

Fiscal Note

State of Alaska
2017 Legislative Session

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

Identifier: HB115CS(FIN)-DOR-TAX-04-10-17
Title: INCOME TAX; PFD CREDIT; PERM FUND
INCOME
Sponsor: FINANCE
Requester: House Finance Committee

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	525.0		3,900.0	6,400.0	6,400.0	6,400.0	6,400.0
Travel	10.0		25.0	50.0	50.0	50.0	50.0
Services	350.0		800.0	1,200.0	1,200.0	1,200.0	1,200.0
Commodities	50.0		100.0	100.0	100.0	100.0	100.0
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	935.0	0.0	4,825.0	7,750.0	7,750.0	7,750.0	7,750.0

Fund Source (Operating Only)

1004 Gen Fund (UGF)	935.0		4,825.0	7,750.0	7,750.0	7,750.0	7,750.0
Total	935.0	0.0	4,825.0	7,750.0	7,750.0	7,750.0	7,750.0

Positions

Full-time	4.0		27.0	45.0	45.0	45.0	45.0
Part-time			10.0	15.0	15.0	15.0	15.0
Temporary							

Change in Revenues

1250 UGF Rev (UGF)	0.0		341,000.0	687,000.0	692,000.0	697,000.0	702,000.0
Total	0.0	0.0	341,000.0	687,000.0	692,000.0	697,000.0	702,000.0

Estimated SUPPLEMENTAL (FY2017) cost: 0.0 (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If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/19

Why this fiscal note differs from previous version:

Revised for House Finance committee substitute. This Fiscal Note shows income tax revenues.

Prepared By: Ken Alper, Director
Division: Tax Division
Approved By: Jerry Burnett, Deputy Commissioner
Agency: Department of Revenue

Phone: (907)465-8221
Date: 04/10/2017 04:00 PM
Date: 04/10/17

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2017 LEGISLATIVE SESSION

BILL NO. HB 115

Analysis

Bill Analysis

The bill establishes a personal income tax based on the taxpayer's adjusted gross income (AGI). The initial tax rate for individual filers is 2.5% of income above \$10,300; for joint filers it is 2.5% of the amount over \$20,600. The top marginal rate is 7% of individual income above \$250,000 and joint income above \$500,000. Each person in the household receives a \$4,000 personal exemption; permanent fund dividends are also excluded from taxable AGI.

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 income, it would vary widely. 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 income tax is effective January 1, 2019, meaning that FY2019 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.

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BILL NO. HB 115

Analysis

Implementation Cost

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. Within the FY2018 Services request, \$250.0 is for the purpose of this implementation plan contract.

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 need will be to build and implement a tax withholding system, which will need to be in operation by January 1, 2019. 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 2020, with a filing due date of April 15. Taxpayers who request and receive extensions would have filing deadlines in October of 2020.

The department envisions a gradual ramping up of the staff needed to collect and administer the tax, with only a core management team hired in FY2018 to lead the regulation drafting and programming contract effort. 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-capital 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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Analysis

We expect to replicate the online filing percentages of the Permanent Fund Dividend Division, currently at 83%. However, processing paper filers will entail manual handling and data entry for approximately 17% of an estimated 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 60 positions 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	0	10	18
Tax Technician	1	6	10
Income Tax Specialist	1	2	3
Appeals Officer	0	3	5
Accounting Technician	0	2	4
Analyst Programmer	1	2	2
Admin Assistant	0	1	2
Total FT	4	27	45
Imaging Operators & Office Assistants	0	10	15
Total PT	0	10	15

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, plus audit travel.

Fiscal Note

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2017 Legislative Session

Bill Version: HB 115
Fiscal Note Number: _____
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Identifier: HB115CS(FIN)-DOA-OAH-03-24-17
Title: INCOME TAX; PFD CREDIT; PERM FUND
INCOME
Sponsor: FINANCE
Requester: House Finance Committee

Department: Department of Administration
Appropriation: Centralized Administrative Services
Allocation: Office of Administrative Hearings
OMB Component Number: 2771

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				34.9	139.8	272.5	272.5
Travel				0.5	1.8	3.6	3.6
Services				2.1	8.5	16.5	16.5
Commodities				0.9	3.5	6.9	6.9
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	0.0	0.0	0.0	38.4	153.6	299.5	299.5

Fund Source (Operating Only)

1007 I/A Rcpts (Other)				38.4	153.6	299.5	299.5
Total	0.0	0.0	0.0	38.4	153.6	299.5	299.5

Positions

Full-time					1.0	1.0	1.0
Part-time							
Temporary							

Change in Revenues

None							
Total	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Estimated SUPPLEMENTAL (FY2017) cost: 0.0 (separate supplemental appropriation required)
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2018) cost: 0.0 (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? No
If yes, by what date are the regulations to be adopted, amended or repealed?

Why this fiscal note differs from previous version:

This fiscal note changes the funding source from general funds to interagency receipts. It addresses the change in the effective date, which impacted the years and amount of funding required.

Prepared By: Christopher Kennedy
Division: Office of Administrative Hearings
Approved By: Sheldon Fisher, Commissioner
Agency: Department of Administration

Phone: (907)269-6741
Date: 03/23/2017 05:30 PM
Date: 03/24/17

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2017 LEGISLATIVE SESSION

BILL NO. CSHB 115

Analysis

HB115 establishes a personal income tax on resident and non-resident individuals, trusts, and estates, with certain exemptions including an exemption for effectively nonresident trust organized in Alaska. In general, the tax is based on a graduated percentage of "income," defined as federal adjusted gross income with certain excluded items added back and certain additional exclusions. The tax is payable by non-residents on the portion of their income "derived from, or connected with" Alaska sources. Like the federal income tax, it would be payable by most taxpayers based on calendar year earnings.

Partnership income and earnings from subchapter-S corporations are encompassed by the tax. There are provisions for rules for determining whether income is Alaska-sourced and therefore taxable for nonresident individuals, estates, trusts, or shareholders of S corporations, and for capturing income routed through entities created for tax-avoidance.

The bill provides that the tax will be due at the same time and in the same manner as federal income tax. There are provisions for withholding.

The tax takes effect beginning in calendar year 2019.

Implementation Cost

The Office of Administrative Hearings (OAH) functions as the state equivalent of the United States Tax Court, presently handling appeals relating to corporate income tax, oil and gas production tax, fish tax, and a variety of other taxes. OAH will have jurisdiction over appeals from final Department of Revenue informal conference decisions (ICDs) on audit findings and other disputes relating to the new tax.

The income tax established in this bill is similar to the income tax in individuals and fiduciaries that existed in the 1970s. The experience in Alaska and other states is that such taxes generate a significant volume of appeals. Appeals can relate to domicile issues, penalties for failure to file and failure to pay, withholding issues, and substantive tax questions. When Alaska had a personal income tax in the 1970s, it accounted for about twenty percent of the workload of three Revenue Appeals Officers (who were then the equivalent in this context of present-day administrative law judges at OAH). The state's population has increased 84% since that time. Moreover, it is anticipated that the complexity of interstate business models today means that the proposed tax would generate interstate taxation disputes at a higher rate than would have been encountered forty years ago.

Experience in Alaska and other states is that such taxes generate a significant volume of appeals. It is anticipated that the appeals will peak soon after the inception of the tax, tapering to a lower level as the public, and the businesses required to withhold, become more accustomed to the personal income tax. However, there would be a preliminary period when relatively few appeals would reach OAH until a large volume of returns had been filed and disputes were generated. The projected annual costs above reflect this and reach a peak of approximately 1.3 times the full-time work of one tax-qualified administrative law judge. OAH believes the work would taper slightly beginning in FY2024, just beyond the horizon of this note.

In order for OAH to complete this work, a full-time, range 24 Administrative Law Judge is being requested. Interagency receipt authority in the amount of \$174.2 will be necessary to bill the Department of Revenue for this service. In addition, it is anticipated that funding may be used for non-permanent hires or professional services contracts to help when appeals are at their peak times.