

HOUSE FINANCE COMMITTEE
THIRD SPECIAL SESSION
September 13, 2021
1:34 p.m.

1:34:24 PM

CALL TO ORDER

Co-Chair Merrick called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Kelly Merrick, Co-Chair
Representative Dan Ortiz, Vice-Chair
Representative Ben Carpenter
Representative DeLena Johnson
Representative Andy Josephson
Representative Bart LeBon
Representative Sara Rasmussen
Representative Steve Thompson
Representative Adam Wool

MEMBERS ABSENT

Representative Bryce Edgmon

ALSO PRESENT

Representative Ivy Spohnholz, Chair, House Ways and Means Committee; Rose Foley, Staff, Representative Ivy Spohnholz.

PRESENT VIA TELECONFERENCE

Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue

SUMMARY

HB 189 EMPLOYMENT TAX FOR EDUCATION

HB 189 was HEARD and HELD in committee for further consideration.

Co-Chair Merrick reviewed the agenda for the meeting.

#hb189

HOUSE BILL NO. 189

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

1:35:12 PM

REPRESENTATIVE IVY SPOHNHOLZ, CHAIR, HOUSE WAYS AND MEANS COMMITTEE, introduced the bill that would reestablish an education payroll tax. She detailed that the State of Alaska had a constitutional obligation as provided by Article VII, Section 1 to provide and maintain a system of public schools open for all children in the state. She explained that the tax would seek to raise a small portion of the overall funding needed to meet the constitutional obligation. She informed the committee that Alaska had a form of an education tax from 1919 until 1980 when it was repealed. The tax in HB 189 was estimated to generate \$64 million to \$66 million annually, with 20.8 percent of taxpayers as nonresidents. She stated that the bill did not come close to solving the state's fiscal situation; however, it could be part of a broad compromise fiscal plan. She thought the legislature was closer to a solution than many people understood.

Representative Spohnholz shared that the House Ways and Means Committee had heard from the Legislative Finance Division on September 1 that if there was a dividend formula of 25 percent of the percent of market value (POMV), the fiscal gap would be about \$347 million in FY 23 and barring a major market correction, it would begin to move into the black in FY 25. She stated it was possible to balance the budget with a small series of tweaks to state laws and HB 189 could be a piece of the bargain. The tax would cost approximately \$572,600 to administer for the creation of five new positions with an administrative cost of less than 1 percent. She shared that her staff was available to provide a sectional analysis if desired.

ROSE FOLEY, STAFF, REPRESENTATIVE IVY SPOHNHOLZ, reviewed the sectional analysis (copy on file):

Section 1 adds a new chapter to AS 43 creating an Education Tax.

Sec. 43.45.011 authorizes the Department of Revenue to collect an education tax on wages and self-employment earnings from a source in Alaska. The amount of tax due is based on an individual's income and established in statute.

Sec. 43.45.021 directs employers to withhold one-half of the estimated tax due from each of an employee's third and fourth regular payrolls of the year and to maintain records of the withholdings. The employer is required to withhold the tax from the employee unless the employee can prove they have already paid the tax due for the calendar year.

Sec. 43.45.031 stipulates that a self-employed individual will remit the tax required under AS 43.45.011.

Sec. 43.45.041 provides a mechanism for a taxpayer to request a refund if an overpayment is made.

Sec. 43.45.051 requires a person to report to the Department of Revenue any payments made to a self-employed individual if reporting of that payment is required by the Internal Revenue Service.

Sec. 43.45.061 directs proceeds from this tax to the public education fund within the general fund.

Sec. 43.45.099 provides definitions for key terms in this chapter.

Section 2 is uncodified law allowing the Department of Revenue to adopt regulations to implement this act.

Section 3 provides an immediate effective date for Section 2, the adoption of regulations.

Section 4 provides an effective date of January 1, 2022 for the Education Tax.

1:39:43 PM

Co-Chair Merrick asked for verification the tax had previously existed from 1919 to 1980.

Representative Spohnholz answered affirmatively.

Co-Chair Merrick asked why the tax had been repealed in 1980.

Representative Spohnholz replied that the tax had been repealed when Trans-Alaska Pipeline System (TAPS) and oil taxes came online. She stated that like many different revenue measures, the tax had been repealed.

Co-Chair Foster recognized Representative Spohnholz's testimony that the state was constitutionally required to provide for education. He referenced her statement that funds [generated by the proposed tax] would be deposited into the Public School Trust Fund. He asked for verification the funds would be designated not dedicated. He was trying to understand if the funds would be sweepable.

Representative Spohnholz responded it was her understanding it would be a designated fund. She deferred the question to Legislative Legal Services.

Representative Rasmussen asked why the bill used the word "workers" instead of "household."

Representative Spohnholz answered that the point was for every worker to be able to contribute. She noted that some households had more than one worker.

Vice-Chair Ortiz stated that AS 43.450.301 stipulated that a self-employed individual would remit the tax. He asked how it would look in the real world. He asked what the process would be for a self-employed individual to make their contribution.

Representative Spohnholz deferred the question to the Department of Revenue (DOR).

DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE (via teleconference),

answered that DOR had a tax revenue management system where individuals could register and pay the tax. He stated there was also an opportunity where DOR would potentially coordinate with the Department of Labor and Workforce Development (DLWD) to work through the existing DLWD system.

[1:42:50 PM](#)

Representative Wool referenced Mr. Stickel's statement that people could register to pay through DOR. He stated the payroll tax would come out of paychecks. He assumed the employer had some responsibility for filing for employees. He thought the tax would be deducted annually from an employee's paycheck. He asked if Mr. Stickel was indicating employers could pay the tax through the DOR system.

Mr. Stickel answered that the bill would tax wages and salaries in addition to self-employment earnings. He explained that for an employee earning wages and salaries through an employer, the employer would withhold the wages, similar to how it worked for federal income tax, state unemployment tax, or Medicare tax. He elaborated that the employer would be responsible for remitting the tax to DOR. The tax would be fairly hassle-free for many workers; the bill specified the tax would be taken out of third and fourth paychecks of the year to be remitted to DOR. He explained that self-employed individuals would be responsible for remitting the tax directly to DOR. There would also be an opportunity for an individual to register with the department for refunds if they had multiple jobs and ended up paying more tax than they would under the bracketed structure.

Representative Wool provided an example of a person working at a restaurant and also driving for Uber. He thought the funds would likely come out of the individual's restaurant employee check instead of from their self-employment income. He asked if people would pay the tax based on the honor system if they were only self-employed.

Mr. Stickel responded that the tax would be withheld from wages and salaries by the employer. He stated that if the second income source pushed the individual into another tax bracket, they would be responsible for paying tax on that portion. He added that DOR would have the powers of audit and enforcement of the tax as it did with any other taxes.

1:46:30 PM

Representative Wool referenced Mr. Stickel's statement about DOR's auditing powers. He reasoned that without a state income tax it was not possible to know what people earned in the State of Alaska other than through federal income tax, which he did not believe was disclosed. He thought the state would not really know if someone had another job other than through the honor system unless DOR had some reason to audit the person.

Mr. Stickel answered that the department had the ability to access confidential information submitted through DLWD or through federal income tax for audit and enforcement purposes. He stated it was something the department could and would likely use to implement the tax.

Representative Rasmussen asked if the decision to take the tax in the third and fourth paychecks, which she believed could fall into the same month, was based on the department's request. She asked for detail.

Representative Spohnholz answered that the third and fourth paychecks had been selected because they [the bill sponsors] did not want the funds to come from the first and second paychecks of the year immediately following the holidays when many people tended to be cash-poor. The idea was delaying to the third and fourth paychecks gave people more opportunity to catch up on their cash flow.

Representative Rasmussen asked if there was an increased cost if the funds were taken out of employees' paychecks monthly. She stated that for an individual earning \$120,000 per year, \$600 coming out of a paycheck in one month may be a substantial portion of their mortgage and may have a bigger financial impact.

Representative Spohnholz deferred to the department.

Mr. Stickel replied that from an administrative standpoint there would be slightly more burden to having 12 payments per employee rather than 2. He thought the difference would be fairly minor. He noted it would change the timing of the revenue impact for the first year of implementation given that the first year assumed the state would receive all of the withholdings in FY 22. He explained that spreading the

withholdings out over 12 months meant the FY 22 number would be a bit lower.

Representative Rasmussen asked if it would be any easier for DOR if it was a flat tax where every Alaskan contributed the same amount of money, more like a user fee instead of a progressive income tax proposal.

Mr. Stickel that it started to get into a policy question that he was not comfortable speaking to. He stated there would likely be some administrative efficiencies to having a set rate per individual.

1:50:59 PM

Representative Spohnholz replied to the questions from Representative Rasmussen. She explained the tax had initially been modeled on the original 1919 legislation. She explained that in 1919, the tax had been a flat and taxpayers had all paid the same amount. She believed the tax had come out of individuals' first paycheck. The bill modified the timing of the payment to give people respite in January. She stated she was agnostic on the particular issue, and she was amenable if it was the committee's will to spread the payments out over 12 months. She addressed the question about the progressivity of the tax and stated it was quite modest. She detailed that the 1919 tax had been \$50 per person. She reiterated that the bill contained modest progressivity. She remarked that it was certainly not equal when considering the percentage of income coming from a person earning \$30,000 per year versus someone earning \$120,000 per year; it had been a policy call made in the House Ways and Means Committee.

Representative Rasmussen asked if the bill considered net or gross tax. She stated someone making \$30,000 per year paid substantially less in federal income tax than a person making \$120,000 per year. She added that a person earning \$120,000 per year was likely paying substantially higher property taxes, which funded a large portion of education in Anchorage. She thought it seemed to be a growing burden on the upper and middle class Alaskans where there were no additional services and help available.

Representative Spohnholz replied that the bill contained a gross tax. She clarified it was a payroll tax, not an income tax. She stated a payroll tax was different than an

income tax that tended to be offset based on deductions and other expenses.

Ms. Foley added that the bill contained a tax on wages under the federal definition in 26 USC 34.01. She noted that Alaska had a highly seasonal workforce and spreading the payment out over 12 months could create difficulties in collection for seasonal employees who may not work 12 months a year.

Representative Josephson referenced Representative Spohnholz's earlier testimony about how the tax could help with the overall bigger picture. He relayed that he had proposed a motor fuel tax, which he knew would offset some general funds; however, he had not thought of it in terms of the need for a big fiscal reform package. He referenced a 50/50 plan [where the POMV draw was divided between government services and the dividend] and highlighted that the legislative Fiscal Policy Working Group talked about a minimum of \$500 million in revenue. He remarked that if it were a sales tax, the state could get by with \$440 million in sales tax and use HB 189 to compliment it [as part of a larger fiscal plan]. He asked how in a 75/25 plan, in combination with other revenue, the bill could be used without the need for a larger tax.

Representative Spohnholz replied that on September 1 the House Ways and Means Committee had heard from the Legislative Finance Division that with a 50/50 split of the POMV, there would be a fiscal gap of about \$1.2 billion in FY 23. She detailed that reducing the dividend portion to 33 percent would result in a gap of about \$614 million. She elaborated that allocating 25 percent of the POMV to dividends would result in a fiscal gap of \$346.7 million in FY 23. Under a 75/25 split the budget began to move into the black by FY 25. She shared that on September 9 in the House Ways and Means Committee, she had proposed a comprehensive fiscal plan that included an update to the dividend formula using a 75/25 split, the employment tax for education in the form of HB 189, oil and gas per barrel tax credit reform in the form of the House Ways and Means Committee bill HB 3007, and Representative Josephson's HB 104 [motor fuel tax]. She reported that combining the four measures would result in a surplus of \$322 million in FY 24, which would enable the state to start addressing its capital deferred maintenance backlog.

[1:56:57 PM](#)

Vice-Chair Ortiz asked for verification that under the 75/25 scenario the state would have a balanced budget in the black by FY 24.

Representative Spohnholz replied that by FY 25 the state would be generating surpluses.

Vice-Chair Ortiz asked if under the scenario the legislature could put a termination date on some revenue measures to get through. He surmised the taxes could go away and the state could move forward with a balanced budget.

Representative Spohnholz agreed that the legislature could put a sunset date on some of the revenue measures. For example, there could be a two-year sunset date on the oil and gas per barrel tax credit bill. The state would have a balanced budget in FY 24 and would functionally be producing surpluses after that time. She explained it would allow the state to make strategic investments in things like universal optional Pre-K, the capital budget, and other.

Representative LeBon asked how the \$64 million to \$65 million broke down into the different groupings. He believed he found the answer on page 2 of the fiscal note analysis. He referenced the number of taxpayers in each group and the dollar amount. He was working out the math.

Co-Chair Merrick noted that DOR would review the fiscal note after the committee had finished with questions.

[1:59:14 PM](#)

Representative Thompson provided an example of a military person living in the dorms on base. He asked if the individual would be taxed. He how military personnel would be impacted.

Mr. Stickel answered that DOR had assumed federal employees would be subject to the tax similar to the way they would be subject to an income tax.

Ms. Foley added that the federal definition for tax on wages specified "that term shall not include remuneration

paid for active service performed in a month for which such employee is entitled to the benefits of Section 112 relating to certain combat zone compensation of members of the Armed Forces of the United States to the extent remuneration for such service is excludable from gross income under such section."

Representative Wool stated that pre-1980 the state had the head tax and an income tax. He asked how much revenue each of the taxes had raised. He observed that the bill would raise \$64 million. He recognized the number was much higher than the head tax in 1979. He thought it had been a flat rate of \$10 per worker. He noted there had been fewer workers and a low fee. He did not know what the income tax had generated at the time.

Representative Spohnholz answered that she would follow up with the information.

Representative Wool asked what oil price assumptions had been used in the legislation, especially relative to revenue to the state. He remarked that the per barrel credit numbers were very dependent on oil price. He referenced an oil glut and price drop during COVID. He highlighted that no one was saying the situation would not occur again. He noted the volatility of the oil market.

Representative Spohnholz replied that the bill used DOR's assumptions; the assumption for the current year was \$71 per barrel. She believed the House Finance Committee had heard presentations from DOR on oil price projections.

[2:02:57 PM](#)

Co-Chair Merrick asked Mr. Stickel to review the fiscal note.

Mr. Stickel shared that the fiscal note had been published on May 6, 2021 for the prior version of the bill. The department had an updated fiscal note in progress for the current bill version. He reported the revenue impact from the new bill version would be very similar to the previous estimate. The department had anticipated \$65 million to \$66 million in annual revenue from the legislation upon full implementation. The estimate assumed about 406,000 wage earners and self-employed workers as the resident taxpayer base. The assumption included a 20 percent increase to the

number or about 81,000 nonresidents in the taxpayer base. The department had coordinated with DLWD to refine some of the assumptions used for the original bill. The current assumption was that nonresidents would increase the taxpayer base by about 15 percent or about 60,900. The slightly reduced number of taxpayers combined with the new bracket structure gave a preliminary revenue estimate of \$64 million to \$65 million for the current bill version.

Mr. Stickel stated the department assumed there would be 75 percent of a full year's worth of revenue in FY 22 given that the tax would take effect midway through the fiscal year. He explained that most employees with salaries and wage income would end up paying their full annual tax within FY 22 (likely in February or March of 2022). He noted there were some seasonal employees who would not pay taxes until FY 23 for the 2022 calendar year. Additionally, some self-employed individuals would not pay until later in the year. The fiscal note showed a \$6 million capital request reflecting an estimate for contracting with the department's contractor FAST Enterprises for a new module to DOR's tax revenue management system. The department was requesting five new ongoing positions with a funding cost of about \$572,600 per year. The new positions would implement and audit the new tax. He reported that the implementation costs had not changed for the new version of the bill.

Representative Spohnholz thanked the committee for the questions during the meeting. She stated that the bill was not a standalone comprehensive fiscal plan, but it was a piece of the larger puzzle as the legislature worked to find ways to fund its constitutional obligations, balance the budget, and create fiscal certainty for Alaskans.

HB 189 was HEARD and HELD in committee for further consideration.

ADJOURNMENT

[2:07:47 PM](#)

The meeting was adjourned at 2:07 p.m.