Alaska State Legislature

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REPRESENTATIVE PAUL SEATON

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Sponsor Statement

HB 365

Alaska has a $3.8 billion budget deficit. This deficit is caused by the precipitous oil price drop to between $30 and $40 per barrel and requires consideration of both state budget reductions and additional revenues. Even though the legislature cut FY16's combined capital and operating budget about $900 million, the price per barrel breakeven point for a balanced budget is still over $100 per barrel. The "easy" cuts were taken last year. A diversification of revenue sources is required. Combining revenues from a Permanent Fund Dividend reduction and a progressive income tax creates a balance most fair to all Alaskans.

HB 365, *Individual Income Tax and Permanent Fund Refundable Tax Credit*, establishes an income and long term capital gains tax on residents and nonresidents, changes the Permanent Fund Dividend (PFD) to a Permanent Fund Refundable Tax Credit and directs a moderate portion of the permanent fund earnings to support state services. Alaska is the only State without a state sales, income, or property tax. An income tax will generate the greatest revenue in an equitable manner at the lowest administrative cost. Individual Alaskan contributions will not balance the budget alone, but are a necessity for a realistic fix along with additional cuts to expenditures.

The income tax will be for both residents and nonresidents; however only qualifying residents will be eligible for the Refundable Tax Credit, under the same eligibility requirements that exist for the PFD today. The Refundable Tax Credit will first be applied to a resident's state income tax due with all remaining amount sent to the resident as a refund. Residents qualifying for the Refundable Tax Credit will be given the option to apply some or all of their credit to Pick Click Give and/or their child's college fund, similar to the PFD arrangement now. This bill would have contributed $1.3 billion to the General Fund in 2015, half coming from the income tax revenues and half coming from the changes made to the permanent fund distributable income calculation.

<u>Permanent Fund Refundable Tax Credit</u>: This portion of the bill will change the dividend to a Refundable Tax Credit. The tax credit would be very similar to how the PFD operates now. The main difference is the tax credit would be first applied to a resident's state income tax due with any remaining amount sent to the resident as a refund. The amount of the tax credit will be taxable income on an individual's Federal taxes, as the PFD is currently. However, state income tax payments can be claimed as an itemized deduction on Federal taxes. Other changes are explained below.

Similarities between the Refundable Tax Credit and the PFD:

- Same application and eligibility requirements
- Similar to PFD, the tax credits can be garnished to pay for state fees, University fees, loan defaults, child support, etc.
- Similar to PFD, the tax credit is not counted as income for residents applying for public assistance, Alaska Pioneer Home, Alaska Veteran Home, or other state programs based on financial need.
- Similar to PFD, a qualifying resident can choose to apply all or some of their tax credit to Pick Click Give and/or their child's college fund.

Changes between the Refundable Tax Credit and the PFD:

- Tax credit refunds, if any, will be received by eligible residents after they have completed the state income tax forms (typically Jan-April). The tax credits are not available for non-residents paying state income tax on wages earned in Alaska.
- Same formula calculation as the PFD for determining income available for distribution – which is 21% of the net income from the permanent fund for the last 5 years. However, currently 50% of the income available for distribution goes to the PFD and 50% stays in the Earnings Reserve. With this bill, 25% of the income available for distribution will go to the Refundable Tax Credits, 25% will go directly to the general fund to support state services, and the remaining 50% will still stay in the Earnings Reserve.
- A tax credit will not exceed $1,200. If the amount calculated for the tax credit exceeded $1,200 per tax credit, the amount in excess of $1,200 shall be appropriated to the general fund.

<u>Individual Income and Long Term Capital Gains Tax:</u> This portion of the bill will create an individual income tax on residents and nonresidents who have income from a source within the state. The tax is equal to 15% of the taxpayer's total federal income tax due. Long term capital gains are additionally taxed by multiplying the taxpayer's long term capital gains for the calendar year by the lesser of:

- 10%; or
- The difference between the taxpayer's federal income tax rate on ordinary income and the taxpayer's federal tax rate on long term capital gains.

Taxpayers can elect to deduct their state income tax payments on their federal itemized deductions- schedule A. The individual income tax would also apply to income earned by Sub-S corporations or limited liability corporations, which currently do not pay the state corporate income tax. Currently, nonresidents pay their home state income tax on money they earned in Alaska. With the passage of HB 365, Alaska would now receive that tax revenue. It's estimated at least 20% of income tax revenue will be paid by nonresidents.