NEW SUSTAINABLE ALASKA PLAN

Pulling Together to Build Our Future

Capped Payroll Tax- Bill Introduction

HB 4001 by Governor Walker

Presentation to the House Finance Committee

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Bill Title

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

Introduction

Recapping Tuesday and Wednesday

Unrestricted General Funds

	(Billions)
FY2018 Budget as passed	$4.3
FY2018 Revenue (fall preliminary)	$1.8
Shortfall (paid from CBRF)	$2.5
CBRF balance at end of year	$2.1

FY2019 Base Budget (status quo service level)	$4.7
includes ~$300 million in "one time" fund replacement	
FY2019 Revenue (fall preliminary)	$2.0
Shortfall (greater than remaining non-PF savings)	$2.7

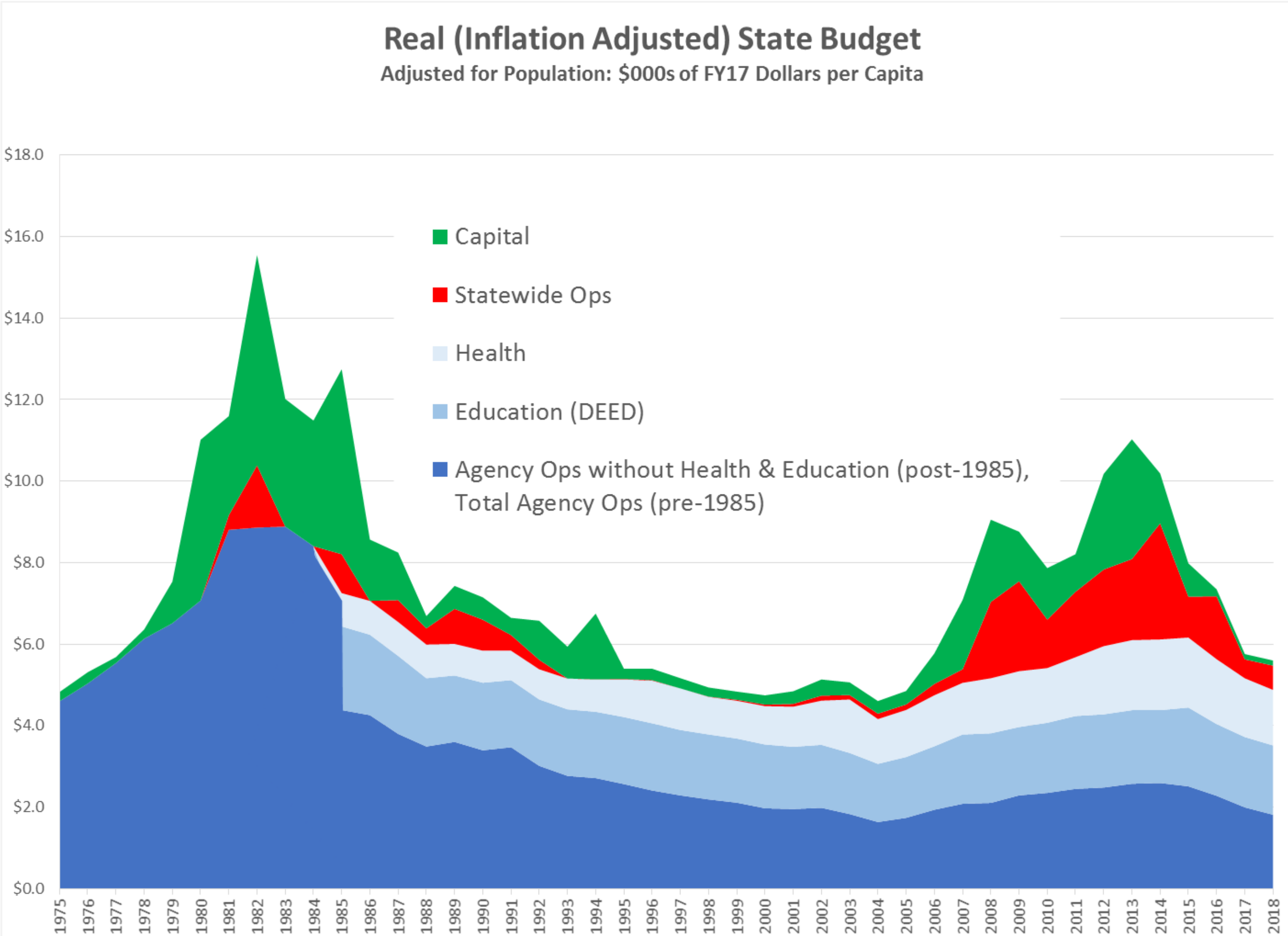
Estimated Revenue from House and Senate versions of SB26	$1.8 - $2.1
Remaining Deficit presuming SB26	$0.6 - $0.9

The main issue is a reduction in oil revenue

($billions)

Fiscal Year	Unrestricted Oil Revenue	General Fund Budget	Overall Surplus (Deficit)
2010	$4.9	$5.1	$0.4
2011	$7.0	$5.5	$2.2
2012	$8.9	$7.1	$2.4
2013	$6.3	$7.8	($0.9)
2014	$4.8	$7.3	($1.9)
2015	$1.7	$6.0	($3.7)
2016	$1.1	$5.4	($3.9)
2017	$1.0	$4.4	($3.0)
2018	$1.3 est.	$4.3	($2.5) est.

Budget has been reduced to 1990s levels when adjusted for inflation and population



OMB 10-year Plan

- Not a policy document- an extrapolation of current trends
- Updated to include Preliminary Fall revenue forecast
- After the $300+ million increase from FY18-19, subsequent years mainly reflect inflation plus known actual liabilities (i.e. debt, retirement funding)
- Status Quo Budget increases from $4.7 billion to $5.5 billion in FY2027 (+$800 million)
- UGF revenue increases from $2.0 billion to $2.8 billion in FY2027 (+$800 million)

Structural budget deficit is still $2.7 billion in 2027

OMB 10-year Plan

- Apparent closing of budget gap in later forecast years is primarily based on the expectation of <u>continuing steady Permanent Fund growth</u>
  - The SB26 models assume the overall fund continues to grow due to indirect inflation proofing, plus deposits of new royalties
  - Annual sustainable “POMV” draw therefore increases to \$2.5 - \$2.8 billion by FY2027
  - Although the budget potentially comes into balance in 2026, deficits before that date will drive the CBRF to an unacceptably low level

Ideal Case

For this to work out, several things <u>all</u> need to happen:

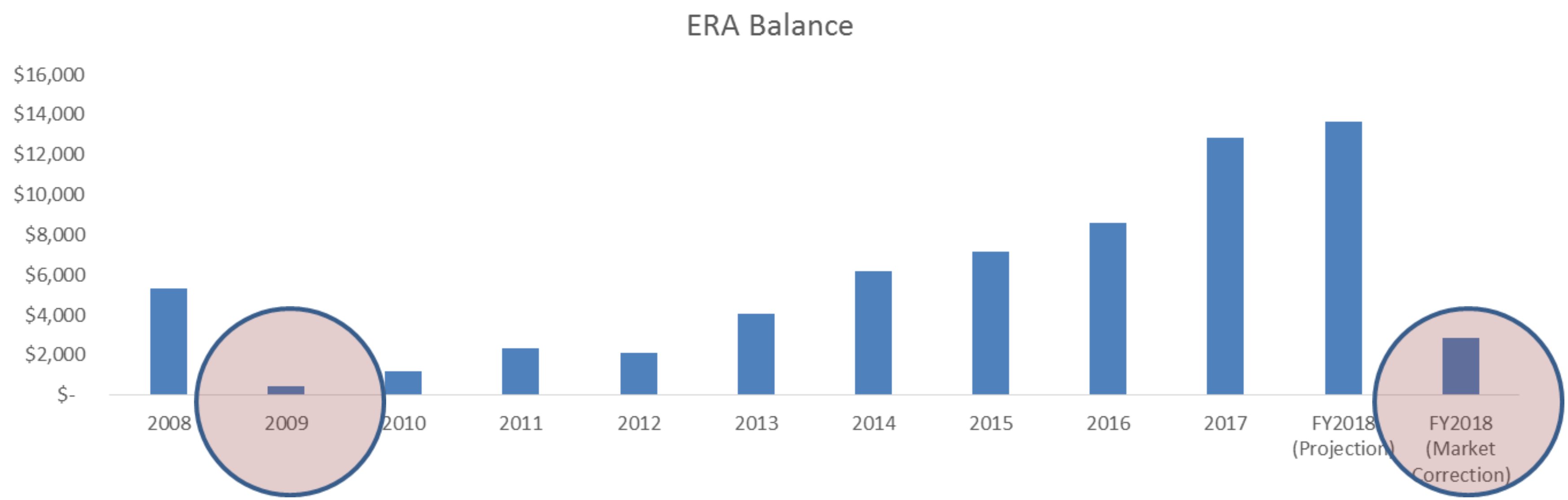
1. Oil production meets the new, more aggressive preliminary fall forecast scenario
2. Oil prices stabilize in the $60 range, adjusted for inflation
3. Flat state budgets that can be contained within the OMB 10-year plan despite deferred maintenance and other needs
4. Senate version of SB26 with 75% / 25% POMV split
5. Permanent Fund grows at a steady 6.95% per year without a major market correction

Elasticity

The following items increase or decrease the size of the future deficits ($millions):

• House Permanent Fund bill (higher dividend)	$175
• $10 oil price shift	$300
• Federal health care changes	$100
• Near term major market correction	$300
• Increases to capital budget	$50+
• Major disaster response	Indeterminate

Earnings Reserve Account Volatility



- The Earnings Reserve Account is the only portion of the Permanent Fund that may be spent
- It holds the gains and losses of the whole Permanent Fund; the corpus is always made whole from losses
- In the FY08-09 market crash, the ERA balance fell to just $420 million
- If markets experienced similar results this year, there would only be enough funds in the ERA to cover a single year's deficit

Why a Broad-Based Tax?

- Even a small tax as proposed in HB4001 covers roughly half the forecasted ongoing deficits
- This buys the state time in case of various contingencies
- A tax combined with PF restructuring and continued budget discipline makes a complete fiscal plan
- If we get to where the CBRF is gone in a couple of years and don't have a revenue measure in place, it takes over a year to collect a new tax
- At that point, the remaining alternative of additional unstructured Earnings Reserve draw could establish a potentially catastrophic long term precedent

HB 4001:
What the Tax Does

Tax Proposal Summary

- 1.5% tax on wages and self-employment income
- Tax paid by individuals earning income in Alaska; two income families would pay for each person
- Does not tax investments, retirement income, rental income, etc.
- Tax is capped at $2,200 or twice the previous year's PFD, whichever is greater
  - Cap applies to incomes over $147,000 / year
- Revenue about $320 million at full implementation
- About 15% of revenue will come from nonresidents

Tax Proposal Summary

Total Wages and Self-Employment Income	Tax Obligation	Permanent Fund Dividend	Net Tax Payment
$25,000	$375	$1,100	($725)
$50,000	$750	$1,100	($350)
$75,000	$1,125	$1,100	$25
$100,000	$1,500	$1,100	$400
$150,000	$2,200	$1,100	$1,100
$200,000	$2,200	$1,100	$1,100

- **For most Alaskans the tax is less than the PFD**
- **Out-of-state residents will pay the highest effective rate because they do not receive PFDs**

Bill Development

Alaska History of Taxes based on Income and Wages

- Began in 1949 at 10% of federal tax liability
- By 1961, the tax was 16% of federal tax liability
- In 1975, Alaska switched from federal tax liability to its own tax brackets
  - Ranged from 3% to 14.5% on taxable income
- Alaska repealed personal income tax in 1980 after oil revenue boom
- “Alaska Fair Tax” (HB303) passed House in 2002. This was an income tax designed to match the effective tax rates of a Sales Tax
- Various bills 2015-17 leading to HB115

Broad Based Tax Analysis

Since the 2016 session, multiple analyses have been done that look at the relative impact of different taxes, cuts, and Permanent Fund restructuring plans:

- Institute of Social and Economic Research at UAA
- Institute for Taxation and Economic Policy
- Tax Foundation
- Northern Economics
- Brad Keithley
- Department of Revenue internal analyses, including Chapter 3 of Fall 2016 Revenue Sources Book

You will likely hear from many of these resources

Income Tax Legislation, 2015-2017

- Approximate revenue from recent bills

29th Legislature

- House 2015-16 bills; $650 million
- Governor's 2016 bills; $200 million

30th Legislature

- SB12, Bishop "School Head Tax"; $70 million
- HB146, Claman "School Head Tax"; $540 million
- HB115, passed House 2017, $700 million

HB 4001 is different from a true income tax

- Does not tax several key types of income:
  - Capital gains
  - Retirement earnings
  - S-corp distributions
- Much less complex administration and staffing need
- Does not require individual filing for typical wage earners

HB 4001 is different from a true income tax

Nevada is one of the seven states that do <u>not</u> have an income tax

Nevada does, however, have a similar payroll tax

"Nevada's Modified Business Tax (MBT), which is remitted by employers (not individuals) on aggregate gross wages (of all employees) above $50,000 per quarter at a rate of 1.475% is currently the only somewhat comparable statewide example."

-Jared Walczak, Tax Foundation,
"Could a Payroll Tax Work for Alaska," October 20, 2017

https://taxfoundation.org/could-a-payroll-tax-work-for-alaska/

Process since Senate voted down HB115 (5/12/17)

- June 5, Governor proposes “compromise”
  - Included budget, SB26, oil tax credits
  - New revenue based on Sen. Bishop's school head tax bill SB12, for at least $100 million
  - Bishop bill actually raised only about $60-$70 million, had had no hearings, and had some technical issues
- June-July, several informal efforts to build a viable compromise bill based on SB12 before adjournment
- Internal administration discussion of multiple revenue options, and outreach to both legislative bodies, led to decision to use a similar structure
- Converted from stair-step to flat-rate to avoid high marginal tax issues at bracket crossovers
- September 22, bill released at time of current special session call

Thought behind the "cap"

- Substantial number of Alaskans ask, in essence, "why are we collecting a tax with one agency while paying a dividend with another?"
  - Certain people, while opposing a tax, are prepared to give up their PFD to help operate government
- Actually eliminating the dividend would be very bad policy for many Alaskans throughout the state, and it is highly unlikely to imagine a majority approving a full elimination
- The structure of the HB 4001 "cap" acknowledges the concerns of those people- basically taxing the dividend back from higher income Alaskans
- The hope is, a tax with this structure will be more broadly acceptable than a full income tax

Technical Language in HB 4001

Bill is about 1/3 the length of HB 115.
Language is adequate to establish, or authorizes regulations to define, many key issues:

- Defining “self-employment” and “from a source in the state” plus other key terms
- Interpretations must be consistent with Multistate Tax Compact
- Incorporates IRS code to a limited degree where needed, state can require a copy of federal return
- Process for withholding and remitting tax by employers
- Filing of reports for payments to self-employed individuals & contract employees
- Individual returns by those required to do so, mainly the self-employed
- Refunds for overpayment

Revenue and Implementation

Revenue Impact

- DOR estimates $160 million in FY2019 due to the tax taking effect in January 2019*
  - This amount is from withholding / employer payments
  - No tax returns filed until April 2020

**(Assumes 1/1/19 effective date as proposed)*

- DOR estimates $320 million in FY2020 based on modeling using aggregated federal income data for Alaska residents

Revenue Details

Revenue estimates are based on 2015 IRS Data

- **About 440,000 total resident taxpayers, revenue $280-$290 million**

68,000	below $10,000 income
62,000	between $10 and $20,000
161,000	between $20 and $50,000
107,000	between $50 and $100,000
38,000	between $100 and $250,000
4,000	above $250,000

- **Net nonresident (after subtracting Alaskans who earn all their income outside) ~12.5%, revenue $40 million**
- **Without the cap, total revenue would be $10 to $20 million higher (foregone from high income individuals)**

Fiscal Note Implementation Cost

- Implementing an individual income tax in 14 months will be a significant logistical challenge
    - Need to draft regulations
    - Need to design, develop, and test technology to administer tax system for over 400,000 taxpayers
- Estimated $300,000 supplemental appropriation request for a contractor to work with DOR on an implementation plan
- Estimated $10,000,000 one time capital appropriation to build income tax into our current tax revenue system
    - Includes withholding, filing, and refunds
- Gradual ramp-up of staffing; eventual annual management cost estimate is $5.2 million with 40 employees
- Total cost over six-year fiscal note period is about 2.5% of projected revenue.

Fiscal Note Implementation Cost

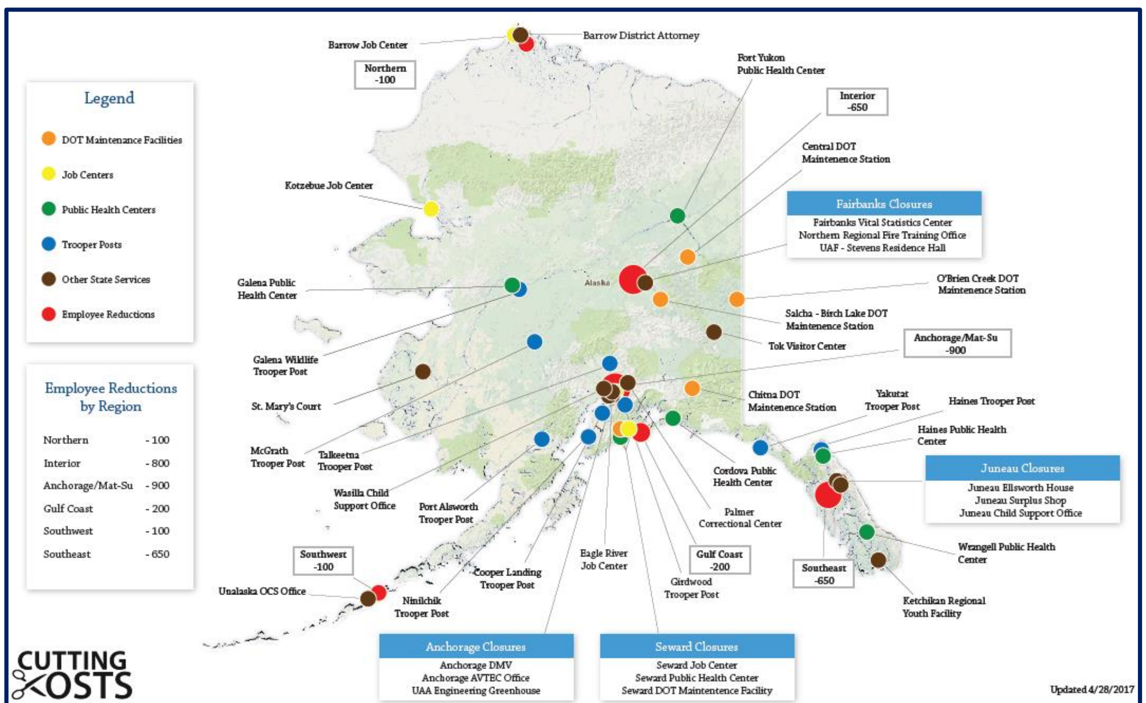
- The Department of Revenue's Fiscal Note is somewhat conservative (meaning too high, we hope)
- Assumes stand-alone system built within the Tax Division
- Items that need to be pinned down (partial list):
  - How much can we limit individual reporting needs vs. relying on employer filing?
  - Process for self-employment filing system
  - Degree of electronic vs. paper filing
  - Potential coordination with Department of Labor (Employment Security Tax). <u>This would have substantial challenges due to federal funding</u>

Economic Impact of Bill

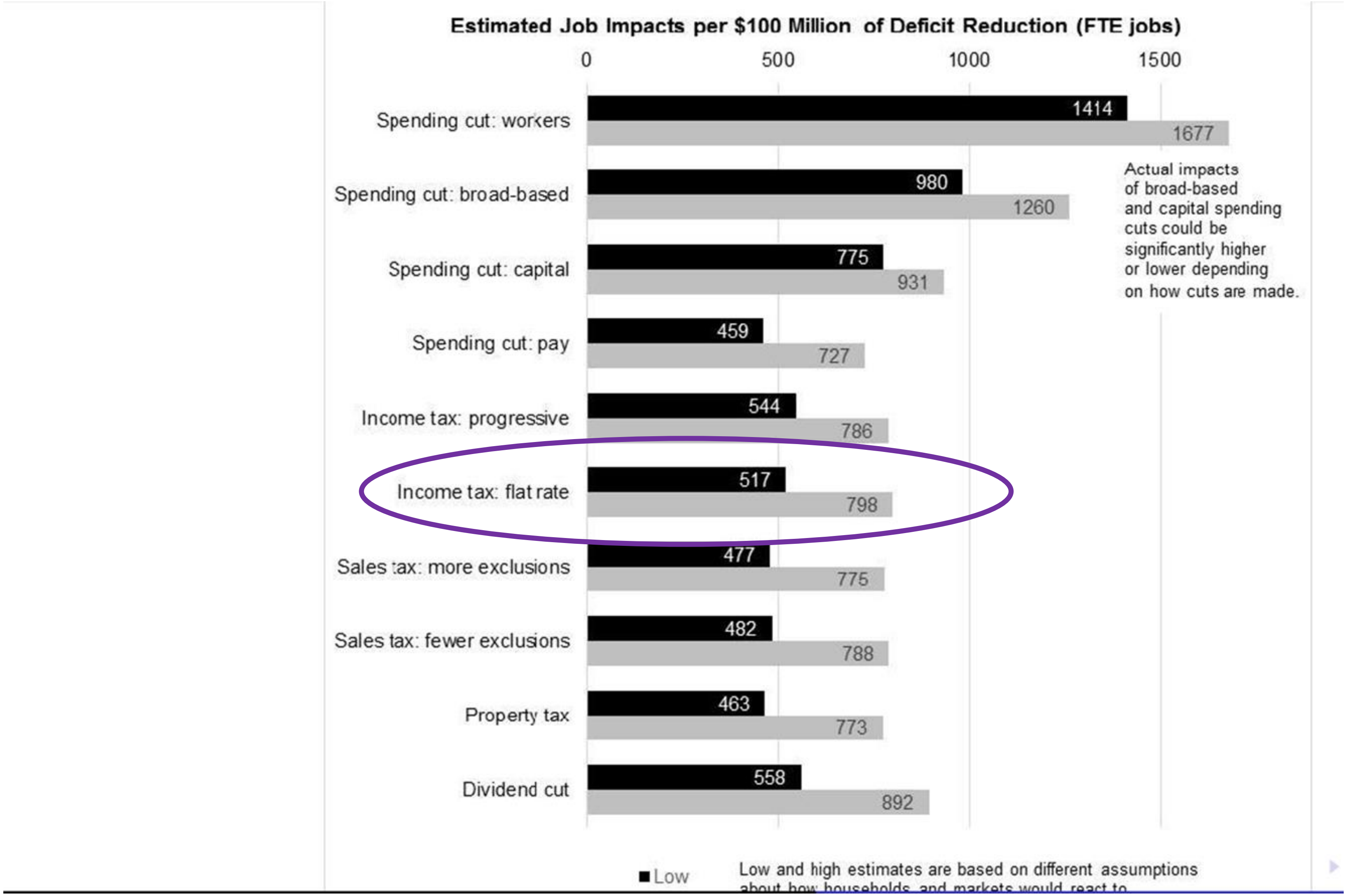
Impact of Recession on Alaska's Economy

Per the Alaska Department of Labor, since the peak:

- Overall economic activity in the state down 17% (much of this due to the reduction in the value of every barrel of oil)
- Total job losses 11,900 positions (3.3%)
- State government job losses 2,700 positions (>10%)
- State facility closures throughout the state

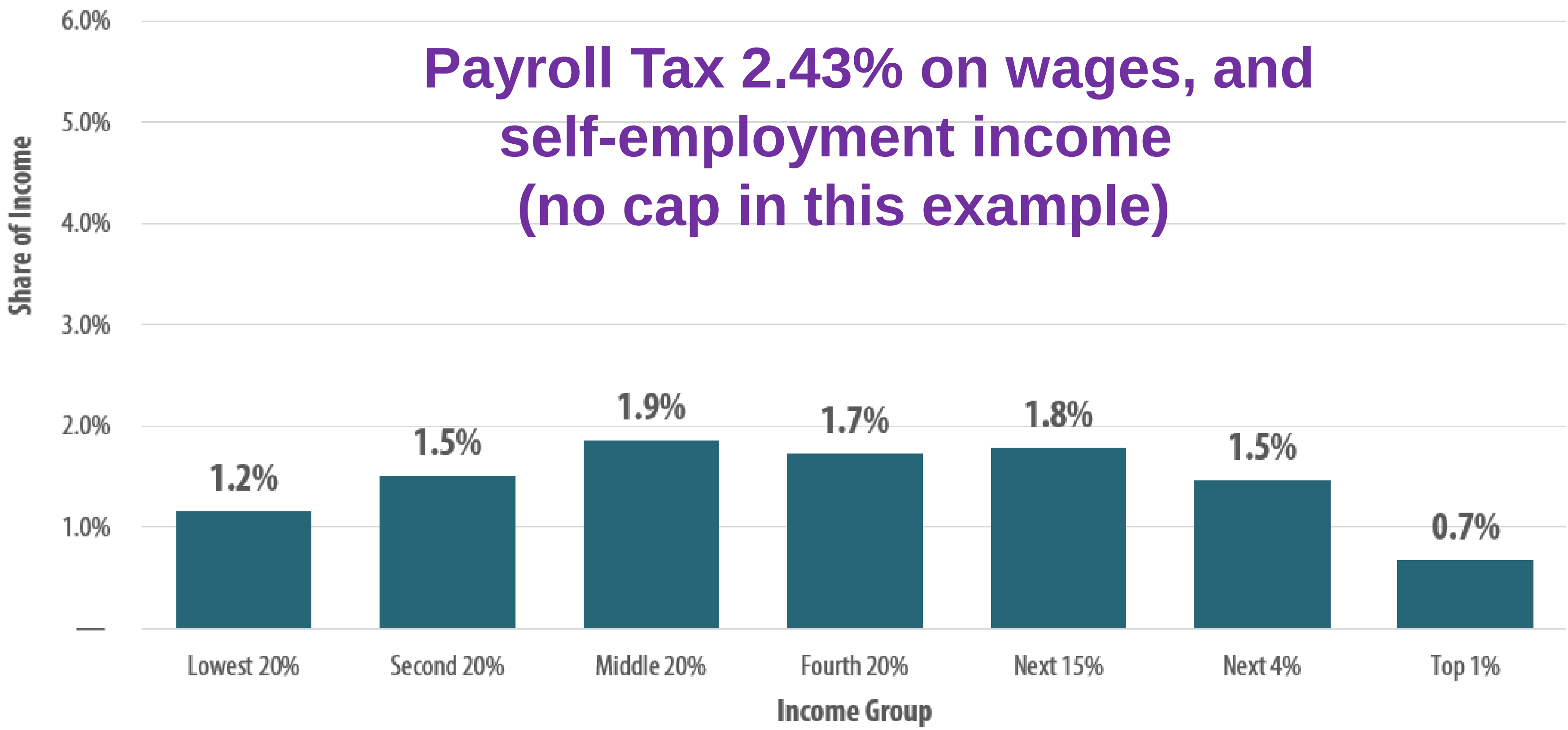


ISER- Job Impact of Different Options



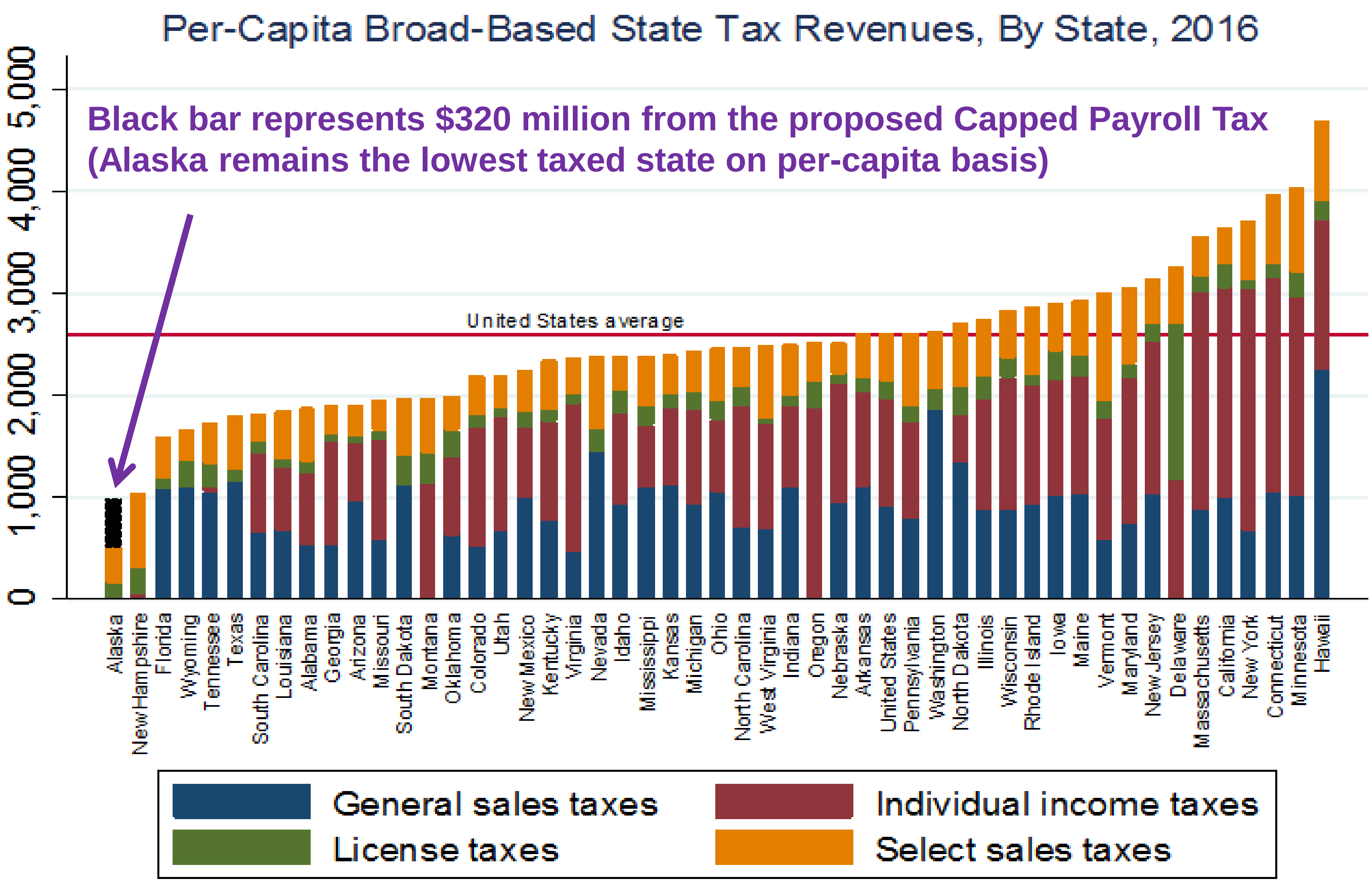
Source: Prof. Mouhcine Guettabi presentation to Senate Labor and Commerce 1/18/17

ITEP analyzed multiple tax options that each would raise $500 million



Source: "Comparing the Distributional Impact of Revenue Options in Alaska," ITEP, April 2017

Comparable Tax Burden



Source: Mouhcine Guettabi, ISER

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Thank You!

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