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**ALASKA**  
PLAN



*Pulling Together to Build Our Future*

## **Capped Payroll Tax- Bill Introduction SB 4001 by Governor Walker**

**Presentation to the Senate Finance Committee**

***Sheldon Fisher, Commissioner***

***Ken Alper, Tax Division Director***

**Department of Revenue**

**November 9, 2017**

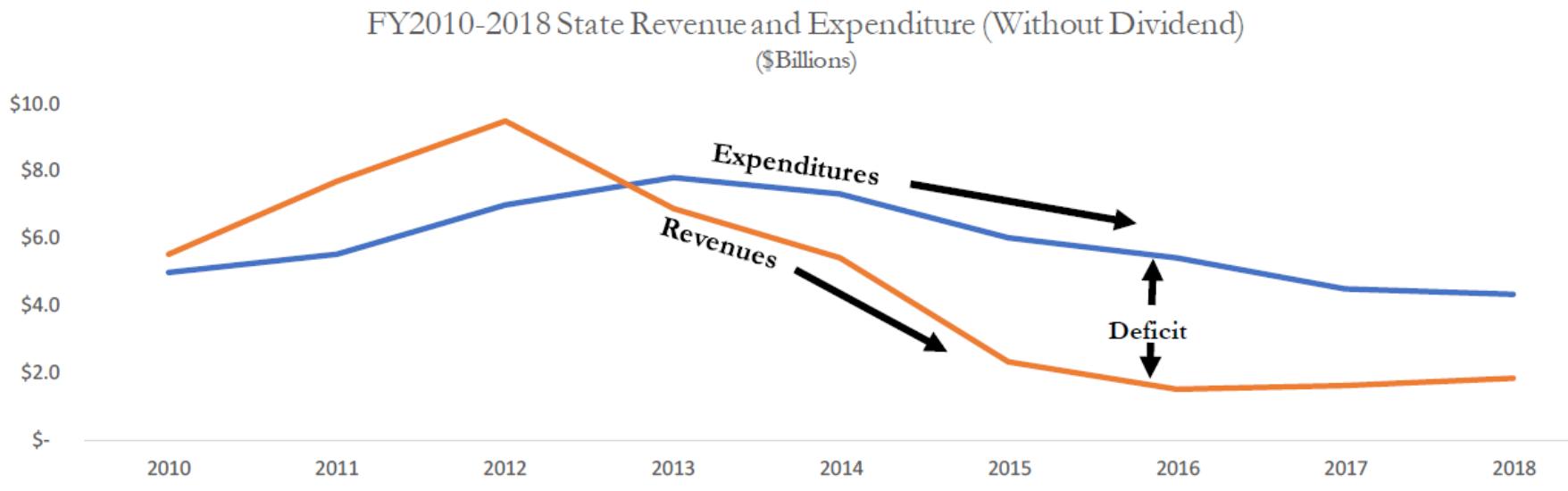
## *Bill Title*

**“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



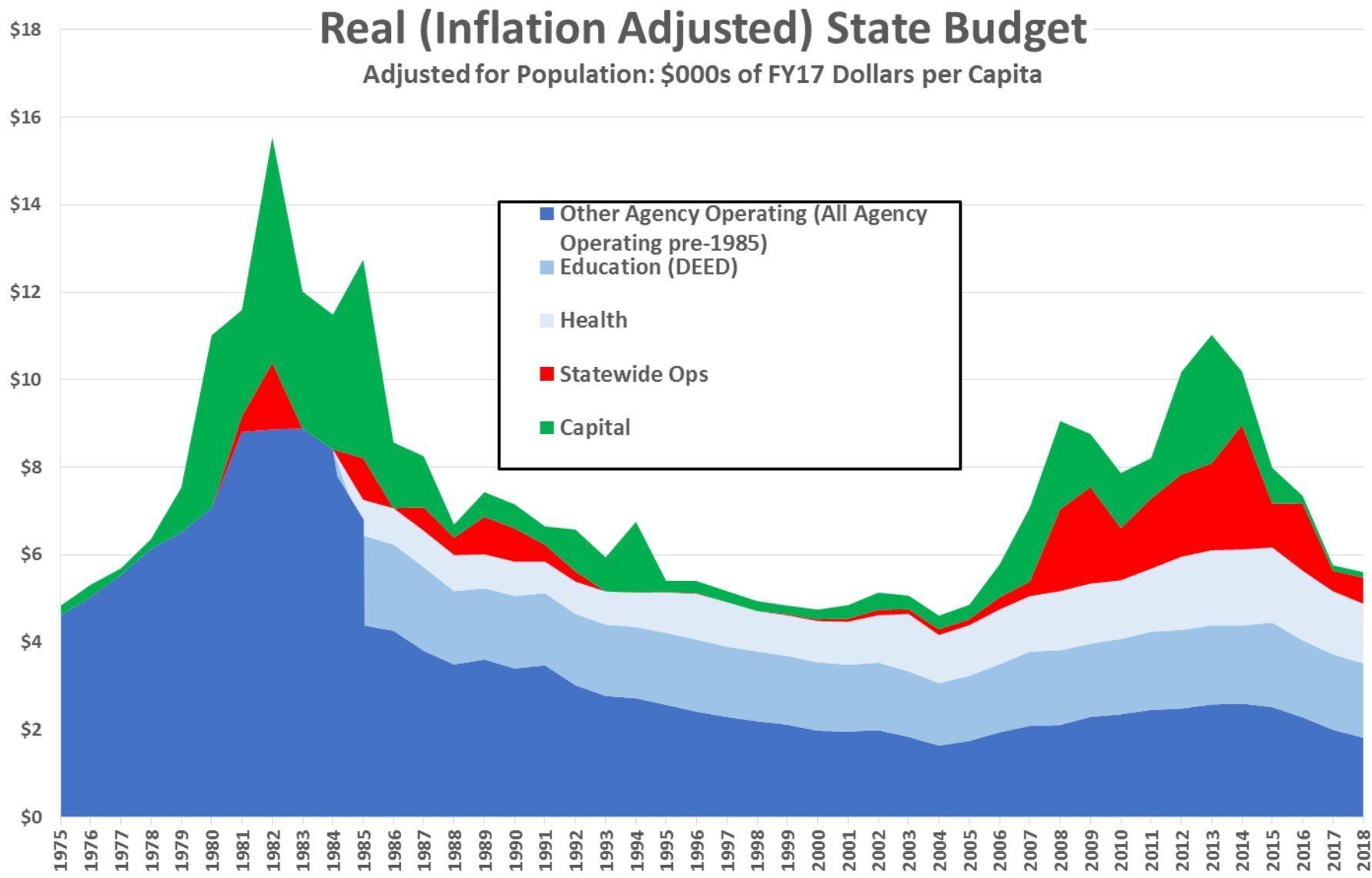
Substantial budget reductions have been made (44 percent since FY2013), but revenues have declined by almost 80 percent during that time.

# *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.

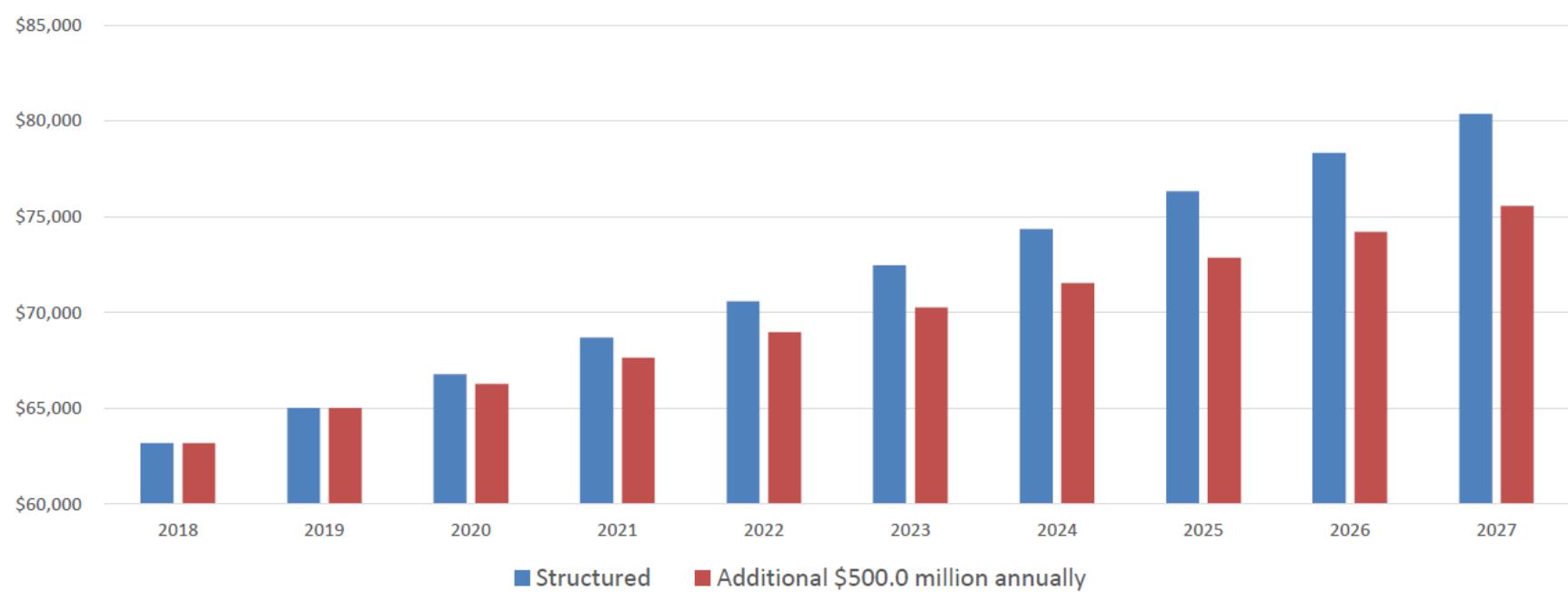
# *Budget has been reduced to 1990s levels when adjusted for inflation and population*



# *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*

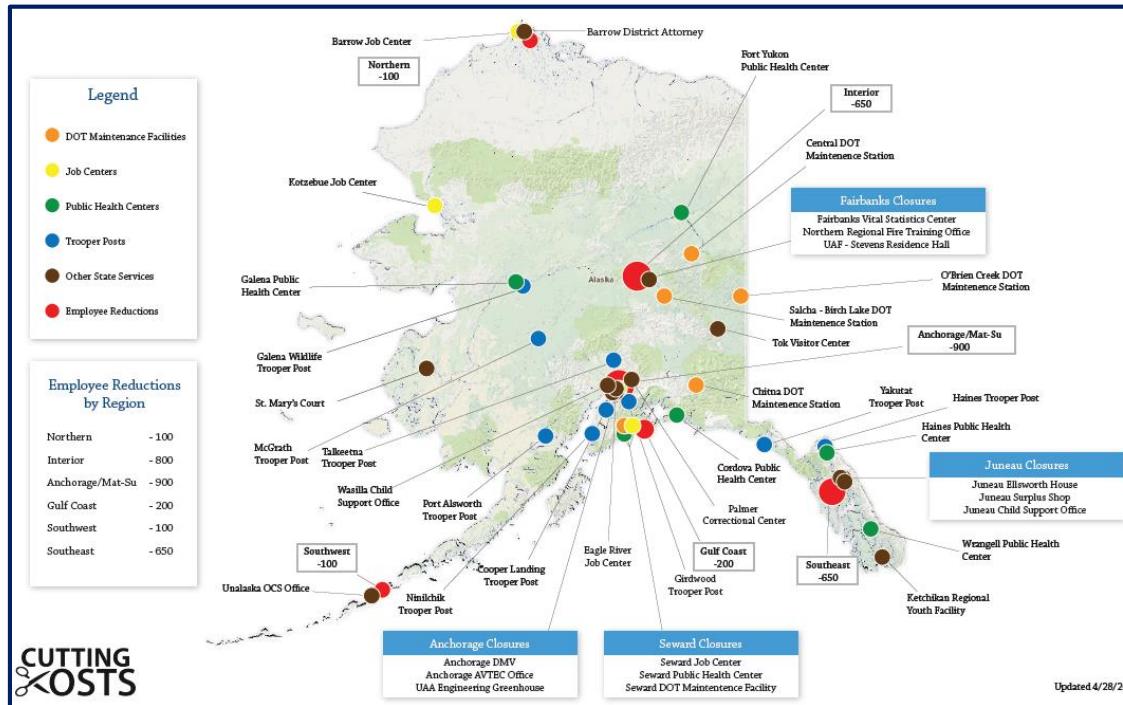
- The Department of Revenue's Fiscal Note is somewhat conservative (meaning too high, we hope)
- Assumes stand-alone system built within the Tax Division
- Items that need to be pinned down (partial list):
  - How much can we limit individual reporting needs vs. relying on employer filing?
  - Process 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

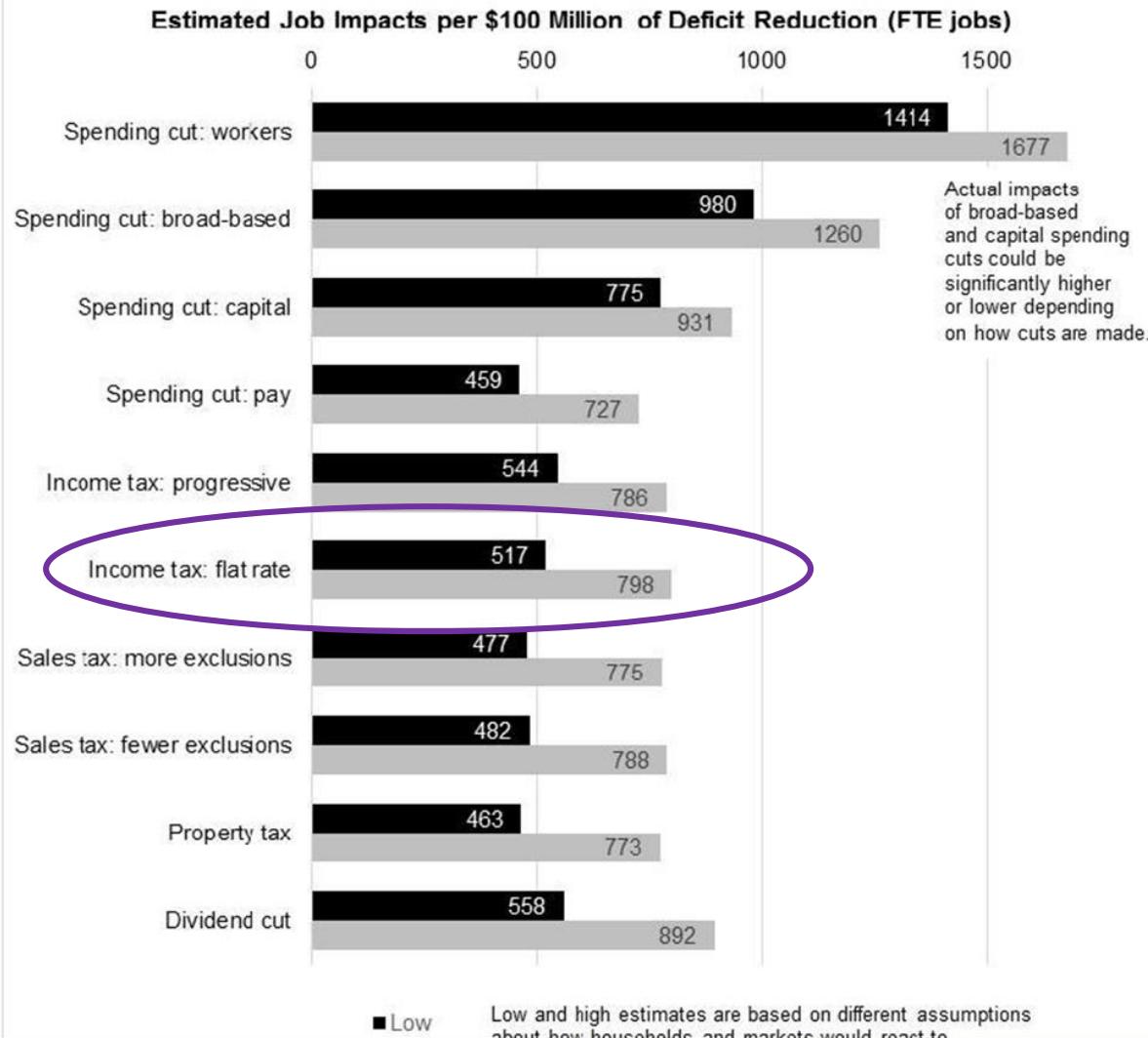
# *Impact of Recession on Alaska's Economy*

## **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

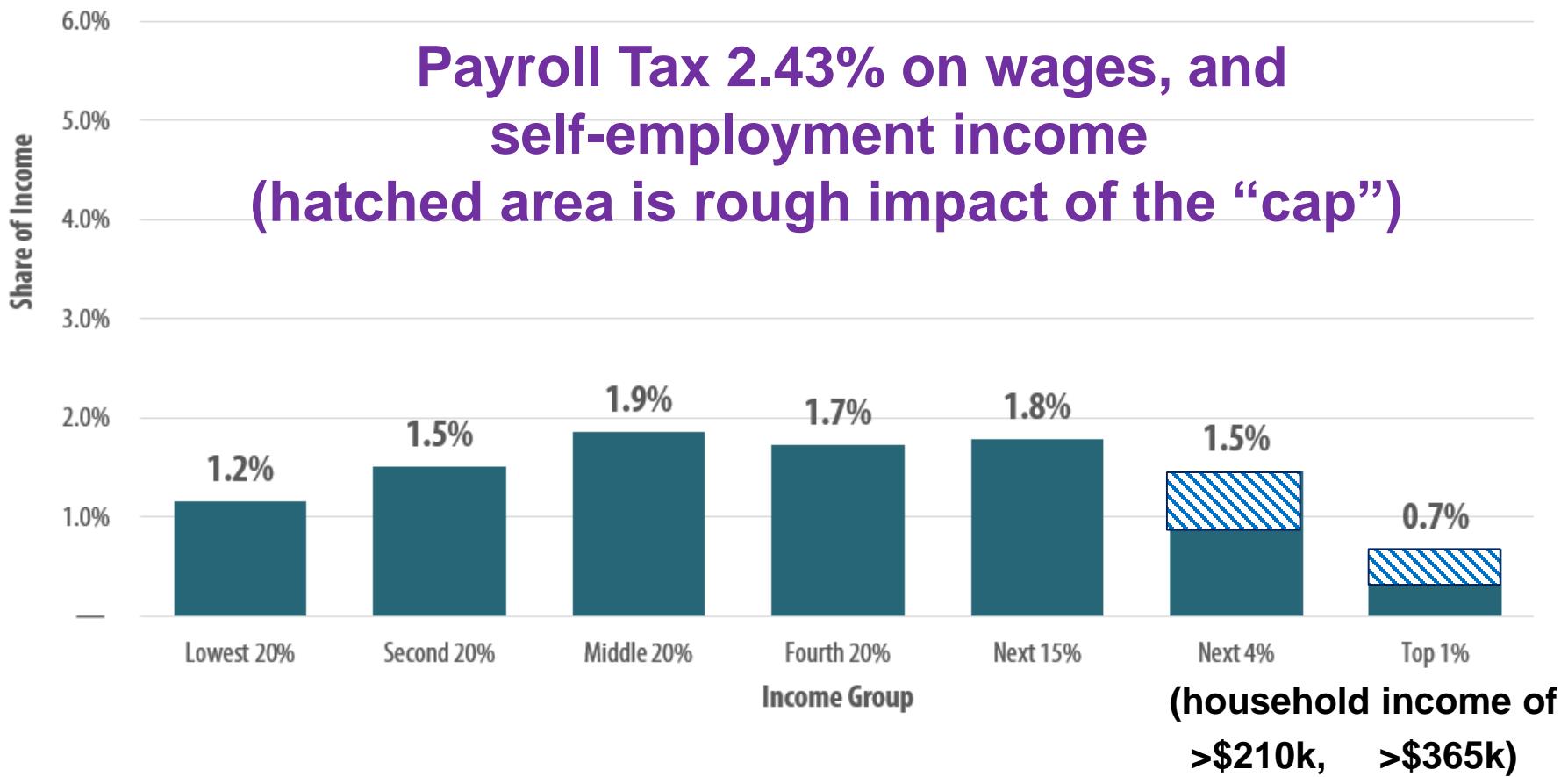


# ISER- Job Impact of Different Options



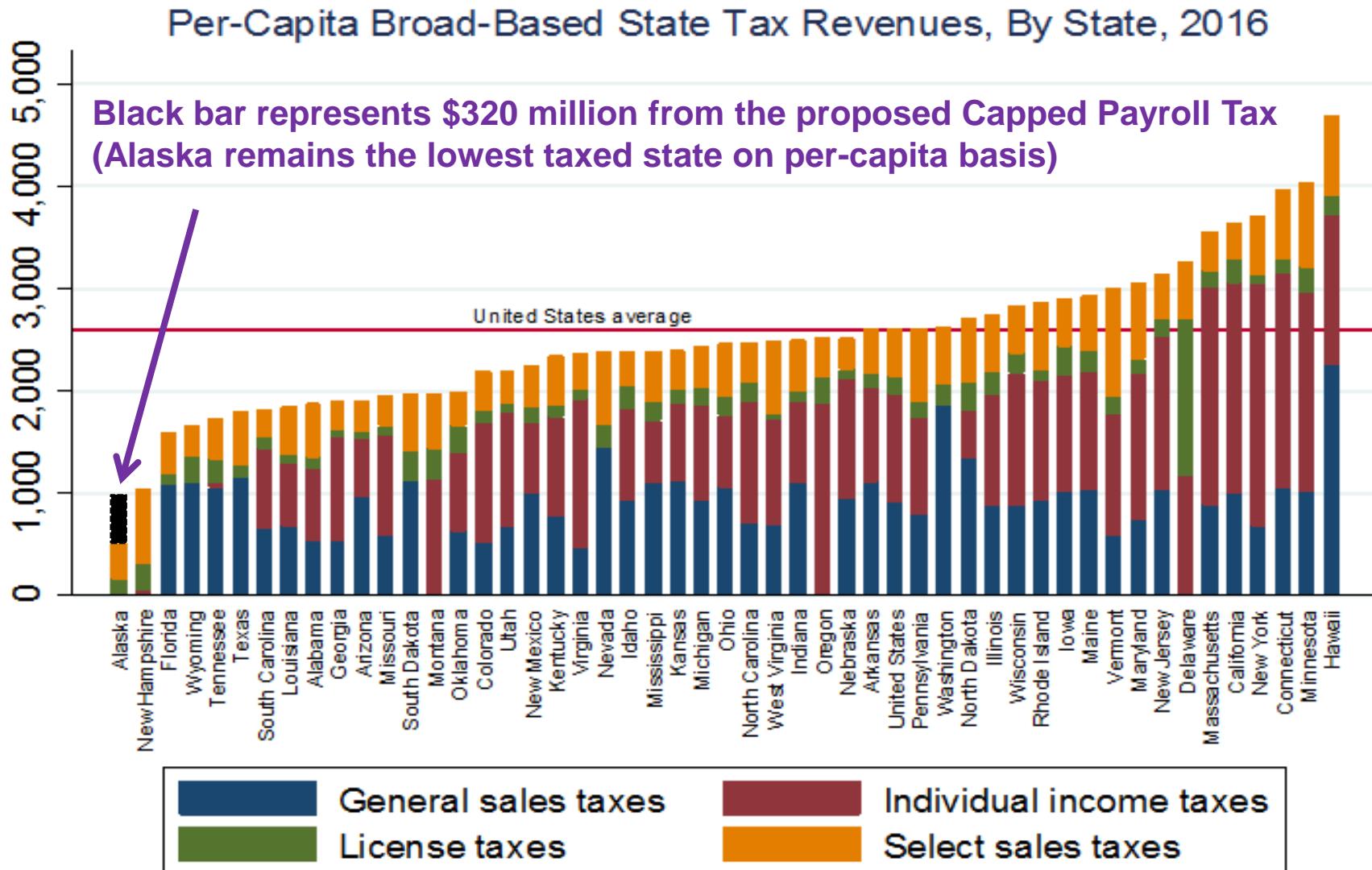
Source: Prof. Mouhcine Guettabi presentation to  
Senate Labor and Commerce 1/18/17

# 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)



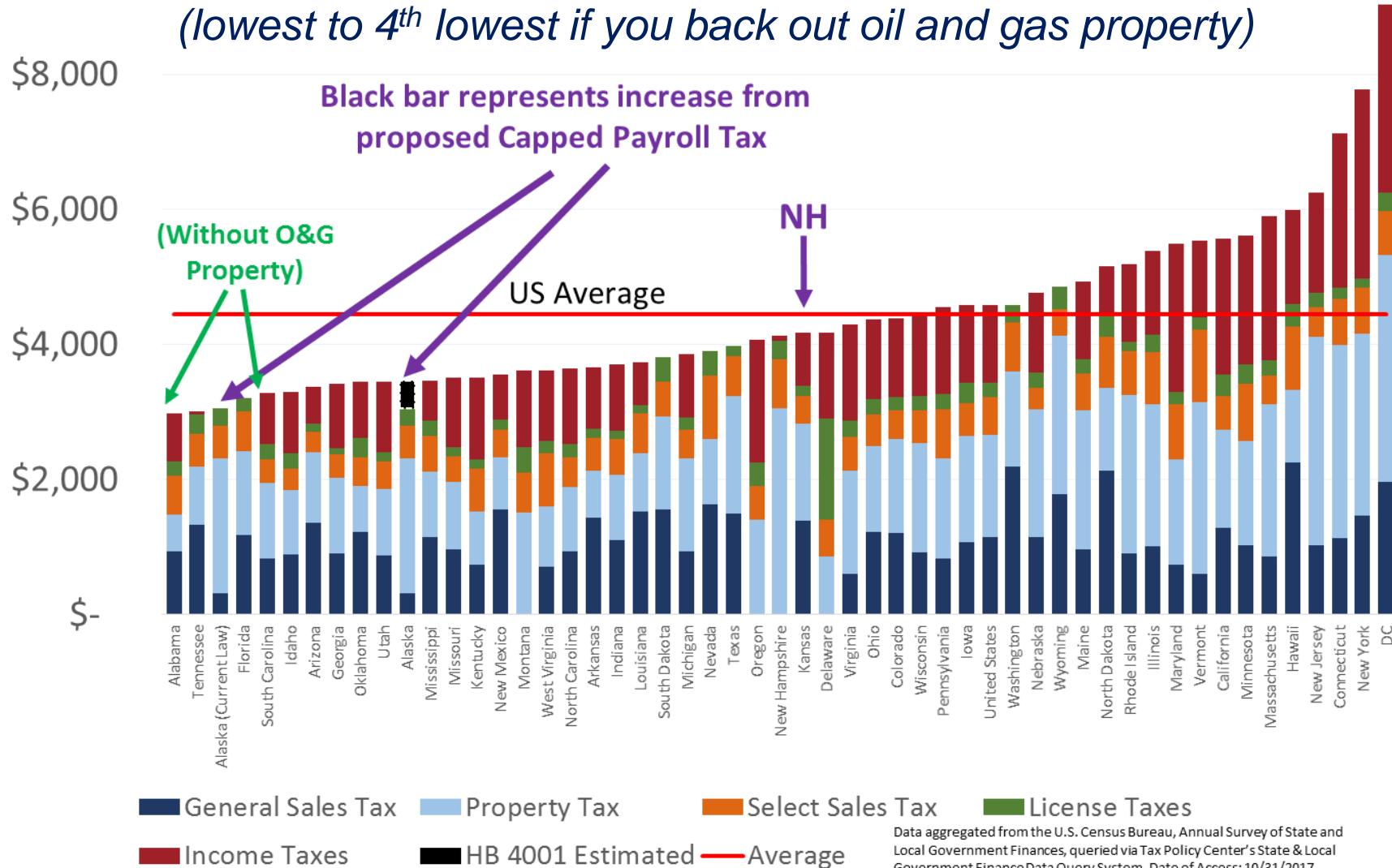
Source: Mouhcine Guettabi, ISER

# Comparable Tax Burden (state and local)

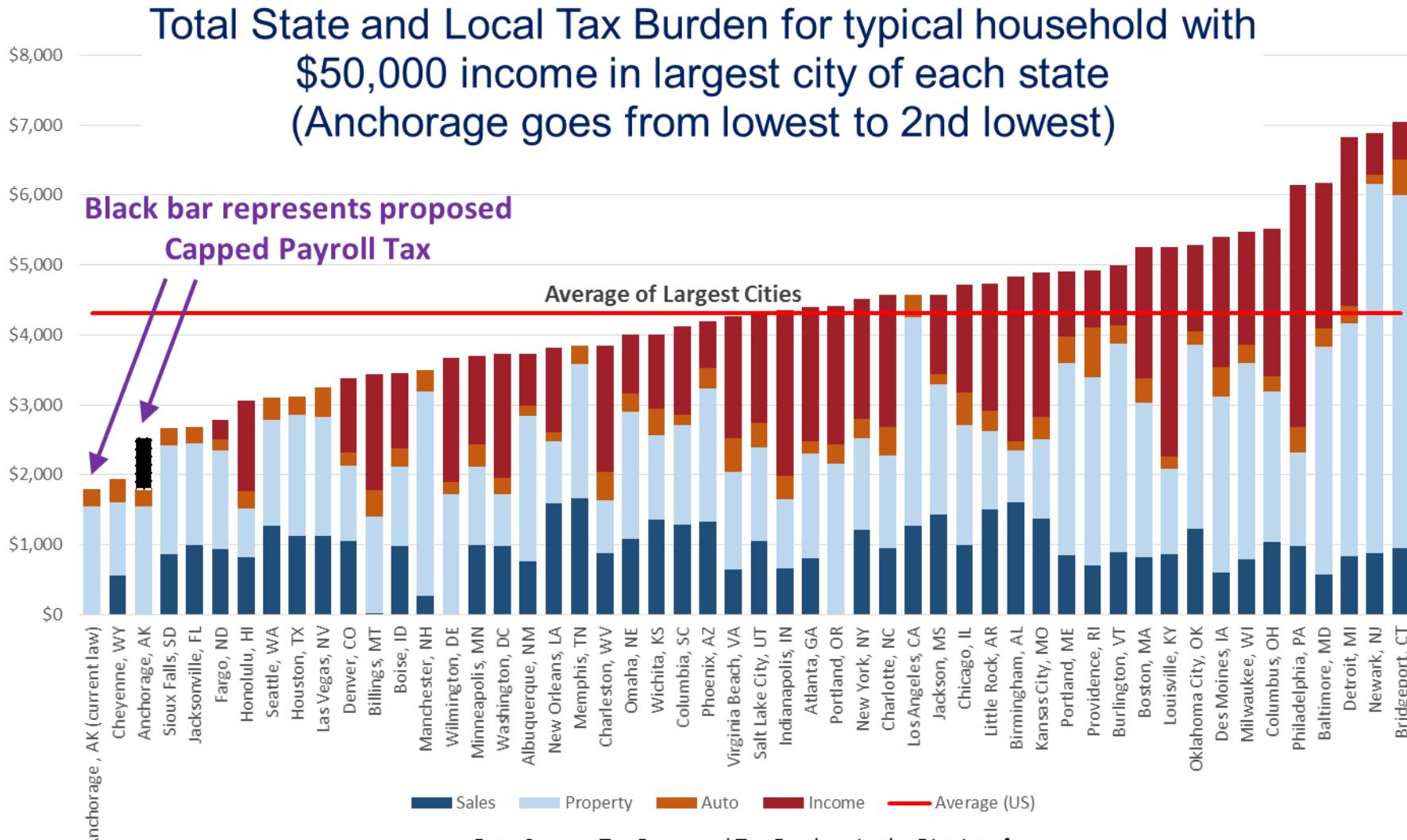
Per-capita broad-based state and local tax burden (2015)

Alaska goes from 3<sup>rd</sup> lowest to 10<sup>th</sup> lowest

(lowest to 4<sup>th</sup> lowest if you back out oil and gas property)



# Comparable Tax Burden (largest cities)



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



# Thank You!

## Contact Information

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