states; deductions from federal adjusted gross income for Alaska income taxes (normally deducted *after* adjusted gross income); gain from a trade of like-kind properties which is not federally recognized or taken as a gain; income from an incomplete non-grantor trust; and any deductions allowed to federal adjusted gross income which relate to income that is not being taxed under this chapter, including deductions for losses on Alaska municipal bonds.

Items subtracted from federal adjusted gross income include: interest or income from federal bonds which are not legally taxable by the states; refunds for overpayment of an income tax; expenses that are not deducted from federal adjusted gross income but that relate to income taxed under this chapter; a gain from a trade of like-kind properties that *is* federally recognized as a gain; gains on Alaska municipal bonds which are not taxed under this chapter; nonresident pension income under 4 U.S.C. 114; military compensation for nonresidents; and the permanent fund dividend

9:47:04 AM

MS. HANSEN noted there is a small typo in this section. The subsections weren't all renumbered after an amendment was adopted on the House floor. She clarified that it is subsection (c) that deals with the personal exemption.

Subsection (b) allows an exemption of $4000 per individual claimed as an exemption on the federal income tax forms. For non-residents the exemption is $4000 per individual claimed times the fraction used to determine the non-resident's taxes due.

Subsection (c) states that expenses not used in the tax year they were incurred may not be carried back to previous year returns, and may only be carried forward for a total of five years.

Sec 43.22.035 (page 10, line 8) - Describes how income from a partnership or an s-corporation shall be adjusted based the additions and subtractions of taxable income under 43.22.030. Subsection (c) states that if partnership income is allocated with the specific purpose of evading taxes, that allocation shall be disregarded.

9:50:23 AM

Sec. 43.22.040 (page 11, line 1) - Describes how income from a trust or estate shall be adjusted based on the additions and subtractions of taxable income under 43.22.030. Taxable income is reduced by the amount distributed to the beneficiaries, in accordance with U.S.C. 661. The Department of Revenue may determine in regulation how the adjustments to income will be allocated between the trust or estate and the beneficiary of that trust or estate. Subsection (b) states that if income or loss is distributed with the specific purpose of evading taxes, that distribution shall be disregarded.

Sec. 43.22.045 (page 11, line 15) –Identifies items of income that are considered as being derived from or connected with a source in the state. This is the income on which nonresidents will be taxed.

Sec. 43.22.050 (page 15, line 26) – Directs the Department of Revenue to create regulations determining what is considered income from a source in the state for business conducted by a nonresident individual, partnership, or s-corporation. The regulations must be consistent with AS 43.19, the multistate compact. This provision will allow the department to create regulations to allocate what income is taxable under this chapter when an out of state business is conducting business both in and out of state.

Sec. 43.22.055 (page 16, line 12) – Directs the department to create regulations to detail what income from a nonresident trust or estate is considered derived from or connected with a source within the state. These regulations shall be consistent with AS 43.22.045, which identifies income from a source within the state.

Sec. 43.22.060 (page 16, line 30) – Provides that the taxable income for a part-year resident, trust, or estate shall be the sum of *all* taxable income associated with the part of the year that the individual or entity was a resident of Alaska and the income from a source in the state for the part of the year that the individual or entity was not a resident of the state.

Sec. 43.22.065 (page 17, line 12) – In the case of a personal service corporation formed to evade taxes, the department may allocate the income between the personal service corporation and the employee-owners if necessary to accurately reflect the source of the income.

9:54:16 AM

Sec. 43.22.070 (page 18, line 9) – States that a taxpayer's taxable year and method of accounting for the state income tax shall be the same as for the taxpayer’s federal income tax. The department shall adopt regulations addressing situations where a taxpayer changes methods of accounting. [For most individuals, the taxable year is the calendar year. However, entities such as partnerships that file an individual income tax return may use a fiscal year in place of a calendar year, and may have different methods of accounting for their income.]

Sec. 43.22.075 (page 18, line 18) **-** Establishes how taxpayers will submit tax returns and make payments for the individual income tax. It clarifies that this tax is due and payable to the department at the same time and in the same manner as the tax payable to the U.S. IRS for federal taxes. The section also outlines procedures in case there are changes to the taxpayer’s federal income tax return. Any overpayments will be reimbursed by the department out of the general fund. As noted above, (i) exempts an individual from the penalty for not filing their income tax electronically. However, a person paid to file returns is not exempt, and must file electronically.

Sec. 43.22.080 (page 19, line 31) - Establishes how taxes will be withheld by employers making payment of wages or salaries. The employer shall deduct and withhold the amount of tax, remit the tax to the department, and provide a written statement to the employee by January 31 of the succeeding year showing the amount deducted and other necessary information, similar to the federal W2. The Department of Revenue shall publish the rate of withholding required by this section.

Sec. 43.22.085 (page 20, line 24) – Partnerships that are required to file an annual return with the federal government shall also file a partnership return with the Department of Revenue, and shall withhold income tax from a nonresident partner. Publically traded partnerships are not required to withhold.

Sec. 43.22.090 (page 21, line 13) – Allows a resident the option to apply some or all of their PFD as a refundable tax payment to their upcoming state income tax due, less any garnishment, levy, donations to Pick Click Give or college funds, etc., as allowed under other sections of statute. For example, a person may apply some or all of their 2018 PFD to their 2018 taxes due. If a person's Refundable Tax payment of their dividend is more than the amount of their state income tax due, any remaining amount will be reimbursed to the person as a tax refund, after the person has filed their state income taxes.

9:59:14 AM

Sec. 43.22.095 (page 21, line 23) - Authorizes the department to create all necessary forms and adopt regulations to implement this tax, including regulations for online filing and online payment and prepayment of taxes due, and forms for itemizing deductions. This section allows the department to adopt Internal Revenue Code regulations, as long as they do not conflict with this chapter.

Subsection (b) clarifies that transactions or payments between related parties must have a reason other than the purpose of lowering taxes. The department may determine and adjust the tax due on such a payment as necessary.

Subsection (d) directs the department to adjust the tax brackets and the personal exemption every two years, based on the Anchorage rate of inflation.

Subsection (e) allows that the legislature may deposit the estimated income collected under this chapter into the public education fund.

Sec. 43.22.100 (page 22, line 31) - allows the provisions of the Internal Revenue Code that are mentioned in this chapter to be considered as if they are fully set out and defined in the chapter itself, unless the provision is inconsistent with the chapter. Allows the department to adopt by reference certain IRS penalties for violations of this chapter.

Sec. 43.22.110 (page 23, line 15) – Allows certain tax information to be released to a banking institution for the purpose of verifying a direct deposit of an income tax refund.

Sec. 43.22.150 (page 23, line 19) – Defines terms used in this chapter. Key terms include 'domiciled', 'resident', and 'resident trust'. Resident is defined as an individual who: lives in the state for the entire calendar year; receives an Alaska permanent fund dividend; or receives a tax benefit such as a property tax exemption only available to a resident individual.

Section 5 (page 26, line 28) – AS 43.23 is amended by adding a new section which directs the Permanent Fund Division in the Department of Revenue to create a place on the PFD application where an applicant may apply some or all of their PFD to their upcoming state income tax due.

Section 6 (page 27, line 2) - AS 43.05.085, AS 43.20.012(b), and AS 43.20.013, a former tax credit for political contributions that existed under Alaska's prior individual income tax which ended in 1980, are repealed on January 1, 2019.

10:04:20 AM

Section 7 (page 27, line 3) - Clarifies that the state income tax created under section 4 of this act only goes into effect starting on January 1, 2019, and will not be applied to any income earned prior to that date.

Section 8 (page 27, line 7) – Authorizes the Department of Revenue to adopt regulations to implement the act, but not before the effective date of the law implemented by the regulation.

10:05:14 AM

CHAIR COSTELLO thanked Representative Seaton and Ms. Hansen, and asked members if they had questions.

SENATOR GARDNER asked Representative Seaton for a copy of his opening comments.

REPRESENTATIVE SEATON agreed to provide it to the chair for distribution.

10:05:57 AM

SENATOR GARDNER said she assumes that his statement that the first $50,000 of income would be taxed at the same rate means the adjusted gross income after the deductions.

REPRESENTATIVE SEATON said yes. The point is that everyone in the same bracket is taxed at the same rate. He added that it's a complex bill but not a complex calculation. Much of the bill gives detailed instructions to the Department of Revenue on implementing regulations.

SENATOR GARDNER referenced page 7 of the presentation and questioned the $300 reduction to the permanent fund dividend.

REPRESENTATIVE SEATON clarified that is an estimate for 2023. Modeled in a tax year 2016 economy, the dividend payout is estimated to be $1,700. The difference between that number and the dividend this year is $300.

MS. HANSEN added that the packet has the full report from the Institute on Taxation and Economic Policy that shows a greater change between next year and 2023. Over time, however, the difference is reduced, and the 2023 estimate is $1,700.

SENATOR GARDNER asked if any states collect tax on income earned in another state. For example, could her husband's nonresident business partner pay income tax on the Alaska earnings to both Alaska and his home state?

REPRESENTATIVE SEATON explained that the Interstate Compact allows a credit when income is taxed in both states so there isn't a double payment.

10:13:20 AM
SENATOR STEVENS asked how much it would cost to manage the tax system with 120 employees.

REPRESENTATIVE SEATON clarified that there would be 60 employees, not 120. The initial implementation cost is $14 million and DOR estimates that total administrative costs will be 1 percent to 1.5 percent. Starting with the adjusted gross income that is reported on the federal 1040 form is financially advantageous to the state because the Internal Revenue Service audits those numbers.

SENATOR STEVENS asked if it's reasonable to assume that 60 employees can administer the tax system when Montana employs 155 people for that purpose.

MS. HANSEN suggested that DOR could speak to the question in detail this afternoon, but her understanding is that that

Montana’s entire tax division employs 155 people. Alaska already has an established tax division and DOR estimates it will only need an additional 60 people to administer the income tax.

SENATOR STEVENS referenced Section 7 and asked if retirement income will be taxed.

MS. HANSEN explained that retirement, Social Security, and pension income that is reported and taxed at the federal level will be taxed on the state level.

REPRESENTATIVE SEATON added that pension and annuity income is entered in box 16(a) of the federal 1040 form and the taxable amount is reported on line 16(b). Social Security benefits are entered in box 20a and the taxable amount is entered on line 20b. Those amounts are part of the calculation of adjusted gross income on the federal level, so they aren’t reported separately on the state form.

SENATOR MEYER said he agrees with Senator Stevens that 60 people probably wouldn’t be enough to administer an income tax. He pointed out that the state is six or seven years behind on the audits for the more complicated oil and gas taxes.

He asked why it isn’t preferable to simply pay a state tax based on a percentage of the federal tax.

REPRESENTATIVE SEATON said his office looked at that approach initially, but it is more complicated and potentially more volatile. Years ago, many states, Alaska included, based their state tax on the federal tax due but none do that now. Now most states use adjusted gross income as the starting point for calculating the state tax.

SENATOR MEYER commented, “It’s a shame we can’t do something simple like just a certain percent. I think accountants are going to love your income tax bill because we’re going to have to hire more accountants.” He recalled that the governor’s income tax bill last year—which was a percentage of the federal tax—was estimated to generate about $400 million, whereas HB 115 is estimated to collect about $700 million. He said the largest fear his constituents have is that the income tax will continue to rise.

SENATOR MEYER continued:

As you know, in the Senate we don't believe we need $700 million with the PFD restructured—Senate Bill 26—at $2 billion, and approximately $300 million in cuts, you're at 2.3 and your deficit's 2.7 so under your income tax proposal we'd be collecting approximately $300 million more than we need. I think that's a concern of people too. Are we going to now suddenly go back to our old habits of spending more money? Whereas, again, in the Senate we like that little bit of deficit, whether it's $300 million or $500 million. It keeps the pressure on us to keep spending down. When you've got $4 billion in your CBR [Constitutional Budget Reserve] you can get away with that for quite some time and maybe hold off on an income tax, hold off on taking money from our constituents as long as possible, because it does have an impact to our constituents and to the economy.

I think that's why we're having difficulty with an income tax proposal and, frankly, it's very inefficient. We're going to give people, under your proposal, a dividend of $1,200 and then take it back via an income tax. I have so many constituents say, 'Look, if you need more money just reduce the dividend down to $800' rather than hiring another 60, 70, 80 state employees to collect the tax from working Alaskans.

I don't know if there's a question in there. It's more a philosophical difference we have in the need for an income tax.

He asked to hear the sponsor's response.

REPRESENTATIVE SEATON clarified that the governor's income tax was $200 million; it was calculated to fill a specific hole in the budget that wasn't filled by the nine other targeted taxes. Doing just an income tax instead of targeting individual industries spreads the burden wider. He pointed out that it costs the same to administer a $650 million tax as a $200 million tax, so collecting the smaller tax is less efficient. He reiterated that this tax is not complicated; it starts with the federal adjusted gross income so most of the calculations are already done. He again directed attention to the tax calculator on the majority website that quickly tells your tax. TurboTax and other tax software also automatically calculates state taxes, he said. Individuals who have income reported on a federal form 1099 would need to send a copy of that 1099 to the state.

SENATOR MEYER maintained that it wouldn't be the same as the federal income tax. For example, he said, the PFD isn't taxed at the state level, but it is at the federal level.

REPRESENTATIVE SEATON clarified that the calculator on the House and Senate majority websites automatically removes the PFD and the $4,000 personal exemption.

SENATOR HUGHES asked how many Alaskans would pay this state income tax.

MS. HANSEN said that in tax year 2014 about 500,000 single and joint returns were filed, but some of those had no tax liability due to the child tax credit and the earned income credit. She opined that most of the filers that would be required to file under the state income tax would pay a small portion.

SENATOR HUGHES offered her understanding that approximately 330,000 returns are filed and that not all the joint returns have two incomes. She maintained that it's a misnomer to call this a broad-based tax if fewer than 400,000 returns are filed. She asked if the calculations account for outmigration, because other states have experienced population loss when an income tax was implemented. That's a concern because the ratio of workers to nonworkers would become skewed, she said.

10:31:45 AM
REPRESENTATIVE SEATON said the calculations in the fiscal note were done by the Department of Revenue (DOR). He pointed out that just six states don't have a state income tax, and all other jurisdictions have a higher tax burden than what HB 115 proposes.

SENATOR HUGHES responded that things like cost of living are also factored into the decision to move.

She asked if he'd looked at the economic impact that HB 115 will have on small businesses. "They're the backbone of our communities so I'm concerned about that," she said.

REPRESENTATIVE SEATON said they've looked at studies from ISER, Northern Economics, and others that say that this is the lowest job loss option to close the deficit. Also, the packets contain the report released yesterday from the Institute on Taxation and Economic Policy titled "Comparing the Distributional Impact of Revenue Options in Alaska." He said a lot of people have the idea that they'll pay state taxes starting with dollar one, but that's not accurate. A single person will start paying after approximately the first $15,300 and a couple filing jointly will have a tax exemption for the first $31,000. He reiterated that people who use the tax calculator on the majority websites realize that the tax burden isn't as large as they imagined. However, he said, people in the million or multimillion dollar income bracket will have a higher tax burden. He encouraged members to read the report, describing it as good information on how to generate $500 million to reduce the deficit. It finds that low- and middle-income families would be better off under a progressive personal income tax than any other option examined in the report.

10:37:30 AM
SENATOR HUGHES said her concern is that most people are in that middle income, so the tax will hit a lot of people. She then questioned why a single adult with an adjusted gross of $75,000 and two dependents pays more than a couple filing jointly with the same adjusted gross and same number of dependents.

REPRESENTATIVE SEATON said it's set up on the individual basis, so there is no advantage to filing jointly. In that scenario the single return has three family members and the joint return has four family members. The single return has one less $4,000 exemption and one less $1,250 PFD exclusion so the income bracket is higher.

SENATOR HUGHES expressed concern about single parents paying more.

CHAIR COSTELLO held HB 115 in committee.

10:39:15 AM
There being no further business to come before the committee, Chair Costello adjourned the Senate Labor and Commerce Standing Committee meeting at 10:39 a.m.