



Capped Payroll Tax- Bill Introduction SB 4001 by Governor Walker

Presentation to the Senate Finance Committee

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Department of Revenue

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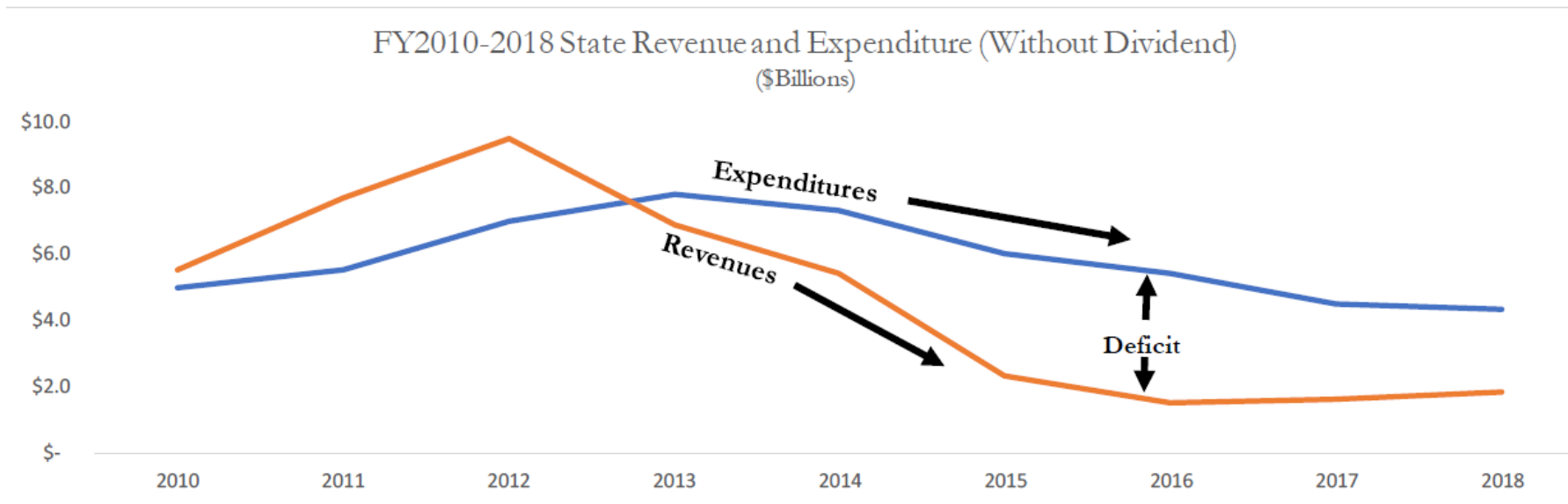
Bill Title

“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

From OMB Director Pitney

Savings: State Budget Overview



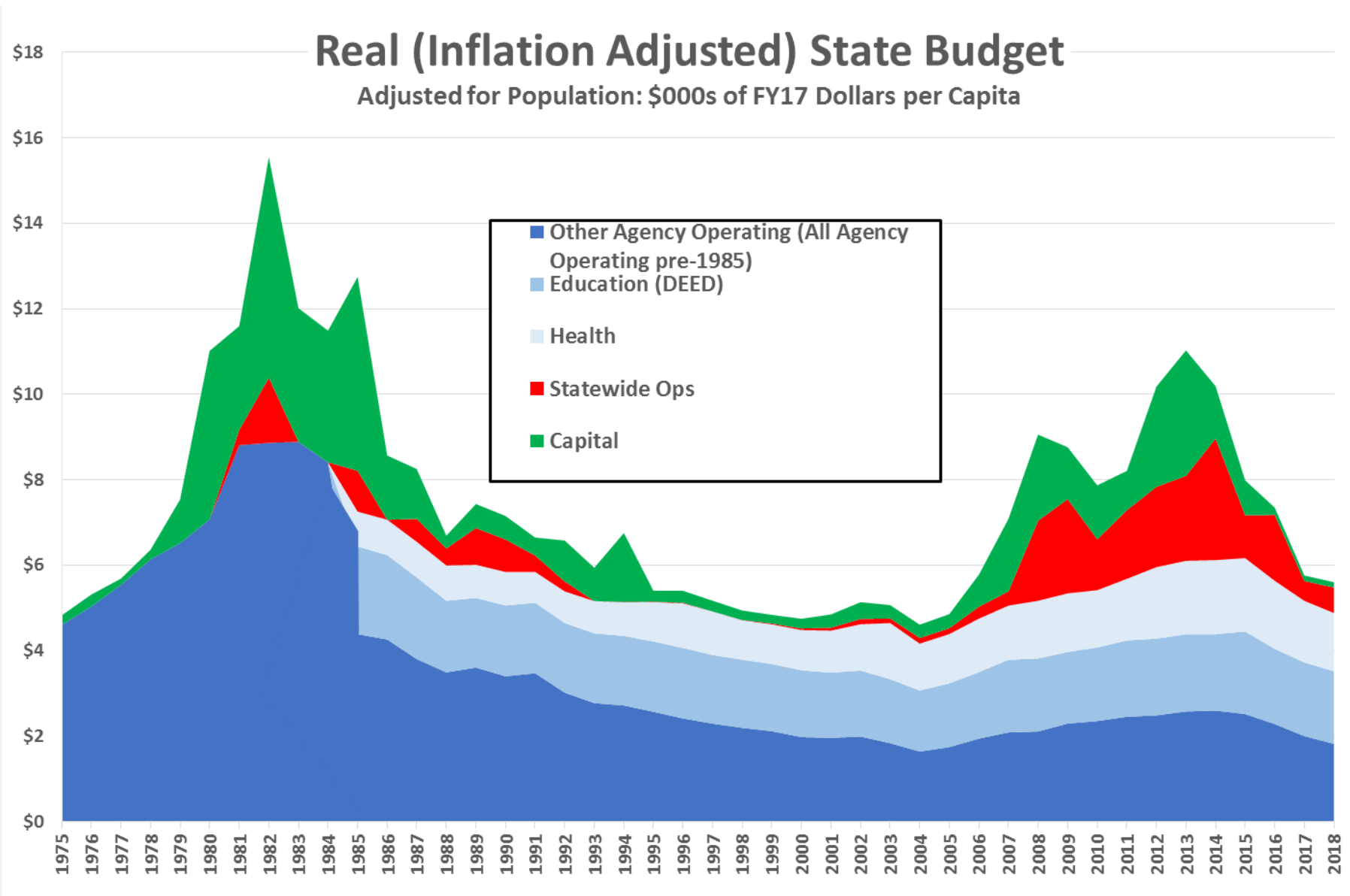
Substantial budget reductions have been made (44 percent since FY2013), but revenues have declined by almost 80 percent during that time.

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	\$0.9	\$4.4	(\$3.1)
2018	\$1.3 est.	\$4.3	(\$2.5) est.

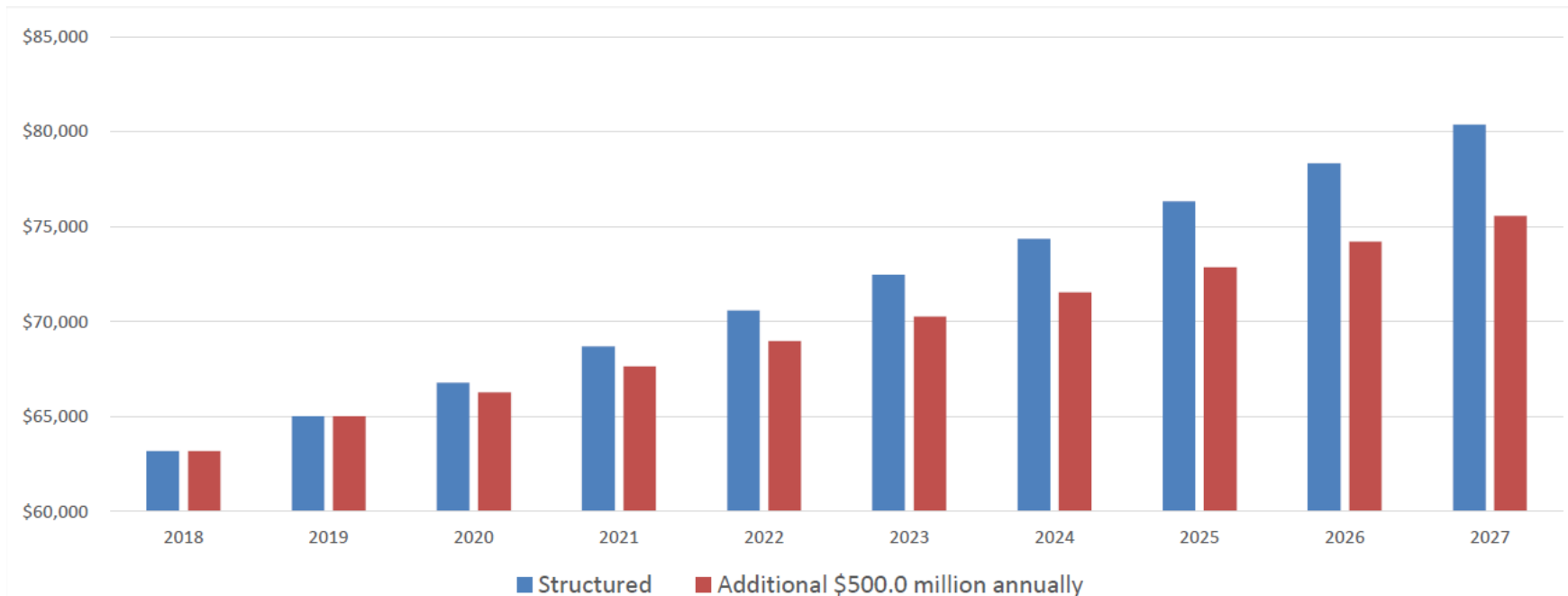
Budget has been reduced to 1990s levels when adjusted for inflation and population



Why a Broad-Based Tax?

- Even a small tax as proposed in SB4001 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

Impact of Unstructured Draws



- Maintaining the CBR balance at \$2 billion minimum level is crucial but leaves little flexibility.
- An additional \$500.0 million annually taken from the ERA above the structured draw reduces the Permanent Fund balance by \$5 billion compared to a structured draw with additional revenues
- That \$5 billion left in the PF generates \$250.0 million annually - reducing future tax.



SB 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, etc.
- Employers withhold and file for wage employees
- Tax is capped at \$2,200 or twice the previous year's PFD, whichever is greater
 - Cap applies to incomes over \$147,000 / year
 - Cap only impacts top 5% of earners
 - Foregone revenue from the cap is \$10 to \$20 million

Tax Proposal Summary

- Revenue about \$320 million at full implementation
- About 15% of revenue will come from nonresidents
- 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

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

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

SB 4001 is different from a true income tax

- Does not tax several key types of income:
 - Capital gains
 - Retirement earnings
 - S-corp distributions
- The administrative structure, as well as the flat rate with a cap, is modeled after the “school head tax” bills such as Sen. Bishop’s SB12 (without the marginal tax issues that come with the stair step structure)
- Much less complex administration and staffing need
- Does not require individual filing for typical wage earners
- Nevada is one of seven states without any income tax, but has a Modified Business Tax (MBT) of 1.43% remitted by employers on wages above \$50,000 (*Tax Foundation*)

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 SB 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 SB 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
- 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) 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 up to 40 employees
- Total cost over six-year fiscal note period is about 2.5% of projected revenue.

Fiscal Note Implementation Cost

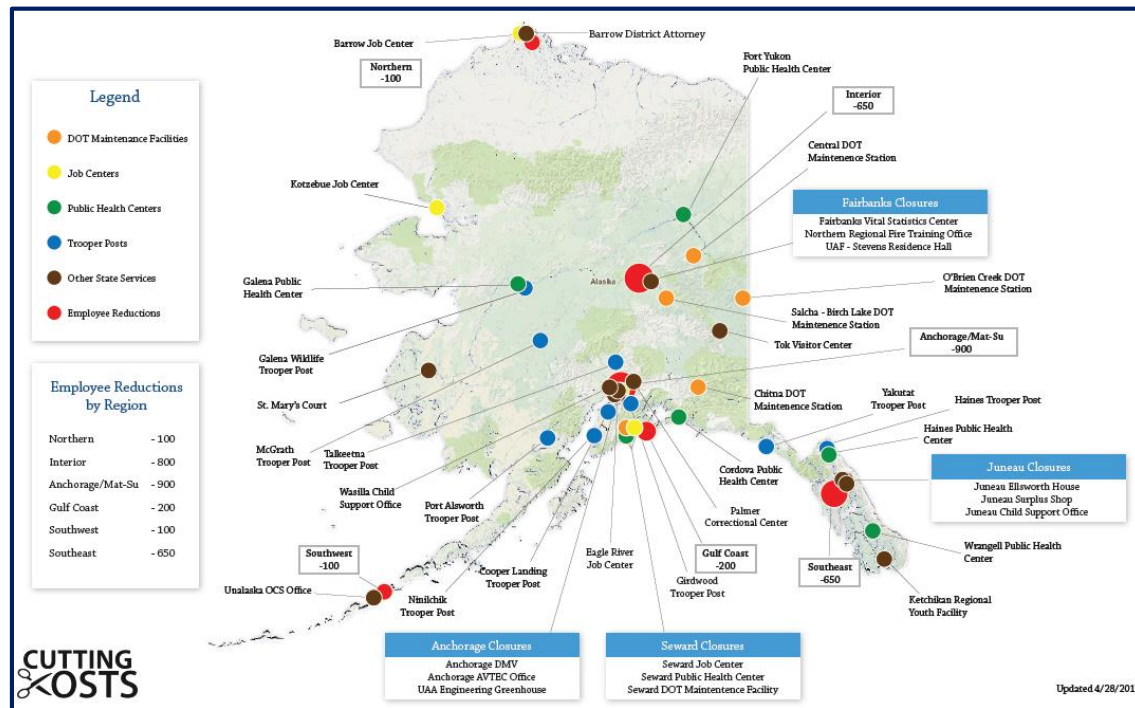
- The Department of Revenue's Fiscal Note is somewhat conservative (meaning too high, we hope)
- Assumes stand-alone system built within the Tax Division
- Items that need to be pinned down (partial list):
 - How much can we limit individual reporting needs vs. relying on employer filing?
 - Process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

Economic Impact of Bill

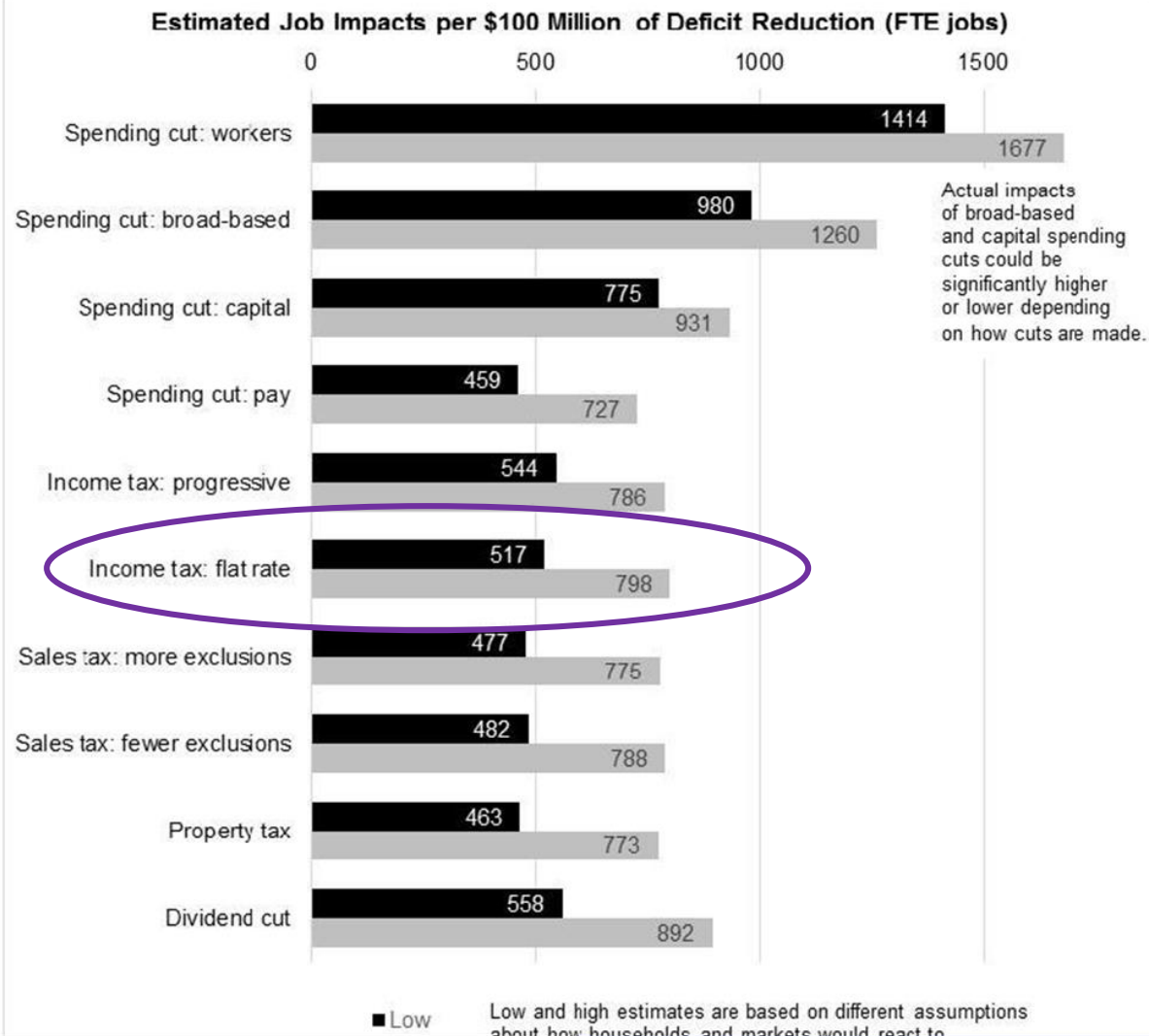
Impact of Recession on Alaska's Economy

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 11,600 positions (3.2%)
- State government job losses 2,600 positions (11%)
- State facility closures throughout the state

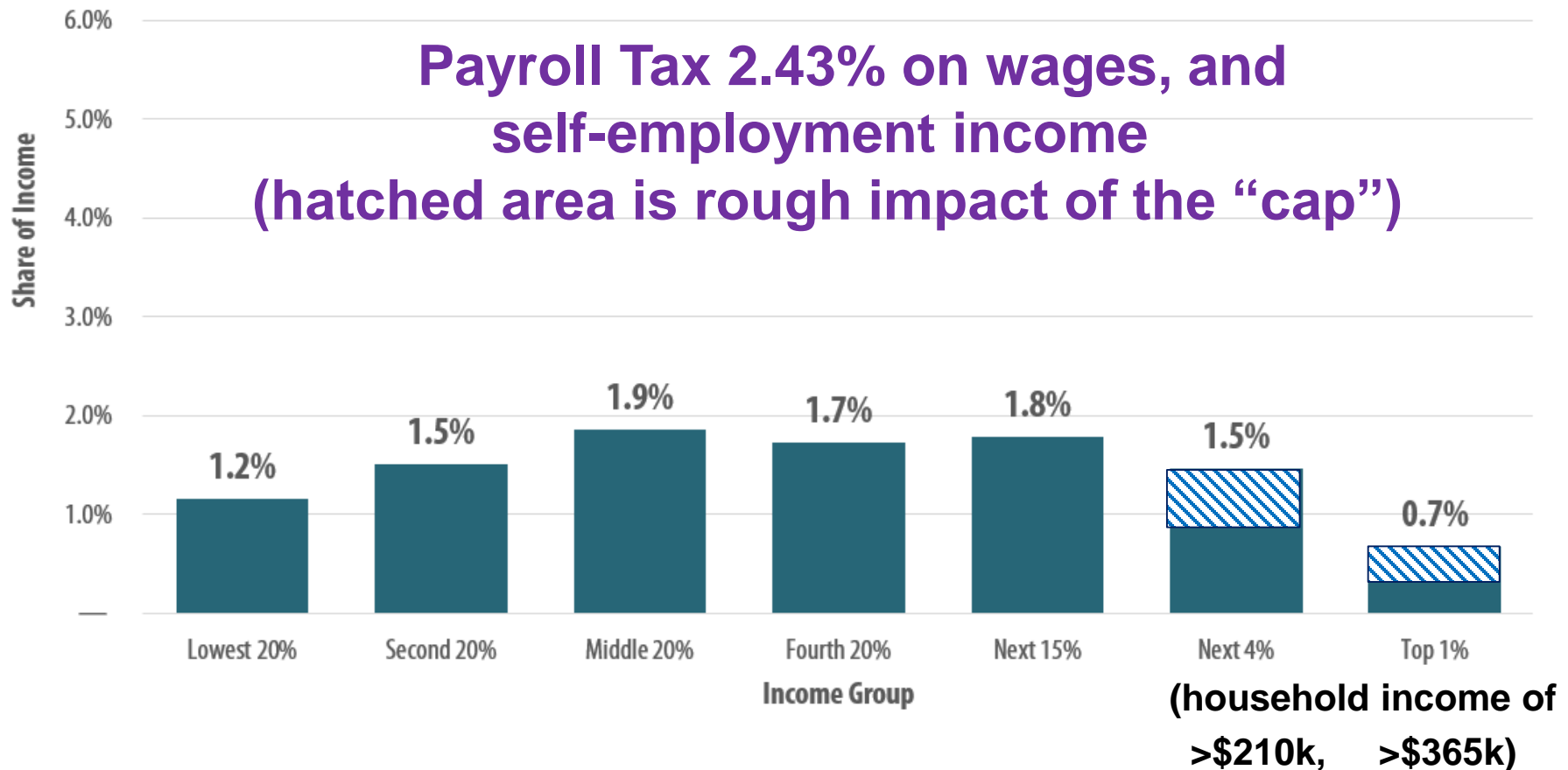


ISER- Job Impact of Different Options



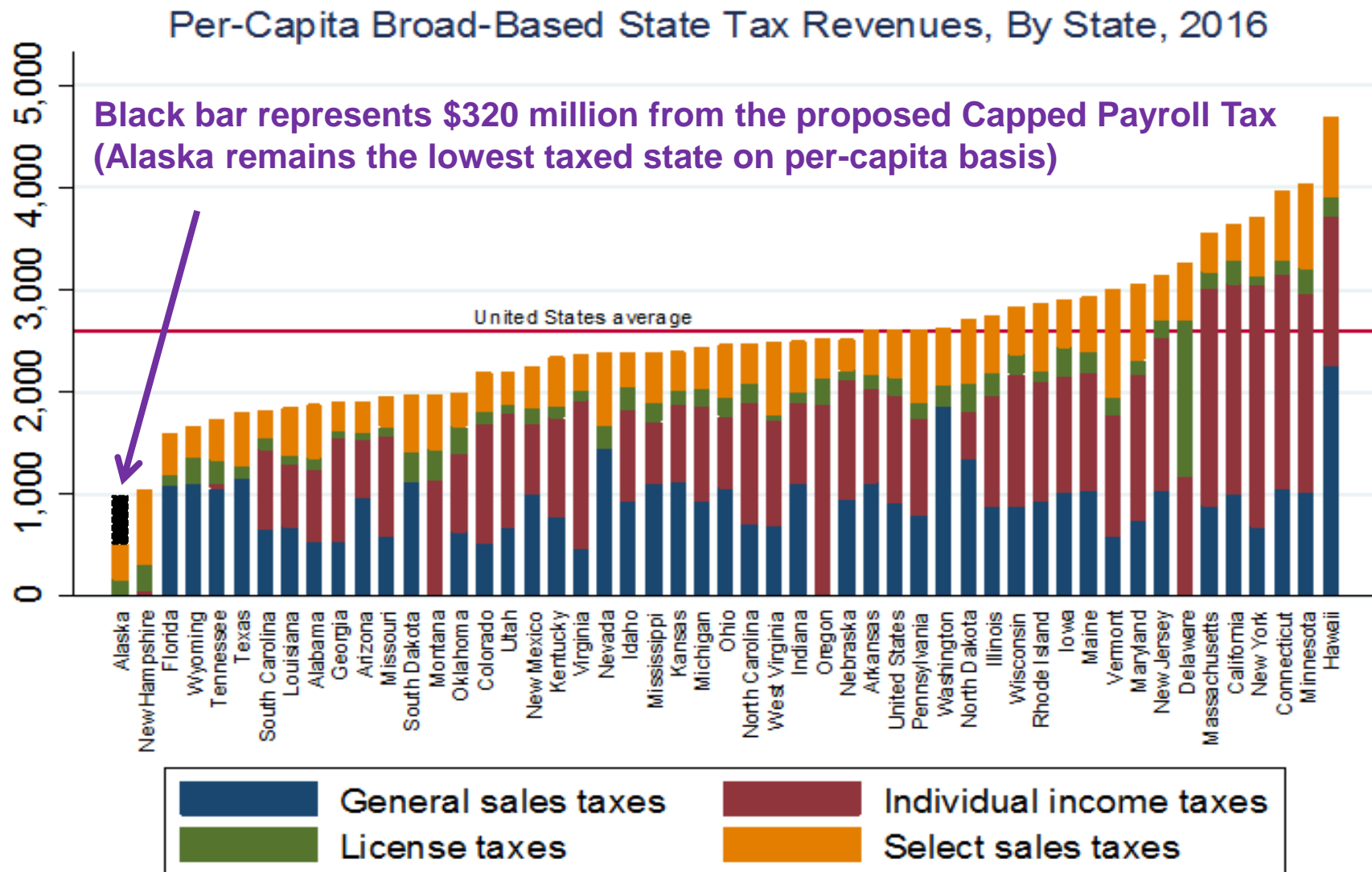
Source: Prof. Mouhcine Guettabi presentation to Senate Labor and Commerce 1/18/17

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 (state to state)



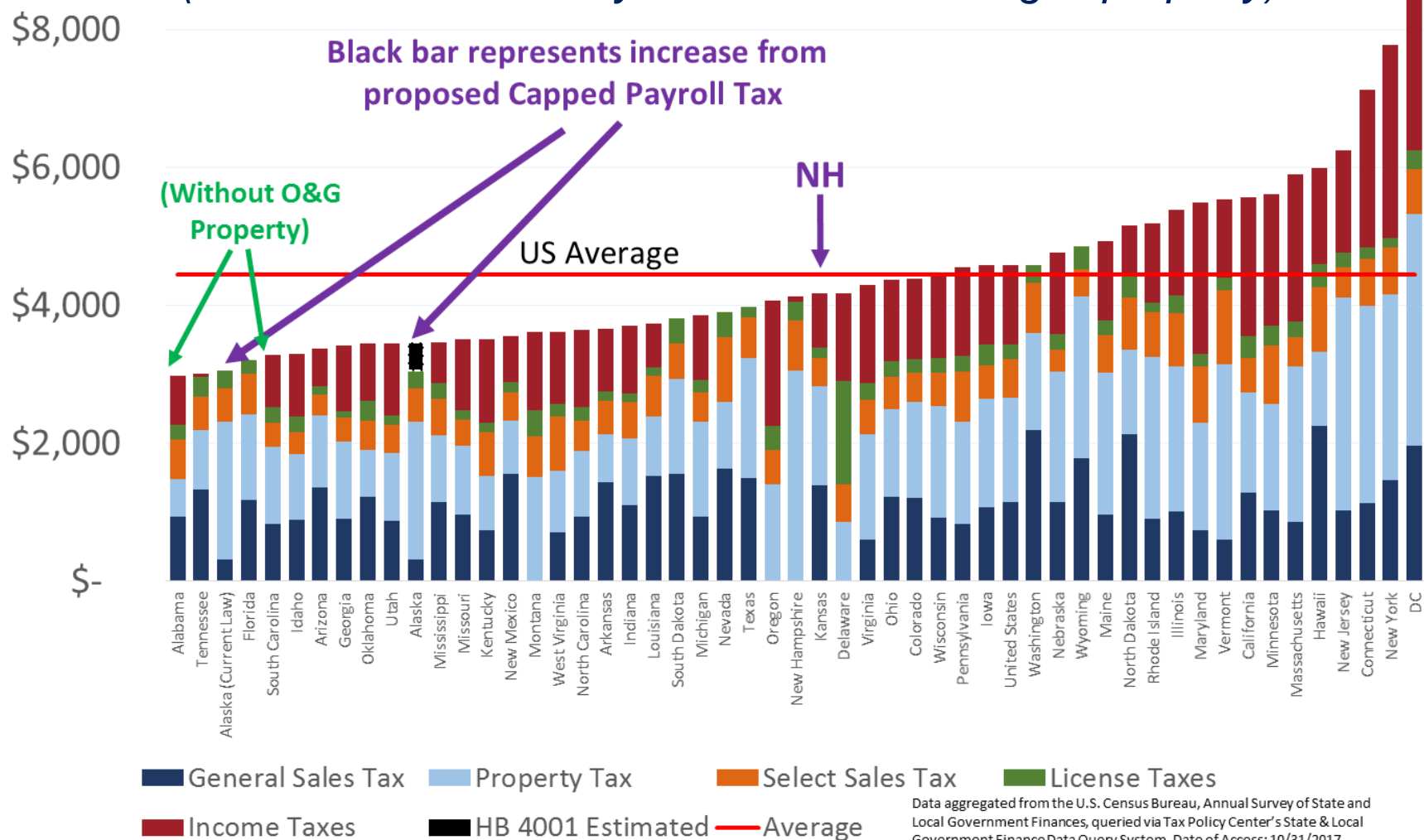
Source: Mouhcine Guettabi, ISER

Comparable Tax Burden (state and local)

Per-capita broad-based state and local tax burden (2015)

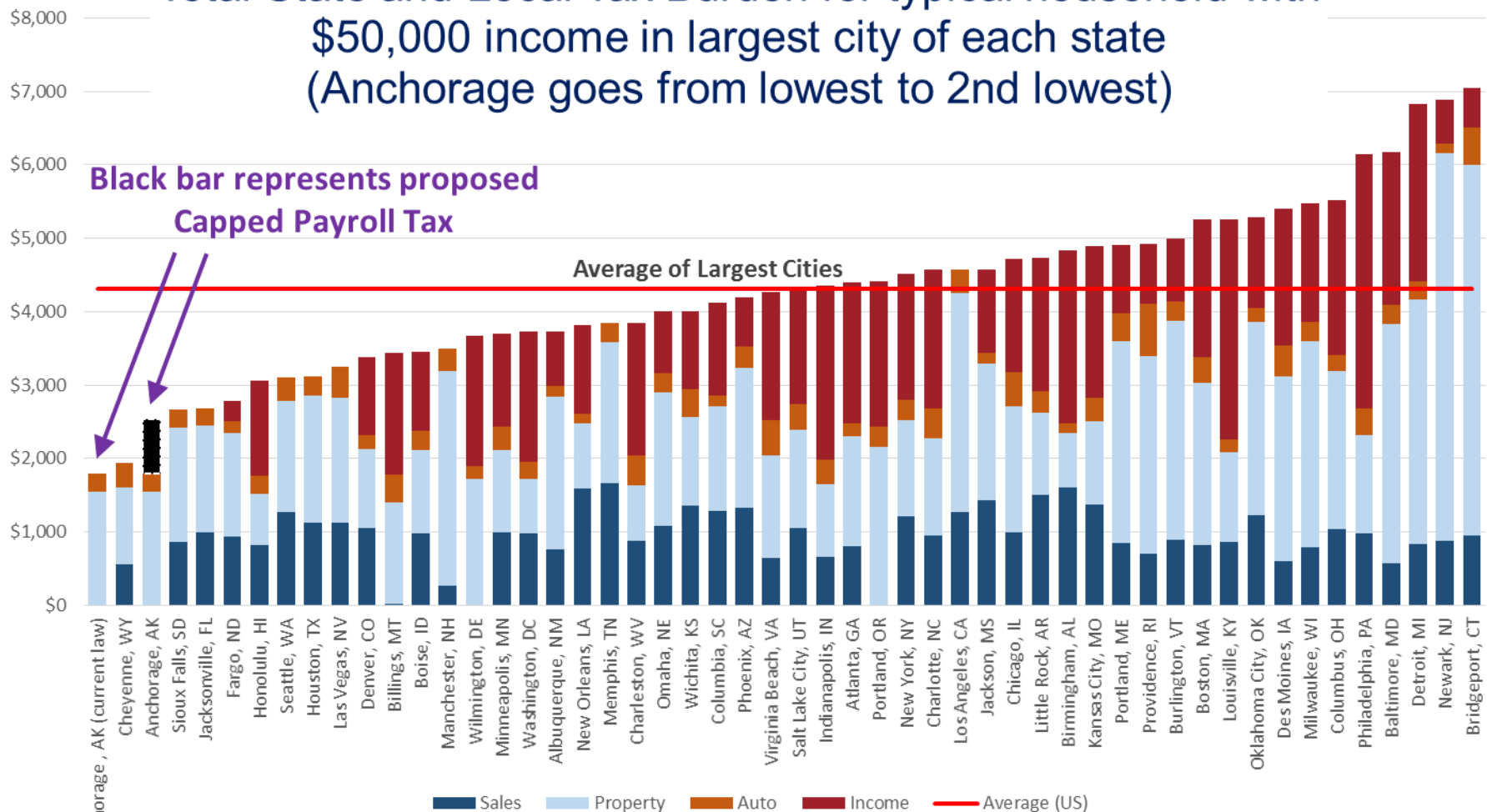
Alaska goes from 3rd lowest to 10th lowest

(lowest to 4th lowest if you back out oil and gas property)



Comparable Tax Burden (largest cities)

Total State and Local Tax Burden for typical household with \$50,000 income in largest city of each state
(Anchorage goes from lowest to 2nd lowest)



Data Source: Tax Rates and Tax Burdens in the District of Columbia - A Nationwide Comparison (December 2016)



Thank You!

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