

# Fiscal Note

State of Alaska  
2017 Legislative Session

Bill Version: HB 115  
Fiscal Note Number: \_\_\_\_\_  
( ) Publish Date: \_\_\_\_\_

Identifier: HB115-DOR-TAX-2-11-17  
Title: INCOME TAX; PFD CREDIT; PERM FUND  
INCOME  
Sponsor: FINANCE  
Requester: (H) FIN

Department: Department of Revenue  
Appropriation: Taxation and Treasury  
Allocation: Tax Division  
OMB Component Number: 2476

## Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2018 Appropriation Requested	Included in Governor's FY2018 Request	Out-Year Cost Estimates				
OPERATING EXPENDITURES	FY 2018	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Personal Services	1,650.0		5,250.0	6,350.0	6,350.0	6,350.0	6,350.0
Travel			50.0	50.0	50.0	50.0	50.0
Services	200.0		700.0	1,000.0	1,000.0	1,000.0	1,000.0
Commodities	50.0		100.0	100.0	100.0	100.0	100.0
Capital Outlay							
Grants & Benefits							
Miscellaneous							
<b>Total Operating</b>	<b>1,900.0</b>	<b>0.0</b>	<b>6,100.0</b>	<b>7,500.0</b>	<b>7,500.0</b>	<b>7,500.0</b>	<b>7,500.0</b>

## Fund Source (Operating Only)

1004 Gen Fund (UGF)	1,900.0		6,100.0	7,500.0	7,500.0	7,500.0	7,500.0
<b>Total</b>	<b>1,900.0</b>	<b>0.0</b>	<b>6,100.0</b>	<b>7,500.0</b>	<b>7,500.0</b>	<b>7,500.0</b>	<b>7,500.0</b>

## Positions

Full-time	10.0		35.0	45.0	45.0	45.0	45.0
Part-time	8.0		15.0	15.0	15.0	15.0	15.0
Temporary							

## Change in Revenues

1250 UGF Rev (UGF)	1,848,000.0		2,263,000.0	2,345,000.0	2,399,000.0	2,452,000.0	2,516,000.0
1251 Non-UGF (Other)	(1,527,000.0)		(1,620,000.0)	(1,697,000.0)	(1,745,000.0)	(1,793,000.0)	(1,852,000.0)
<b>Total</b>	<b>321,000.0</b>	<b>0.0</b>	<b>643,000.0</b>	<b>648,000.0</b>	<b>654,000.0</b>	<b>659,000.0</b>	<b>664,000.0</b>

**Estimated SUPPLEMENTAL (FY2017) cost:** 250.0 (separate supplemental appropriation required)  
(discuss reasons and fund source(s) in analysis section)

**Estimated CAPITAL (FY2018) cost:** 14,000.0 (separate capital appropriation required)  
(discuss reasons and fund source(s) in analysis section)

## ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? yes  
If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/18

## Why this fiscal note differs from previous version:

Not applicable; initial version.

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Agency: Department of Revenue  
Phone: (907)465-8221  
Date: 02/11/2017 10:00 AM  
Date: 02/11/17

# FISCAL NOTE ANALYSIS

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## Analysis

### Bill Analysis

The bill changes the annual formula upon which allowable draws are made from the Alaska Permanent Fund's Earnings Reserve Account. It establishes an annual draw of 4.75% of the average market value for the first five of the six preceding fiscal years. Of this allowable draw, 33% is appropriated directly to the dividend fund from which Alaskans receive their annual Permanent Fund Dividend, and 67% is appropriated to the general fund.

The bill also establishes a personal income tax based on 15% of the taxpayer's federal tax liability. In addition, there is a surtax of at least 10% of the taxpayer's long term capital gains. For all taxpayers, there is a minimum tax due of \$25. The tax is payable by both Alaska residents and non-residents on the portion of their income derived from income earned within the State. Like the federal income tax, it would be payable based on calendar year earnings.

To qualify as "from a source in the state," income is broadly defined to include regular compensation, as well as income and rents from property, business, and other assets within Alaska. Business income, including partnership income and earnings from subchapter-S corporations transacting business in Alaska will also be subject to this tax. Taxes paid to other states, based on income derived in those states, can be credited from this tax.

The bill allows Alaskans to direct the Department of Revenue to pay all or a portion of their permanent fund dividends towards their tax liability. It additionally provides for withholding of income by employers, with regular remittance to the state. Employers must also provide annual income statements analogous to the federal W-2. The annual tax return would be due at the same time as the federal return, currently April 15 with any extensions tied to the federal filing. Both payments and refund requests would be received with the annual filing.

In its first year of full implementation, the cost to the average Alaskan would be about \$900 per capita. As the impact would be proportionate to each household's federal tax, it would vary widely by income level and eligibility for various federal tax credits. Any impact would be partially mitigated because state individual income taxes are deductible from federal taxes, meaning Alaskans who itemize would reduce their federal tax liability by the amount of their state tax multiplied by their marginal federal tax rate.

### Revenue Impact

The permanent fund sections of the bill are effective June 30, 2017. This means that the 67% of the 4.75% POMV draw would be available in Fiscal Year 2017, and the 33% would be the mechanism by which the October 2017 PFD were paid. The income tax sections are effective January 1, 2018, meaning that FY2018 revenue would be for only the second half of the fiscal year, entirely in the form of withholding taxes. The Tax Division's income tax revenue model is based on aggregated federal income data for Alaska residents. We then account for incremental revenue based on the estimated income of out of state residents, partially offset by the out-of-state income of Alaskans. The revenue estimates assume 100,000 taxpayers paying at the \$25 "minimum tax" rate.

	Revenue Source (\$millions)			
	Income Tax	\$25 minimum tax	Permanent Fund Earnings (67% of 4.75% POMV)	Total
FY2017	\$ -	\$ -	\$ 1,446	\$ 1,446
FY2018	\$ 319	\$ 2	\$ 1,527	\$ 1,848
FY2019	\$ 640	\$ 3	\$ 1,620	\$ 2,263
FY2020	\$ 645	\$ 3	\$ 1,697	\$ 2,345
FY2021	\$ 651	\$ 3	\$ 1,745	\$ 2,399
FY2022	\$ 656	\$ 3	\$ 1,793	\$ 2,452
FY2023	\$ 661	\$ 3	\$ 1,852	\$ 2,516

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#### Implementation Cost

Changes to permanent fund management, and any possible associated costs, are outside the scope of this analysis.

Adding an individual income tax, especially on a tight timeline, would be a significant challenge to the Tax Division. We have recently completed implementation of the Tax Revenue Management System (TRMS), which created an integrated online tax application used by both taxpayers and administrators for the 25 tax types currently administered by the Division. We expect to engage FAST Enterprises, the TRMS contractor, to build an income tax module into TRMS. This will require the re-mobilization of staff to Alaska who were involved in the original project; FAST has staff who are well informed about Alaska's processes and have excellent working relations with our staff. FAST has built and currently maintains individual income tax systems for 17 other states, and is currently developing them in at least four others.

The initial need will be to engage a contractor to work with Department leadership to create an implementation plan with more refined estimates of staffing, space, supply, and equipment needs. The cost estimates in this fiscal note are a first attempt to anticipate the results of this analysis. The \$250.0 supplemental request will enable us to develop this plan.

The \$14,000.0 capital request reflects an estimate for our contract with FAST to add the income tax module as well as the Department's other short term implementation costs. This is a multi-year process and much of the actual spending will not occur until after we begin collecting revenues. The initial fast-track need will be to build and implement a tax withholding system, which will need to be in operation by January 1, 2018. In addition to the software development, this will require a rapid and robust outreach to the business community throughout Alaska, as well as integration with national accounting and tax software vendors in order to update programs such as TurboTax and QuickBooks to incorporate Alaska.

Once the withholding system is in place, the contractor and staff will begin building the tax return filing and examination modules, with their associated databases, communications, and integration with our existing imaging, accounting, and collections systems. We will also need to build linkages with the Permanent Fund Dividend Division. The legislation creates an annual tax, meaning that the first tax returns will be filed in January of 2019, with a filing due date of April 15. Taxpayers who request and receive extensions would have filing deadlines in October of 2019.

The department envisions a gradual ramping up of the staff needed to collect and administer the tax. As part of our research into the potential costs, we spoke to tax administrators at the State of Montana, which has a population about 1/3 higher than Alaska's and uses FAST for its income tax. Montana's Revenue Department has 155 employees dedicated to their income tax, which scales back to about 120 for Alaska using a simple per-capita adjustment. We intend to implement an income tax with half this number, 60 employees including a substantial group of seasonal part-time imaging and data entry technicians. We expect the new staff to be roughly split between our Juneau and Anchorage offices.

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We expect to replicate the online filing percentages of the Permanent Fund Dividend Division, currently at 83%. However, the 17% of paper filers will entail manual handling and data entry for approximately 75,000 out of 400,000 tax returns. In contrast, the Tax Division's largest current taxpayer base is the State Corporate Income Tax, with approximately 22,000 total filers half of whom file perfunctory reports indicating no tax liability due to their S-corporation status.

We do not expect to need full staffing until FY2020. The eventual addition of 53 FTE's to the Tax division (45 full time plus 15 part time imaging and data entry technicians) would increase the staff of the Tax Division by approximately 50%. However, throughout the six-year period covered by this fiscal note, we anticipate total implementation costs, operating plus capital, to equal approximately 1.5% of additional state revenue from just the income tax components.

**An initial analysis of the staff needs within the Tax Division to implement a personal income tax is as follows:**

Title	FY18	FY19	FY20+
Audit Supervisor	1	1	1
Tax Auditor	4	15	18
Tax Technician	2	6	10
Income Tax Specialist	1	3	3
Appeals Officer	0	4	5
Accounting Technician	0	2	4
Analyst Programmer	1	2	2
Admin Assistant	1	2	2
<b>Total FT</b>	<b>10</b>	<b>35</b>	<b>45</b>
Imaging Operators & Office Assistants	8	15	15
<b>Total PT</b>	<b>8</b>	<b>15</b>	<b>15</b>

In addition to the staff cost, most of the other budget impact will be for internal state costs such as additional work space, postage, phones and servers, and the use of hearing examiners on tax appeal issues. We anticipate additional travel for taxpayer outreach and education.