

ALASKA STATE LEGISLATURE

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HB 115: Education Funding Act **Version: K**

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 7) – Clarifies that this Act may be known as the Education Funding Act.

Section 2 (page 1, line 10) – Legislative intent language outlining what income level for an individual or a couple is considered exempt from this income tax.

Section 3 (page 2, line 8) – 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 43.22.075(i) – (see page 19, line 11).

Section 4 (page 2, line 18) – Creates the Individual Income Tax within AS 43.22

Sec. 43.22.010 (page 2, line 20) – 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 4, line 4) – 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 4, line 15) –Defines the tax on trusts and estates. Trusts are taxed at the same rates as an individual under the income tax brackets in 43.22.010, except that the first \$10,300 is not exempt as it is for an individual. Nonresident trusts are taxed on Alaska source income. Alaska Native Settlement trusts receive alternative federal tax treatment and are taxed at 2.5% by this state income tax. Trusts that are not taxed federally, including union pension trusts and charity trusts, are not taxed under this chapter.

Sec. 43.22.025 (page 5, line 26) – 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 7, line 7) - Defines the income that is considered taxable income under this chapter. This is based on the federal adjusted gross income with a few specific 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. Alaska municipal bonds will also not be taxed.

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 as 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 9, line 25) - 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 10, line 18) - Describes how income from a trust or estate shall be adjusted based on 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 11, line 1) –Identifies items of income that are considered 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 15, line 12) – 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 individual, partnership, or s-corporation. 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 15, line 29) – 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. These regulations shall be consistent with AS 43.22.045, which identifies income from a source within the state.

Sec. 43.22.060 (page 16, line 16) – 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 16, line 29) – In the case of a personal service corporation formed to evade taxes, the department may allocate the income between the personal service corporation and the employee-owners if necessary to accurately reflect the source of the income.

Sec. 43.22.070 (page 17, line 26) – States that a 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. 43.22.075 (page 18, line 4) - 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, (i) 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. 43.22.080 (page 19, line 17) - 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.

Sec. 43.22.085 (page 20, line 10) – 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. Publically traded partnerships are not required to withhold.

Sec. 43.22.090 (page 20, line 30) – 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. 43.22.095 (page 21, line 9) - 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.

Subsection (e) allows that the legislature may deposit the estimated income collected under this chapter into the public education fund.

Sec. 43.22.100 (page 22, line 17) - 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. Allows the department to adopt by reference certain IRS penalties for violations of this chapter.

Sec. 43.22.110 (page 23, line 1) – Allows certain tax information to be released to a banking institution for the purpose of verifying a direct deposit of an income tax refund.

Sec. 43.22.150 (page 23, line 5) – 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.

Section 5 (page 26, line 13) – AS 43.23 is amended by adding a new section which directs the Permanent Fund Division in the 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 6 (page 26, line 19) - 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 7 (page 26, line 20) - Clarifies that the state income tax created under section 4 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 8 (page 26, line 24) – 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.

Section 9 (page 26, line 29) – Section 8, regulatory authority, takes effect immediately.

Section 10 (page 26, line 30) – The effective date of the bill is January 1, 2019.