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MEMORANDUM

March 9, 2026

SUBJECT: Tax Credits; Federal Income Tax
(HB 152; Work Order No. 34-LS0674\A)

TO: Representative Ky Holland
Attn: Mark Lambert

FROM: Emily Nauman 
Director

You asked several questions about permanent fund dividend (dividend) disbursement structure. Specifically, you are interested in distribution of the dividend as a tax credit against the income tax proposed under HB 152 and the potential federal tax implications and legality of that structure. The questions below have been refined and reworked from your original inquiry, based on conversations with your staff, Mr. Lambert.

Questions

If the dividend was converted to a refundable tax credit, would it be subject to federal income tax?

Before beginning the discussion, it is important to acknowledge that the tax consequences of an action for any certain individual cannot be predicted with certainty; each individual may make decisions that affect the status and categorization of income and expenditures. Therefore, how one individual would treat a particular payment or benefit cannot be predicted with certainty.

In general, portions of a tax credit applied against state income taxes are not taxable income for purpose of the federal income taxes.¹ However, portions of credits refunded

¹ Tax credits that only reduce the amount of tax a taxpayer would otherwise owe are not taxable income because "the [taxpayer] has received no money or other 'income' within the meaning of the Internal Revenue Code." *Randall v. Loftsgaarden*, 478 U.S. 647, 657 (1986).; ". . . State tax credits [do not represent] a right to receive income from the state. Instead, they merely represent[] the right to reduce a taxpayer's State tax liability. It is without question that a government's decision to tax one taxpayer at a lower rate than another taxpayer is not income to the taxpayer who pays lower taxes. A lesser tax detriment to a taxpayer is not an accession to wealth and therefore does not give rise to income." *Tempel v. Comm'r*, 136 T.C. 341, 351 (2011), *aff'd sub nom. Esgar Corp. v. Comm'r*, 744 F.3d 648 (10th Cir. 2014). As explained below, to meet this exception, the taxpayer must not be given an option about whether to apply the dividend as a tax credit, application as a tax credit must happen without taxpayer action.

after reducing state tax liability are generally treated as income for federal tax purposes.² Refunds are generally subject to federal income tax under the constructive receipt doctrine. Under the constructive receipt doctrine, the federal government treats income as taxable when it is under the taxpayer's control.^{3,4}

There are exceptions to the general rule that a refund is subject to federal taxation, including if the refund constitutes a "return of capital" or payment of taxes,⁵ a payment for general welfare, or a disaster relief payment.⁶

Of these exceptions, Mr. Lambert indicated you were specifically interested in the general welfare exclusion. Under the general welfare exclusion, income is not included in income for federal income tax purposes.⁷ To qualify under the general welfare

² Excess portions of tax credits that remain "after first reducing state-tax liability and that may be refunded [are] an accession to [a taxpayer's] wealth, and must be included in [] federal gross income [] for the year in which [the taxpayer] receive[s] the payment or [is] entitled to receive the payment unless an exclusion applies. And there is no exclusion from federal income tax simply because a payment comes from a state government." *Maines v. Comm'r*, 144 T.C. 123, 136 (2015) (internal citations omitted).

³ Where a taxpayer has an "unqualified, vested right to receive immediate payment," federal law requires a taxpayer to recognize the amount as income. *Jombo v. Comm'r*, 398 F.3d 661, 663 (D.C. Cir. 2005). *See also* 26 CFR 1.451-2 ("Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given."). Although the doctrine itself is about the timing of income for tax purposes, the regulation clearly evidences that the federal tax rules impute income to a taxpayer when that money is available to them.

⁴ Under the constructive receipt doctrine, giving a taxpayer an option to apply the entire dividend as a tax credit or use it for some other purpose very likely makes the full dividend amount subject to federal taxation under the receipt doctrine.

⁵ *Id.* at 137 - 138. Whether this exclusion applies to a taxpayer might depend on whether the taxpayer itemizes deductions.

⁶ Disaster relief payments are not included in income for federal income tax purposes under 26 U.S.C. 139, which defines a qualifying disaster relief payment as one that is paid by a government to reimburse necessary personal expenses incurred as a result of a disaster or to reimburse expenses incurred for the repair or rehabilitation of a personal residence if damage is attributable to a qualified disaster.

⁷ I.R.S. P.L.R. 201816004 (Apr. 20, 2018).

exclusion, "payments must (i) be made from a governmental fund, (ii) be for the promotion of the general welfare (that is, based on individual or family need), and (iii) not represent compensation for services."⁸ Payments from welfare programs must require recipients to show need to qualify for the general-welfare exclusion.⁹ So, if a permanent fund dividend tax credit were also structured as a general welfare payment, a refund from the credit would likely be exempt from federal taxation.

In summary, the portion of a dividend automatically applied as a tax credit likely will not be subject to federal taxation. However, unless the dividend program is restructured to meet the general welfare or another exception, the portion of a dividend refunded to an individual after it is applied as a tax credit would likely result in federal taxable income for the individual.

Could the same statutory structure, including the application process, be used to apply for the refundable tax credit?

Yes, the current dividend could be restructured to instead be applied as a refundable tax credit. It is possible that changing the structure of the dividend by converting it into a tax credit only for qualified residents, could risk the constitutionality of the program. A credit given to only state residents would likely be vulnerable to the same constitutional challenges as the dividend: challenges under the equal protections clauses under the state and federal constitutions and under the privileges and immunities clause of the federal constitution. Because the current structure of the dividend has been upheld,¹⁰ there is

⁸ *Id.*

⁹ *Bailey v. Commissioner*, 88 T.C. 1293, 1300 (1987).

¹⁰ As I'm sure you are aware, the dividend has a long history of associated litigation. In *Zobel v. Williams* the United States Supreme Court found that dispersal scheme that made payments based on the number of years a resident had lived in the state violated the equal protection clause of the Fourteenth Amendment of the Constitution of the United States because it divided citizens "into expanding numbers of permanent classes" (based on years of residency) that could not be rationally justified by any of the state's arguments in the case. *Zobel v. Williams*, 457 U.S. 55, 65 (1982). After *Zobel*, a simpler payout scheme was enacted that allocated an equal amount to every resident but required a minimum two-year residency. That dividend structure was also challenged, though only at the superior court level. *Lindly v. Malone; Simianer v. State*, Civil Actions 3AN-90-2586 and 3AN-90-2821 Consolidated, Superior Court, Third Judicial District, July 18, 1990. The resulting oral court order rejected the two-year residency requirement but upheld a one-year residency requirement as "fairly and substantially related to the state's interest of establishing bona fide residency." Thus, the superior court held the one-year residency requirement overcame the equal protection challenge. *Id.*, transcript at 6. See also *Greisen ex rel. Greisen v. United States*, 831 F.2d 916 (9th Cir. 1987), cert. denied, 485 U.S. 1006, 108 S. Ct. 1469, 99 L. Ed. 2d 699 (1988) (holding that the dividend payments are made for a public purpose). The decision did not apply the privileges and immunities clause, noting that the test under the equal protection clause of

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reason to think that an identical tax credit would survive similar challenges if tested. However, as I reiterated to Mr. Lambert, the dividend program is unique to this state and therefore, we cannot be sure how a court would view the program if it was converted to a tax credit, where a different set of laws might apply.¹¹

If I may be of further assistance, please advise.

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the state constitution is more stringent than the test under the federal privileges and immunities clause. *Id.*, transcript at 7.

As to whether the court's decision in the *Lindly* case is good law, note that the decision was not appealed, so there is no Alaska Supreme Court decision in the case and no published opinion. Although the summary judgment order in the *Lindly* case could conceivably still have some persuasive power, the decision would probably not be considered a controlling precedent in any other court case relating to durational residency requirements. *McCoy v. State*, 59 P.3d 747, 755 (Alaska App. 2002) ("unpublished decisions are not 'precedent' in the sense that they control or restrict future judicial decision-making.").

Note that there have been other cases regarding the permanent fund dividend since *Lindy* which have given the Supreme Court an opportunity to strike down the program, and the court has not done so. For examples, see *Harrod v. State, Dep't of Revenue*, 255 P.3d 991 (Alaska 2011) and *Ross v. State, Dep't of Revenue*, 292 P.3d 906 (Alaska 2012).

¹¹ The dividend program is currently a benefit program, where courts have consistently allowed some distinction between residents and nonresidents. A different line of case law applies to tax programs. Other states have earned income tax credits, many refundable, issued based on residency. However, earned income tax credits are also needs-based or have some other income qualification. Interestingly, Washington, though it does not have an income tax, has a refundable earned income tax credit for residents (a person who is in the state more than 183 days). RCW 82.08.0206. The amount of the credit depends on income, but an individual making more than \$61,555 annually is not eligible. Washington State Department of Revenue. *Working Families Tax Credit: Eligibility*, available at <https://workingfamiliescredit.wa.gov/eligibility> (accessed March 7, 2026).