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HB 115: State Revenue Restructuring Act Version: L

Sectional Analysis- Long Version

Please note that a sectional analysis of a bill or resolution should not be considered an authoritative interpretation of the measure itself. The legislation is the best statement of its contents.

Section 1 (page 1, line 10) – Clarifies that all components of this bill are part of a comprehensive revenue act and the act may be known as the State Revenue Restructuring Act.

-----Appropriations from the Earnings Reserve Account-----

Section 2 (page 2, line 1) – Add a new subsection (*l*) to AS 36.30.015 to direct the trustees of the Alaska Permanent Fund Corporation to adopt regulations regarding procurement.

Section 3 (page 2, line 9) - Amends AS 36.30.990(1) to add the Alaska Permanent Fund Corporation to the list of entities excluded from the definition of ‘agency’ for the purposes of the state procurement code. This exempts the corporation from the requirements in the state procurement code.

Section 4 (page 3, line 3) – Amends AS Sec. 37.05.055(b), relating to the marine highway fund, to conform to the changes made in section 6.

Section 5 (page 3, line 10) – Amends AS 37.10.430(c), relating to the subaccount in the constitutional budget reserve fund, to remove the requirement that any funds invested in the subaccount shall be invested under the assumption that those funds will not be needed for at least five years.

Section 6 (page 3, line 19)– Amends AS 37.13.010(a) and deletes AS 37.13.010(a)(2). The resulting change means that the Alaska Permanent fund will be filled by the constitutionally required 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, and net profit shares. The *additional 25%* of royalties from leases issued after December 1, 1979, which are above the constitutionally required 25%, will now remain in the general fund and will not be deposited into the permanent fund.

Section 7 (page 4, line 5) – Amends AS 37.13.140 by adding “and market value” to section title. This section directs the Permanent Fund Corporation to continue computing net income of the fund excluding any unrealized gains or losses but removes the calculation for determining distributable income from the earnings reserve.

Section 8 (page 4, line 17) – Amends AS 37.13.140 by adding subsection (b). This subsection indicates that the corporation will determine the amount of earnings available for distribution each year and describes how that amount will be calculated. The amount available for distribution is 5.25% of the average market value (POMV) of the permanent fund for 5 of the last 6 fiscal years, including the fiscal year just ended. For example, a POMV draw on June 30th, 2017 (FY17) would include FY12, 13,14,15, and 16, but not FY17. The “average market value” includes the balance of the earnings reserve but does not include the quantity of the principal ascribed from Amerada Hess monies due to the existing prohibition against using Amerada Hess monies to fund the dividend. This is the structured annual draw from the earnings reserve account.

Section 9 (page 4, line 27) – Adds a new section to further amend AS 37.13.140(b), created by this act, to reduce the amount available for distribution from 5.25% to 5% of the average market value (POMV) of the permanent fund. This change is effective July 1, 2019 and will replace the distribution rate created in the previous section.

Section 10 (page 5, line 6) – AS 37.13.145(b) directs how the legislature will distribute and transfer money from the earnings reserve account. In subsection (1), 0.25 percent of the average market value (POMV) of the fund is transferred from the earnings reserve to the permanent fund. This amount is completely separate from the amount available for distribution calculated under AS 37.13.140(b) (sections 8 and 9) and is not a part of the percent of market value calculated in that section. Subsections (2) and (3) make use of the percent of market value (POMV) calculated under AS 37.13.140(b). Subsection (b)(2) appropriates 33% of the POMV draw from the earnings reserve to the dividend fund. AS 37.13.145(b)(3) appropriates 67% of the POMV draw from the earnings reserve to the general fund.

Section 11 (page 5, line 19) –Clarifies AS 37.13.145(d) to state that Amerada Hess funds are to be treated as other income to the permanent fund, except they are not available for distribution for permanent fund dividends or the general fund under AS 37.13.145(b), but instead are to be deposited into the Alaska capital income fund. It is existing law that these funds are not available for distribution. This section removes references to AS 37.13.145 (c), related to inflation proofing, which is repealed by this act.

Section 12 (page 5, line 29) –Adds a new subsection (e) to AS 37.13.145. After appropriation by the legislature for the permanent fund dividend and to the general fund as described in Section 3 of this act, the legislature may appropriate from the earnings reserve to the permanent fund principal, an amount which exceeds four times the amount calculated for distribution under AS 37.13.140(b). This means that when the earnings reserve account is larger than four times the calculated annual POMV draw, that excess is placed into the fund’s principal to help protect the fund against inflation. However that transfer is limited no more than the cumulative amount necessary to cover the inflation proofing amounts that were not transferred in past years.

New Subsection (f) is added to AS 37.13.145 to state that the legislature shall appropriate from the earnings reserve account the additional amount, if necessary, to provide for a per person dividend of \$1,250 per eligible Alaskan. This additional appropriation is in effect for fiscal years 2018 and 2019. [This subsection is repealed at the end of fiscal year 2019.]

Section 13 (page 6, line 13) – Further amends AS 37.13.145(e), previously created by this act, to remove references to subsection (f). Subsection (f), created in the previous section, is repealed on June 30, 2020 (the last day of fiscal year 2019). This new version of AS 37.13.145(e) becomes effective on that date.

Section 14 (page 6, line 26) – Amends AS 37.13.150 to clarify that the unexpended balance of the permanent fund corporation’s annual operating budget, which comes from the fund’s earnings, is treated as income and is included in the calculation of the permanent fund’s market value.

Section 15 (page 7, line 1) – Clarifies that the mental health trust fund is not included in the computation of net income or market value available for distribution to the permanent fund dividend or the general fund.

-----**Start of Income Tax section**-----

Section 16 (page 7, line 5) – AS 43.05.045(a) clarifies that there is a penalty if a state income form is not filed electronically. However, individual filers are exempt from this penalty as noted later in AS 43.22.070(h) – (see page 20, line 27).

Section 17 (page 7, line 15) – Creates the Individual Income Tax within AS 43.22

Sec. 43.22.010 (page 7, line 17) – Imposes a progressive income tax on residents and nonresidents on their taxable income. Taxable income, defined later in this chapter, is based on federal adjusted gross income with some state specific modifications. Residents are taxed on all taxable income, while nonresident individuals will be taxed on income from a source within the state.

Subsection (b) outlines the income tax brackets for an individual.

Subsection (c) outlines the income tax brackets for two individuals who file jointly; those who are eligible to file a joint *federal* income tax return are eligible to file jointly in the state. Under subsection (d) and (e), those that are eligible to file a joint return federally but do not do so are directed how to file on the state level.

Subsection (f) describes how two individuals who filed a joint federal return but who are not both residents of Alaska shall file with the state. They may choose to file separately, as nonresidents, under the tax brackets described in (b) of this section, or they may elect to file jointly under the brackets in (c) but only if both choose to be taxed as residents.

Sec. 43.22.015 (page 9, line 1) – Describes how a nonresident individual will determine their Alaska state income tax due. Their tax is determined on all of their taxable income, using the brackets in 43.22.010(b). That tax is then reduced by a ratio based on how much of the nonresident’s taxable income is from a source within the state. [Nonresidents who choose to file jointly are not eligible to use this allocation of income, and are instead considered as residents.]

Sec. 43.22.020 (page 9, line 11) – Defines the tax on trusts and estates. Resident trusts are taxed at 7%, except for Alaska Native Settlement trusts. Alaska Native Settlement trusts receive alternative federal tax treatment and are taxed at 2.5% by this state income tax. Nonresident trusts are also taxed at 7% but only on their income that is connected to a source in the state.

Sec. 43.22.025 (page 9, line 28) – Provides a credit to residents for taxes paid to another state based on income earned in that other state (so someone is not taxed twice on the same income). A credit for income taxes paid in another state cannot reduce the tax due to Alaska below what it would have been if the out of state income was never included in the calculation of the tax due. This means that regardless of the amount of income tax the resident paid in other states, the credit cannot reduce the

amount of income tax due to Alaska below what the resident individual would owe on just the income that is not taxed by other states.

Sec. 43.22.030 (page 11, line 9) - Defines the income that is considered taxable income under this chapter. This is based on the federal adjusted gross income with specific few items added and subtracted. Specific to Alaska, this section allows a per person exemption of \$4000 and also allows the permanent fund dividend to be deducted from state tax.

Items added into federal adjusted gross income include: interest and income from state and municipal bonds and certain United States bonds which are not taxed by the federal government but which are taxable by the states; deductions from federal adjusted gross income for Alaska income taxes (normally deducted *after* adjusted gross income); gain from a trade of like-kind properties which is not federally recognized or taken as a gain; and any deductions allowed to federal adjusted gross income which relate to income that is not being taxed under this chapter.

Items subtracted from federal adjusted gross income include: interest or income from federal bonds which are not legally taxable by the states; refunds for overpayment of an income tax; expenses that are not deducted from federal adjusted gross income but that relate to income taxed under this chapter; a gain from a trade of like-kind properties that *is* federally recognized as a gain; nonresident pension income under 4 U.S.C. 114; military compensation for nonresidents; the permanent fund dividend; and \$4000 per individual claimed that is an exemption on the federal income tax forms.

Subsection (b) states that expenses not used in the tax year they were incurred may not be carried back to previous year returns, and may only be carried forward for a total of five years.

Sec 43.22.035 (page 12, line 23) - Describes how income from a partnership or an S-corporation shall be adjusted based the additions and subtractions of taxable income under 43.22.030. Subsection (c) states that if partnership income is allocated with the specific purpose of evading taxes, that allocation shall be disregarded.

Sec. 43.22.040 (page 13, line 17) - Describes how income from a trust or estate shall be adjusted based the additions and subtractions of taxable income under 43.22.030. Taxable income is reduced by the amount distributed to the beneficiaries, in accordance with U.S.C 661. The Department of Revenue may determine in regulation how the adjustments to income will be allocated between the trust or estate and the beneficiary of that trust or estate. Subsection (b) states that if income or loss is distributed with the specific purpose of evading taxes, that distribution shall be disregarded.

Sec. 43.22.045 (page 13, line 31) –Identifies items of income that are included as being derived from or connected with a source in the state. This is the income on which nonresidents will be taxed.

Sec. 43.22.050 (page 18, line 9) – Directs the Department of Revenue to create regulations determining what is considered income from a source in the state for business conducted by a nonresident. The regulations must be consistent with AS 43.19, the multistate compact. This provision will allow the department to create regulations to allocate what income is taxable under this chapter when an out of state business is conducting business both in and out of state.

Sec. 43.22.055 (page 18, line 18) – Directs the department to create regulations to detail what income from a nonresident trust or estate is considered derived from or connected with a source within the state. This regulations shall be consistent with 43.22.045, which identifies income from a source within the state.

Sec. 43.22.060 (page 19, line 4) – Provides that the taxable income for a part-year resident, trust, or estate shall be the sum of *all* taxable income associated with the part of the year that the individual or entity was a resident of Alaska and the income from a source in the state for the part of the year that the individual or entity was not a resident of the state.

Sec. 43.22.065 (page 19, line 17) – States that taxpayer’s taxable year and method of accounting for the state income tax shall be the same as for the taxpayer’s federal income tax. The department shall adopt regulations addressing situations where a taxpayer changes methods of accounting. [For most individuals, the taxable year is the calendar year. However, entities such as partnerships that file an individual income tax return may use a fiscal year in place of a calendar year, and may have different methods of accounting for their income.]

Sec. 43.22.070 (page 19, line 26) - Establishes how taxpayers will submit tax returns and make payments for the individual income tax. It clarifies that this tax is due and payable to the department at the same time and in the same manner as the tax payable to the U.S. IRS for federal taxes. The section also outlines procedures in case there are changes to the taxpayer’s federal income tax return. Any overpayments will be reimbursed by the department out of the general fund. As noted above, (h) exempts an individual from the penalty for not filing their income tax electronically. However, a person paid to file returns is not exempt, and must file electronically.

Sec. 43.22.075 (page 20, line 30) - Establishes how taxes will be withheld by employers making payment of wages or salaries. The employer shall deduct and withhold the amount of tax, remit the tax to the department, and provide a written statement to the employee by January 31 of the succeeding year showing the amount deducted and other necessary information, similar to the federal W2. The Department of Revenue shall publish the rate of withholding required by this section. Withholding is also required for payments made to independent contractors.

Sec. 43.22.080 (page 21, line 25) –Partnerships that are required to file an annual return with the federal government shall also file a partnership return with the Department of Revenue, and shall withhold income tax from a nonresident partner.

Sec. 43.22.085 (page 22, line 5) – Allows a resident the option to apply some or all of their PFD as a refundable tax payment to their upcoming state income tax due, less any garnishment, levy, donations to Pick Click Give or college funds, etc., as allowed under other sections of statute. For example, a person may apply some or all of their 2018 PFD to their 2018 taxes due. If a person’s Refundable Tax payment of their dividend is more than the amount of their state income tax due, any remaining amount will be reimbursed to the person as a tax refund, after the person has filed their state income taxes.

Sec. 43.22.090 (page 22, line 15) - Authorizes the department to create all necessary forms and adopt regulations to implement this tax, including regulations for online filing and online payment and prepayment of taxes due, and forms for itemizing deductions. This section allows the department to adopt Internal Revenue Code regulations, as long as they do not conflict with this chapter.

Subsection (b) clarifies that transactions or payments between related parties must have a reason other than the purpose of lowering taxes. The department may determine and adjust the tax due on such a payment as necessary.

Subsection (d) directs the department to adjust the tax brackets and the personal exemption every two years, based on the Anchorage rate of inflation.

Sec. 43.22.095 (page 23, line 18) allows the provisions of the Internal Revenue Code that are mentioned in this chapter to be considered as if they are fully set out and defined in the chapter itself, unless the provision is inconsistent with the chapter.

Sec. 43.22.150 (page 23, line 29) – Defines terms used in this chapter. Key terms include ‘domiciled’, ‘resident’, and ‘resident trust’. Resident is defined as an individual who: lives in the state for the entire calendar year; receives an Alaska permanent fund dividend; or receives a tax benefit such as a property tax exemption only available to a resident individual.

----- **end of Income Tax section** -----

Section 18 (page 27, line 15) - Adds a new subsection (c) to AS 43.23.025, relating to the calculation of the permanent fund dividend, to state that for fiscal years 2018 and 2019 the amount of the permanent fund dividend shall be at least \$1250. [This section is repealed at the end of fiscal year 2019].

Section 19 (page 27, line 21) – Amends AS 43.23.055(1) to clarify that the department of revenue will annually pay permanent fund dividends from the dividend fund without further appropriation.

Section 20 (page 29, line 6) – AS 43.23 is amended by adding a new section which directs the Permanent Fund Division Department of Revenue to create a place on the PFD application where an applicant may apply some or all of their PFD to their upcoming state income tax due.

Section 21 (page 29, line 12) – Repeals AS 37.13.145(c), the existing statute for inflation proofing of the permanent fund, on July 1, 2017

Section 22 (page 29, line 13) - AS 43.05.085, AS 43.20.012(b), and AS 43.20.013, a former tax credit for political contributions that existed under Alaska’s prior individual income tax which ended in 1980, are repealed on January 1, 2019.

Section 23 (page 29, line 14) – AS 37.13.145(f) and AS 43.23.025(c), both created by this act, are repealed on June 30, 2020. These subsections relate to the minimum dividend of \$1250 which is set of fiscal years 2018 and 2019 only.

Section 24 (page 29, line 15) - Creates a new section in uncodified law which sets the amount the legislature may appropriate from the earnings reserve account for fiscal year 2017. The amount is equal to 5.25 percent of the average market value of the fund, minus \$695,650,000 which is the value of the permanent fund dividends already paid from the earnings reserve account for fiscal year 2017.

Section 25 (page 29, line 25) - Clarifies that the state income tax created under section 17 of this act only goes into effect starting on January 1, 2019, and will not be applied to any income earned prior to that date.

Section 26 (page 29, line 29) – Authorizes the Department of Revenue to adopt regulations to implement the act, but not before the effective date of the law implemented by the regulation. Additional transition language is included in subsection (b) to allow the commissioner of revenue and the Alaska Permanent Fund Corporation to adopt the necessary regulations to implement this act.

Section 27 (page 30, line 8) –If section 24 takes effect after June 29th of 2017, section 24 is retroactive to June 29th, 2017.

Section 28 (page 30, line 12) – Sections 1, 24, 26, and 27, take effect immediately.

Section 29 (page 30, line 14) – Sections 2 and 3 of this act, relating to the Alaska Permanent Fund Corporation and the state procurement code, take effect on January 1, 2018.

Section 30 (page 30, line 15) – Sections 16, 17, 20, 22, and 25, relating to the income tax, take effect on January 1, 2019.

Section 31 (page 30, line 16) – Section 9 of this act, reducing the distribution rate from the earnings reserve, takes effect on July 1, 2017.

Section 32 (page 30, line 17) – Section 13, updating AS 37.13.145(e) to conform with the deletion of AS 37.13.145(f), is effective on June 30, 2020.

Section 33 (page 30, line 18) – Unless otherwise mentioned in sections 28-32, the effective date of this act is July 1, 2017.