

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

April 25, 2017

1:32 p.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

**OTHER LEGISLATORS PRESENT**

Senator Cathy Giessel  
Representative Dan Saddler

**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

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03/14/17	(H)	FIN AT 8:30 AM HOUSE FINANCE	519
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 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)  
 04/25/17 (S) Heard & Held  
 04/25/17 (S) L&C AT 1:30 PM BELTZ 105 (TSBldg)

**WITNESS REGISTER**

KEN ALPER, Director  
 Tax Division  
 Department of Revenue  
 Juneau, Alaska

**POSITION STATEMENT:** Delivered a PowerPoint titled "New Sustainable Alaska Plan Pulling Together to Build Our Future" during the hearing on HB 115.

JERRY BURNETT, Deputy Commissioner  
 Office of the Commissioner  
 Department of Revenue (DOR)  
 Juneau, Alaska

**POSITION STATEMENT:** Answered questions and provided information related to HB 115.

**ACTION NARRATIVE**

[1:32:20 PM](#)

**CHAIR MIA COSTELLO** called the Senate Labor and Commerce Standing Committee meeting to order at 1:32 p.m. Present at the call to order were Senators Gardner, Stevens, Hughes, and Chair Costello. Senator Meyer arrived soon thereafter.

**HB 115-INCOME TAX; PFD PAYMENT/CREDIT;**

[1:32:59 PM](#)

CHAIR COSTELLO announced the consideration of HB 115. She advised that she asked the Department of Revenue to focus their presentation on three areas: 1) how the income tax would be implemented, 2) the fiscal notes associated with the tax, and 3) the revenue projections.

She welcomed Senator Giessel and Commissioner Hoffbeck.

[1:34:32 PM](#)

KEN ALPER, Director, Tax Division, Department of Revenue, Juneau, delivered a PowerPoint titled "New Sustainable Alaska Plan Pulling Together to Build Our Future." He advised that earlier today the Chair asked him to start with a brief synopsis of the origin of the language in the bill and DOR's role in developing that language.

He explained that the income tax bills last year were tied to federal liability, but, as other states have recognized, that approach has structural problems. When DOR started to prepare bills for this session, he asked the Department of Law (DOL) to shift the basis to adjusted gross income. Because there was no internal expertise, DOL contracted with Professor Pump, an expert on state and local taxation from the University of Connecticut. For a contract fee of \$85,000, he delivered a draft income tax bill based on adjusted gross income. When the governor chose not to introduce an income bill this session, DOR asked Representative Seaton and the House Finance Committee if they wanted to use this technical language in their bill. They chose to incorporate it. He described HB 115 as a hybrid that marries the House Finance Committee's tax tables, revenue goals, and ideas about exemptions with the technical language that Professor Pump developed on how to tax based on adjusted gross income.

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SENATOR MEYER joined the committee.

1:37:16 PM

MR. ALPER said the bill proposes a bracketed tax on Alaska taxable income. Speaking to the following charts, he explained that the numbers in the left columns represent income before both the \$4,000 individual deduction and the \$1,250 baseline PFD exemption. A filer who has an adjusted gross of \$10,300 would have zero state tax liability. A filer who has an adjusted gross of \$10,300 - \$50,000 would pay 2.5 percent of the amount over \$10,300. Therefore, an individual with an adjusted gross of \$50,000 would pay 2.5 percent of \$39,700 or \$992.50. The tax liability steps up for each bracket until the individual who earns more than \$250,000 pays \$10,992.50 plus 7 percent of the amount over \$250,000. The brackets are doubled for joint filers, but the tax rates remain the same.

Single Filer or Non-Resident Income	Tax
Below \$10,300	\$0
\$10,300 - \$50,000	2.5 % of amount over \$10,300
\$50,000 - \$100,000	\$992.50 + 4% of amount over \$50,000
\$100,000 - \$200,000	\$2,992.50 + 5% of amount over \$100,000
\$200,000 - \$250,000	\$7992.50 + 6% of amount over \$200,000
\$250,000 or more	\$10,992.50 + 7% of amount over \$250,000

Joint Filer Income	Tax
Below \$20,600	\$0
\$20,600 - \$100,000	2.5 % of amount over \$20,600
\$100,000 - \$200,000	\$1985 + 4% of amount over \$100,000
\$200,000 - \$400,000	\$5,985 + 5% of amount over \$200,000
\$400,000 - \$500,000	\$15,985 + 6% of amount over \$400,000
\$500,000 or more	\$21,985 + 7% of amount over \$500,000

MR. ALPER referenced Senator Hughes' question from this morning and described the "marriage bonus" embedded in the bill. A single filer who marries someone without an income will pay a lower tax as a joint filer. He described the three goals of the marriage triangle for income taxes: 1) the tax rate rises as income levels rise; 2) prevent a marriage penalty or bonus; and

3) the stay-at-home-spouse penalty or bonus. Mathematically it's only possible to accomplish two of the three goals and HB 115 does so. It is a progressive tax and there is no stay-at-home-spouse penalty.

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MR. ALPER discussed the revenue impact of HB 115 outlined on slide 3. DOR estimates that \$341 million will be collected from withholding in the second half of FY2019. This assumes an effective date of January 1, 2019, although the bill passed the House with a failed effective date. Tax returns will not be filed until April 2020.

DOR estimates, based on modeling using aggregated federal income data for Alaska residents, that \$687 million in revenue will be collected in FY2020.

CHAIR COSTELLO asked how he came up with those estimates because she doesn't believe it's possible to know how much will be raised until the tax is instituted.

MR. ALPER said DOR has IRS aggregate information on Alaska filers from 2014. DOR therefore knows how many joint filers there were in Alaska, how many had incomes of \$50,000 - \$100,000, and the total taxes they paid to the federal government. "At that level of granularity, we could break it out to the expectation of how people will be filing this state tax and make certain assumptions, and get reasonably accurate information." Adjustments have been made to the baseline data to account for known changes such as high unemployment and layoffs in certain sectors. Normal inflation and economic background growth are also added to the estimate.

CHAIR COSTELLO opined that 2014 is quite a lookback considering the significant job losses and recession the economy has undergone in the last year. The public should know that these are guesses as much as anything because the information isn't current. "We're in uncharted territory," she said.

MR. ALPER argued that there is surprising stability in the underlying income figures and that adjustments can be made for changes in both the employment rate and wages.

CHAIR COSTELLO asked if nonresident workers are figured into the estimate.

MR. ALPER said there is considerable data on the number of nonresident workers and where they fit on the income scale. He explained the basic math and advised that the most accurate estimate in the first year is that \$84 million will be nonresident income taxes.

CHAIR COSTELLO said the sponsor's statement that it will take Alaskans about a minute to figure out their state tax liability is probably not the case.

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MR. ALPER said more and more taxpayers use tax software or a professional to prepare their return. The state tax is typically a one button add on, which takes just seconds to run the calculation. The tables on slide 2 are similarly simple and easy to use. It gets complicated for the multi-state filer, but those are the more complex taxpayers that tend to already have professional assistance with their taxes.

SENATOR HUGHES asked if the adjustments to the 2014 data account for: 1) the 4,000 higher wage jobs lost in the oil and gas industry, and 2) outmigration that has happened in other states that instituted an income tax.

MR. ALPER confirmed that oil industry adjustments have been incorporated into the baseline data, and that the bill accounts for future population. It does so by assuming a percentage of underlying growth and the drag factor that's created when taxes rise.

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SENATOR HUGHES asked if the administration did an economic analysis of how Professor Pomp's proposal would impact the economy, particularly small businesses.

MR. ALPER said several different analyses of the potential impacts on the economy have been done in the last year and the committee will be hearing from those entities. Professor Pomp was told that the income tax was to raise X dollars. His specific expertise was to provide language to ensure that everyone was accounted for and that people couldn't avoid taxes by moving their money around and hiding it through different shell transactions. The fact that this is a \$680 million bill is a decision that was made in the House, not by Professor Pomp and his language.

[1:51:59 PM](#)

SENATOR HUGHES asked if any modeling was done to see how small businesses would be affected by the proposed income tax. She shared that a lot of small businesses and S Corporations have voiced concern with the bill and she is likewise concerned.

MR. ALPER said he appreciates the concern, but the latest study from the Institute on Taxation and Economic Policy (ITEP) shows that middle income people pay less under this type of tax than under a sales tax that raises the same amount of money. He reminded members that the proposed tax is tied to adjusted gross income in total. The things that feed into [line 37 on IRS form 1040] include wages, S Corporation distributions, partnership income, sole proprietor income, and retirement income that is taxable. This mix of these business and wage incomes provides an Alaska-specific data set.

CHAIR COSTELLO welcomed Representative Dan Saddler.

She asked Mr. Alper to continue the presentation.

[1:53:51 PM](#)

MR. ALPER referenced the revenue summary on slide 3 and advised that DOR's fiscal note shows revenue increasing to a little over \$700 million in FY2023. He said that slides 4-6 use federal data and extrapolate it to Alaska-specific numbers. The chart on slide 4 shows how the 230,000 returns fall into the income chart after adjusting for the \$4,000 personal deduction. Individuals making less than \$50,000 will have an average tax liability of \$407. The average taxpayer making \$50,000-\$100,000 will have an average tax liability of just less than \$1,800. He noted that the \$60,000-\$70,000 income range is the crossover point where the tax exceeds the PFD. By comparison, the 110 single resident taxpayers with over \$1 million in income would pay the state an average of a little more than \$152,000. After further analysis DOR estimates that 35-40 percent of the total tax receipts will come from households earning more than \$250,000/year.

CHAIR COSTELLO asked if taxpayers would be required to indicate in advance that they want to pay some of their tax liability with their dividend.

MR. ALPER replied there is a calendar issue because the dividends come out in October and taxes are due in April of the next year. Individuals would need to pre-pledge before they receive their dividend.

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SENATOR HUGHES asked if 230,106 is the total number of non-joint returns.

MR. ALPER said yes.

SENATOR HUGHES said this doesn't reflect the sponsor's statement this morning that about 500,000 Alaskans would be paying.

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MR. ALPER directed attention to slide 5 that shows that another [128,220] returns will be filed by joint filers. The total of single and joint returns is just less than 360,000 tax returns. The joint returns do not reflect the second adult. That would bring the total to about 490,000 filers and then the children would be added. The expectation is that nearly every Alaskan will file a tax return, although a portion will have zero tax liability.

He said the question asked this morning is best addressed by looking at the zero brackets in the charts on slides 4 and 5. About 88,000 returns—or 20-22 percent of taxpayers—will have zero tax liability. Keeping that number as low as possible was part of the reason for basing the tax on the adjusted gross income. He noted that the original version of this bill had a minimum tax level where everyone would have paid at least \$25. "These are important conversations," he said, "because it's widely understood that a broad-based tax means everyone should participate in the cost of government."

CHAIR COSTELLO reminded Senator Hughes that the committee heard this morning that no state in the nation calculates its income tax as a percentage of the federal tax. It's not only unpredictable but the federal government may stop allowing a deduction for state tax. The point was well made, she said.

SENATOR HUGHES calculated that about 400,000 would pay.

MR. ALPER said there are about 400,000 adults in the state and roughly 20 percent of the filers will pay zero tax.

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SENATOR MEYER recalled that he told Senator Gardner that 35-40 percent of the tax receipts would come from filers with incomes of \$200,000 and higher.

MR. ALPER clarified that he said \$250,000 and higher.

SENATOR MEYER calculated that 60-65 percent of the tax receipts would come from incomes below \$250,000.

MR. ALPER agreed with the calculation. He further calculated that 60 percent of 400,000 filers represents 240,000 households that in aggregate would pay about \$400 million. He said those non-wealthy Alaskans would pay a substantial tax but still smaller than the overall average. He posited that most million-dollar income earners who pay \$150,000 to the state itemize. They are paying federal income tax at the 40 percent marginal tax rate, so the \$150,000 they're paying the state only costs them \$90,000; \$60,000 will come off their federal taxes.

SENATOR MEYER asked if the implication is that people who make \$250,000 and above are wealthy and people making less than \$250,000 are not wealthy.

MR. ALPER said no; DOR was asked to do this analysis using \$250,000 as a threshold in another context in another bill. He described Representative Clamen's tax bill that has a maximum tax of \$8,000 for filers making more than \$250,000. That bill tracked HB 115 up to the \$250,000 level, but it brought in less revenue from the higher income individuals.

SENATOR HUGHES admitted that she was stuck on the number of payers. She reviewed her calculations and concluded that "there's a considerable number of adults who would not be paying."

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MR. ALPER said the graphs on slides 4 and 5 indicate that 360,000 taxpayers represent about 490,000 adults, and that 80 percent of those adults will pay something to the state. He couldn't say how many adults pay nothing because they are below an income threshold or some other reason.

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CHAIR COSTELLO asked him to walk through (for the individuals listening online) the number of returns for each income level shown on slide 5.

MR. ALPER stated that the 17,071 joint filers who make less than \$20,600 would have zero tax liability. The 62,208 households in the \$20,600-\$100,000 income range have a 2.5 marginal tax rate; the average tax liability per return is \$971. The 37,127 households in the \$100,000-\$200,000 income range have a 4 percent marginal tax rate; the average tax liability per return

is \$3,608. The 8,032 households in the \$200,000-\$400,000 income range have a 5 percent marginal tax; the average tax liability per return is \$9,853. The 2,031 households in the \$400,000-\$500,000 income range have a 6 percent marginal tax; the average tax liability per return is \$18,862. The 1,230 households in the \$500,000-\$1,000,000 income range have a 7 percent marginal tax; the average tax liability per return is \$36,096. The 520 households in the \$1,000,000 and over income range have a 7 percent marginal tax; the average tax liability per return is \$145,933.

He said it's important to note that the bracket that has the highest number of joint filers does not generate the highest amount of revenue. The 62,208 joint filers in the second bracket generate just \$60 million. The filers in \$100,000-\$200,000 bracket generate the most revenue at \$134 million. The joint filers in the \$1 million plus bracket generate \$76 million, or roughly 11 percent of the total income tax. Combined with single filers in the \$1 million plus bracket brings the total revenue to \$93 million or 14 percent of the total revenue.

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SENATOR STEVENS said his concern is that there may be a tipping point at which time people living on a fixed income may begin to leave when they retire. That's what they did in the 1970s. He asked Mr. Alper to reflect.

MR. ALPER opined that the higher cost of living and higher income levels balance out, and wherever retirees move is likely to be a higher tax jurisdiction. Washington state, for example, doesn't have an income tax but the state sales tax is 10 percent. Another factor is that not all retirement income is taxed. For example, a lower income senior won't see much of their Social Security reflected in their adjusted gross income. "Very little of the fixed income of seniors—if they truly are lower income/fixed income—is going to actually be taxable. Quite likely, that's where a lot of the zero filers are going to come into this equation," he said.

CHAIR COSTELLO asked how seniors living in assisted living homes who pay \$5,000-\$7,000 monthly will be affected by HB 115. "Are you aware of that or do you think we'll hear this evening during public testimony?"

MR. ALPER said he looks forward to hearing testimony about that, but people who are paying those fees out of pocket aren't

exceedingly low income. Also, anyone living in subsidized housing wouldn't pay tax on that subsidy.

CHAIR COSTELLO asked Mr. Alper to continue the presentation.

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MR. ALPER turned to slide 6 that lays out the calculation to reach the estimated \$673 million in revenue generated by the income tax. The total joint and single return tax liability before the PFD deduction and residency adjustments is \$652 million. Subtract the \$30 million PFD deduction to arrive at \$622 million. Subtract the \$34 million of Alaska resident income earned in other states and add the \$84 million of nonresident income earned in Alaska to arrive at \$673 million, which is a 2017 number. The modeling adjustment brings the total to \$687 for FY2020.

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MR. ALPER turned to implementation of the tax on slide 8.

CHAIR COSTELLO said she would first like him to describe the tax division as it exists now what it will look like should HB 115 pass.

MR. ALPER explained that the tax division currently has 110 authorized positions, about 10 of which are vacant. Roughly two-thirds of those are in the Anchorage office and the other third are in Juneau. The division has a three-person management team: a director, a deputy director, and an operations manager who oversees the back-office operations. He said a large portion of the need associated with the bill is new back-office positions in IT and accounting. The hope is to get 80 percent of the expected 400,000 filers to do so electronically, but that still leaves 80,000 paper forms. This means that a substantial new team would be required to open those envelopes and scan the documents into the system.

He listed the 25 different tax programs the division currently administers. Each group has its own structure, but generally there is a supervisor as well as several auditors and technicians. He summarized, "You have auditors and technicians and supervisors and then the back-office folks."

MR. ALPER said the 60 people the bill anticipates needing will include a supervisor, 20 some auditors, 10 or more technicians, and as many as 15 back-office/data handlers. A handful of special project specialists will also be needed to work with the

supervisor. They are higher range positions for experienced professionals. Another IT position and an office assistant will also likely be added.

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SENATOR STEVENS asked what the difference is that would cause Montana to need roughly twice as many people as Alaska to administer its income tax.

MR. ALPER explained that Alaska already has a tax division and doesn't need to double up on many of the existing positions. If the need for 60 additional positions is inaccurate, that will be clear when the implementation contractor is hired. More to the point, he said, is that the entire cost to implement is 1.5 percent of the revenue and the ongoing administration costs are way less than 2 percent. He said he recognizes that this is a major step that elicits strong feelings, but the implementation and administration costs shouldn't be the deciding factor to have an income tax.

CHAIR COSTELLO asked him to discuss the need to promulgate regulations. She specifically asked about the potential need to write regulations around the section of the bill that talks about mistakes and the assumption that the department is right and the taxpayer wrong, and the potential need to hire an administrative law judge. She noted that Neil Slotnick with the Department of Administration (DOA) was available to explain the DOA fiscal note.

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MR. ALPER said that when he discussed staffing earlier in the presentation he neglected to mention that DOR has a five-person appeals team and they would need to add a couple of these positions to handle potential income tax appeals. He explained that the first step in the appeals process is before that internal appeals team. The next step in an appeal is before an administrative law judge in DOA's Office of Administrative Hearings. He explained that DOR's fiscal note includes approximately \$200,000/year to pay for the services of an administrative law judge, and DOA's fiscal note requests interagency receipt authority to bill DOR for that service. He opined that the technical language in the bill that assumes the state is in the right is boilerplate income tax language.

MR. ALPER said there is no question that the bill will mandate a large, multi-part regulatory package. However, the fact that it has 27 pages of technical language will make that easier. It

doesn't leave a lot of judgment to the regulation writer. "This bill provides extraordinarily precise direction as far as what should be in those regulations and how we should be interpreting these various provisions."

CHAIR COSTELLO said the sponsor went into that this morning.

MR. ALPER said Ms. Hansen from the sponsor's office is an extraordinary resource and deserves a tremendous amount of credit for the bill being where it is today.

SENATOR HUGHES referenced Senator Steven's concern and expressed doubt that the income tax could be implemented and administered with just 60 additional people.

MR. ALPER suggested Deputy Commissioner could provide a fresh perspective.

2:30:50 PM

JERRY BURNETT, Deputy Commissioner, Office of the Commissioner, Department of Revenue (DOR), explained that some of the work associated with the income tax will be spread to DOR's Administrative Services Division, existing employees in the Tax Division, and the Department of Administration. Also, the Tax Division has become more efficient as technology has advanced. He opined that it is not an unreasonable assumption that 60 employees will be sufficient. "We have many ways of addressing the problem you're concerned about."

CHAIR COSTELLO asked if there were further questions about implementation of HB 115.

SENATOR STEVENS said you very clearly heard Senator Meyer talk about what the Senate does and does not support to address the budget gap. He listed reducing the Permanent Fund Dividend, establishing a percent of market value (POMV), cuts to four major areas, the use of the Constitutional Budget Reserve (CBR), and oil tax credits. He asked if it is his position that the only way to balance the budget is to institute an income tax.

MR. ALPER said it doesn't matter what he thinks, but he agrees with the Governor that we need a complete plan. It's not wise to build in a structural deficit that's in the multiple hundreds of millions of dollars per year, he said. The problem with basing the solution on the permanent fund without some other feature is that it leads to four choices: 1) you cut the budget by a certain amount each year; 2) you're forced to try to raise a tax

quickly; 3) you spend from the Constitutional Budget Reserve; or 4) you take more out of the Permanent Fund Earnings Reserve. Choice 4 presents the biggest danger, he said. The Permanent Fund has very strict rules for managing it that need to be respected. Changing them is a generationally significant decision for Alaskans. "Building in a structural deficit might be making a system where it's too easy to fail." That's why we need a complete package, he said.

CHAIR COSTELLO asked if he is speaking on behalf of the governor or himself.

MR. ALPER said he was speaking on behalf of himself. He was paraphrasing the Governor and Commissioner to an extent, but wouldn't say that is their policy without checking with them first.

[2:37:49 PM](#)

SENATOR MEYER said it's hard to explain to constituents why it's not more efficient to cut the size of the dividend. He opined that it's inefficient to give money in the form of the dividend and then take it back in the form of an income tax.

MR. ALPER said that's accurate for the \$50,000-\$60,000 middle-income earner. They will probably pay an income tax that is equivalent to the dividend. A lower income person will pay less and get the same dividend and the \$1 million plus income person will pay over \$100,000 in taxes and get the \$1,000 dividend back. He agreed with the sponsor's statement that there is an inherent equity to the income tax.

SENATOR MEYER said fairness is a matter of interpretation. He posited that middle-income people, those earning less than \$250,000, will pay the bulk of this tax.

CHAIR COSTELLO thanked the presenters and held HB 115 in committee.

[2:42:22 PM](#)

There being no further business to come before the committee, Chair Costello adjourned the Senate Labor and Commerce Standing Committee meeting at 2:42 p.m.