

## Explanation for amendments to Version L of HB 115

**#1: L.4:** This corrects an error to the jointly filed brackets in version L. The bottom of the brackets, the income level below which there is no tax, was intended to be double of the bottom bracket for the individual filer, since there are two people included in a joint return.

That bottom level for the individual filer is \$10,300 and should therefore be \$20,600 for joint filers. \$22,600 was inadvertently included in the draft.

This amendment changes the bottom of the joint filer brackets to \$20,600 and adjusts the totals in the other brackets accordingly.

### **#2: L.5:**

This deletes the requirement to withhold money from amounts paid to independent contractors. [Independent contractors file a 1099]

This section was originally inserted to assist in collection and compliance, however further research indicated that other states do not require withholding on independent contractors due to the administrative burden.

### **#3: L.6:**

This is an administrative section allowing tax return information to be released to a bank in order to verify the deposit of a tax refund. This language was included in the original HB 115 but was inadvertently excluded from version L.

### **#4: L.9**

This amendment makes five changes to version L to assist in administration and tax compliance. These changes relate to partnerships, s-corporations, and personal service companies.

1. In section 43.22.020, tax on trusts and estates, (page 9 line 26), subsection (c) is amended to clarify that a banking corporation that is a non-resident trustee remains a non-resident trustee *even if* that banking corporation is later acquired by a resident banking corporation.

The intention of (c) is to maintain the non-taxable status of the trusts exempted under (b) of this section even if a bank is later acquired by a resident bank, which is not a controllable event for the trust parties and should therefore not influence their status.

2. On page 12 line 27 and 28, section 43.22.035 is being amended from “a partner’s or shareholder’s distributive share” to now read “a partner’s distributive share or a shareholder’s pro rata share.” Partnerships have distributive shares and s-corporations have pro rata shares; this amendment insures the bill uses precise language.

3. On page 18, section 43.22.050 is being amended to include a reference to a nonresident’s income from an s-corporation or from a partnership.

43.22.050 deals with business conducted in the state by a nonresident and directs the department to regulate what is considered “income from a source within the state” according to 43.19 (the multistate tax compact which regulates business taxation across state lines). Since a non-resident business can include an s-corporation or a partnership, income from those businesses needs to be included in this section.

4. This inserts a new section 43.22.065 relating to personal service and s-corporations. It states that when a personal service corporation or an s-corporation is used for tax avoidance or evasion, the department may allocate the income in a manner to properly reflect the individual the income should be attributed to.

This is a mirror of similar tax avoidance language on the federal level under U.S. Code 269A. This sort of tax evasion has been a problem in other states that do not have this explicit language.

5. On page 22 a subsection is being added to 43.22.080, withholding on nonresident partners; composite returns. This directs the department to set out regulations for partnerships required to withhold on a nonresident partners income; the regulations would allow those partnerships to choose to file a composite return on behalf of their nonresident partners. Non-resident partners can elect to be included in a composite return, in which case the non-resident partner would not need to file their own return (unless they have other income from within Alaska). Composite returns are allowed in many other states.

#### **#5: L.17**

This amendment makes changes to the administrative sections of the income tax, section 43.22.070 to assist in clarity of the administration.

It changes who is required to file a tax return from “a person required to pay tax under this chapter” to “A taxpayer.” This is more precise because there may be some taxpayers (defined as individuals subject to tax under the bill) who may not be required to *pay* tax after they take their deductions and adjustments.

The amendment further clarifies that the department shall publish a level below which an individual will not be required to file a return. This will be based on a person’s federal adjusted gross income; because there is no tax on taxable income under \$10,300 and each person is eligible for a per person deduction, there are some income levels below which it can be assumed

that person will not have a tax liability and should not need to file. This will also allow the department to outline when a dependent can file on their parent's return.

#### **#6: L.18**

This amendment adds to section 43.22.030, where Alaska taxable income is defined.

Under 43.22.030(1)(A), interest on municipal bonds is added back into adjusted gross income [The federal government exempt some or all municipal bond interest from tax at the federal level, but does not prohibit the states from taxing them; by adding them back into adjusted gross income, they become taxable by the state]. However, this section exempts bonds issued by Alaska from the state income tax.

In order to ensure that Alaska bonds are fully tax exempt from the state tax, it is necessary to change federal adjusted gross income to the extent that Alaska bonds *were* taxed at the federal level. In new subsections (1)(B) and (C), any losses on Alaska bonds that were deducted from federal adjusted gross income (FAGI) are added back in. Under new subsection (2)(G) any gains from Alaska bonds that were included in FAGI are now subtracted so they will not be taxed by the state.

#### **#7: L.19**

This amendment makes 8 clarifying changes to the sections relating to the tax rates and taxable income. The intent behind these language changes is to make these sections more readable.

1. On page 7, 43.22.010, (a)(2) is reordered to more clearly state that a nonresident will be taxed on income that is derived from or connected to a source in the state of Alaska.
2. On page 8 and 9, the title of 43.22.015 is changed to "calculation of tax on a nonresident individual." This is a more accurate reflection of the intent of 43.22.015.
3. In 43.22.015, calculation of tax on a nonresident individual, a reference is added to 43.22.045 which is the section defining what income is considered "from a source within the state." The addition of this reference helps to clarify the numerator of factor that is applied to a nonresident's tax to determine what they owe; the numerator is the taxable income from a source within the state and the denominator is the total taxable income (from all sources). That fraction is multiplied by the nonresident's tax (which is calculated on their *total* income) to determine what is due just for their Alaska source income.
5. In 43.22.030, the definition of taxable income, subsections (1)(E) and (2)(C) refer to deductions for expenses related to income that is taxable either on the federal level [(1)(E)] or on the state level [(2)(C)]. "directly or indirectly" related to income is added to both subsections to more accurately reflect existing common tax language.

6. In 43.22.030(2)(C), on line 31 “a” is replaced with “the” to clarify that we are only allowing deductions for income that is taxable under *Alaska’s* state income tax (this chapter) and not all income that is generally taxable any state. [We do not want to allow deductions for income that Iowa taxes but that we have chosen not to tax, like Alaska municipal bonds.]

7. Page 12 line 10 clarifies that a trust is not eligible for the per person exemption under this chapter. This clarification is necessary because, for all other purposes, a trust is considered an individual but because it does not have individual living expenses it should not be provided with an exemption of this size.

8. In 43.22.045, income derived from a source within the state, (a)(7) is reordered to clarify that income connected to items (i)-(vi) *is* considered taxable income. That was always the intention of this section, but the previous order did not make it clear.

#### **#8: L.23**

This amends 43.22.080 to clarify that publically traded partnerships are not required to withhold under this section. The non-resident partners of a publically traded partnership change so frequently during the year that requiring the partnership to withhold would be administratively burdensome.

#### **#9: L.25**

This amends sections throughout the bill to replace the phrase “income or a gain, loss, or deduction” with the phrase “an item of income, gain, loss, or deduction.” This is phrase more closely reflects the language used in existing tax law.

#### **#10: L.35**

This is an administrative amendment which does 4 things.

1. In 43.22.070 it clarifies that a tax return is due to the state at the same time as a return is due federally, and that same extensions apply. [Currently 43.22.070 only states when the *tax* is due, not the return.]

2. In 43.22.070(h), relating the exemption from the electronic filing requirement, it is clarified that an *individual* is exempt from the electronic filing requirement. The current term “taxpayer” includes trusts and estates, as well as partnerships filing on behalf of their partners. Corporate entities such as partnerships are required to file electronically.

3. A new subsection(i) is added to 43.22.070 allowing the department to outline how a joint filer can be relieved of joint liability for a tax on a joint return. Generally speaking, both filers of a joint return are held responsible for all the tax due even if only one spouse earned all the income

or claimed improper deductions. Adding this section allows the department to create exceptions to that.

4. Adds a new subsection to 43.22.095, reference to Internal Revenue Code, allowing the department to adopt several IRS penalties. 6654= failure to pay, 6662 = underpayment, 6664 = definitions of underpayment, 6694 = understatement by a tax preparer, 6695 = failure by tax preparers to sign or provide a copy of a return, 6700 = tax shelters, 6701 = aiding tax understatement, 6702 = frivolous tax submission, 6707 = failure to report transactions, 6713 = disclosure of information by tax preparers, 7201 = attempt to evade tax, 7202 = willful failure to collect or pay tax, 7206 = false statements, 7207 = fraudulent returns, 7216 = disclosure or use of information by preparers, 7407 = action to stop a tax preparer from further engaging in lawful actions, 7408 = action to stop conduct related to tax shelters.

### **#11: L.31**

This amendment addresses a specific type of trust where an individual begins to create a “non-grantor” trust (a trust where they are not the beneficiary of the income and therefore the income is not attributable to them) but they do not make it a complete trust. This allows them to avoid the federal gift tax. On the federal level they are treated as a “non-grantor” trust meaning the income is not taxed to them, but because the trust is incomplete they may actually have access to the income. This amendment would disregard that option and add the income from an incomplete non-grantor trust back into the adjusted gross income of the individual who transferred the property to the trust.

### **#12: L.32**

This removes subsections (C), (D) and (E) from the 43.22.150(19), the definition of a resident trust. Because those sections made any trust governed by laws of the state a resident trust, they also made ‘non-resident’ trusts that are only administered in the state “resident” trusts and therefore taxable. [Note: there are states that tax a broader definition of resident trusts to include those that are only administered in that state, but others have exemptions.].

### **#13: L.40**

This clarifies under 43.22.020 that a union pension trust formed excluded from federal taxation under USC 401(a) and 501(a) are not taxable under this chapter.

These trusts are exempt from federal taxation; therefore they are not included in federal adjusted gross income and also not a part of Alaska taxable income. This means that they are already excluded from taxation under this chapter, but this language makes that clear.

**#20 L.12**

This amendment deletes the language which would remove the 5 year investment requirement from the subaccount of the CBR. While there is value in this intent, it is not appropriate in this bill at this time.

**#21: L.11**

This amendment deletes the language allowing the Alaska Permanent Fund Corporation to set their own procurement language. While there is value in this intent, it is not appropriate in this bill at this time.

*Amendment forthcoming:*

An amendment to change the tax on trusts under 43.22.020 from the flat 7% to a bracketed tax similar to the one applied to individual incomes but with a few adjustments.

An amendment to clarify that are exempt from taxation at the federal level are exempt from taxation under this tax.

These trusts are exempt from federal taxation; therefore they are not included in federal adjusted gross income and also not a part of Alaska taxable income. This means that they are already excluded from taxation under this chapter, but this language will make that clear.