

House Bill 37

Income Tax and POMV Allocation



Representative Adam Wool
Presentation to the House Ways and Means Committee
May 13, 2021

What Does HB37 Do?

Two major changes that, taken together, would balance Alaska's budget for the foreseeable future and form the centerpiece of a sustainable fiscal plan:

1. Add an individual income tax of 2.5% of federal "Adjusted Gross Income."
 - The first \$10,000 of income (\$20,000 for joint filers) would be exempted from the tax.
PFD income is also tax exempt.
2. Restructure the annual "percent of market value" (POMV) draw from the Permanent Fund so that 20% of the draw is designated to pay permanent fund dividends (PFDs)

...but first a little background

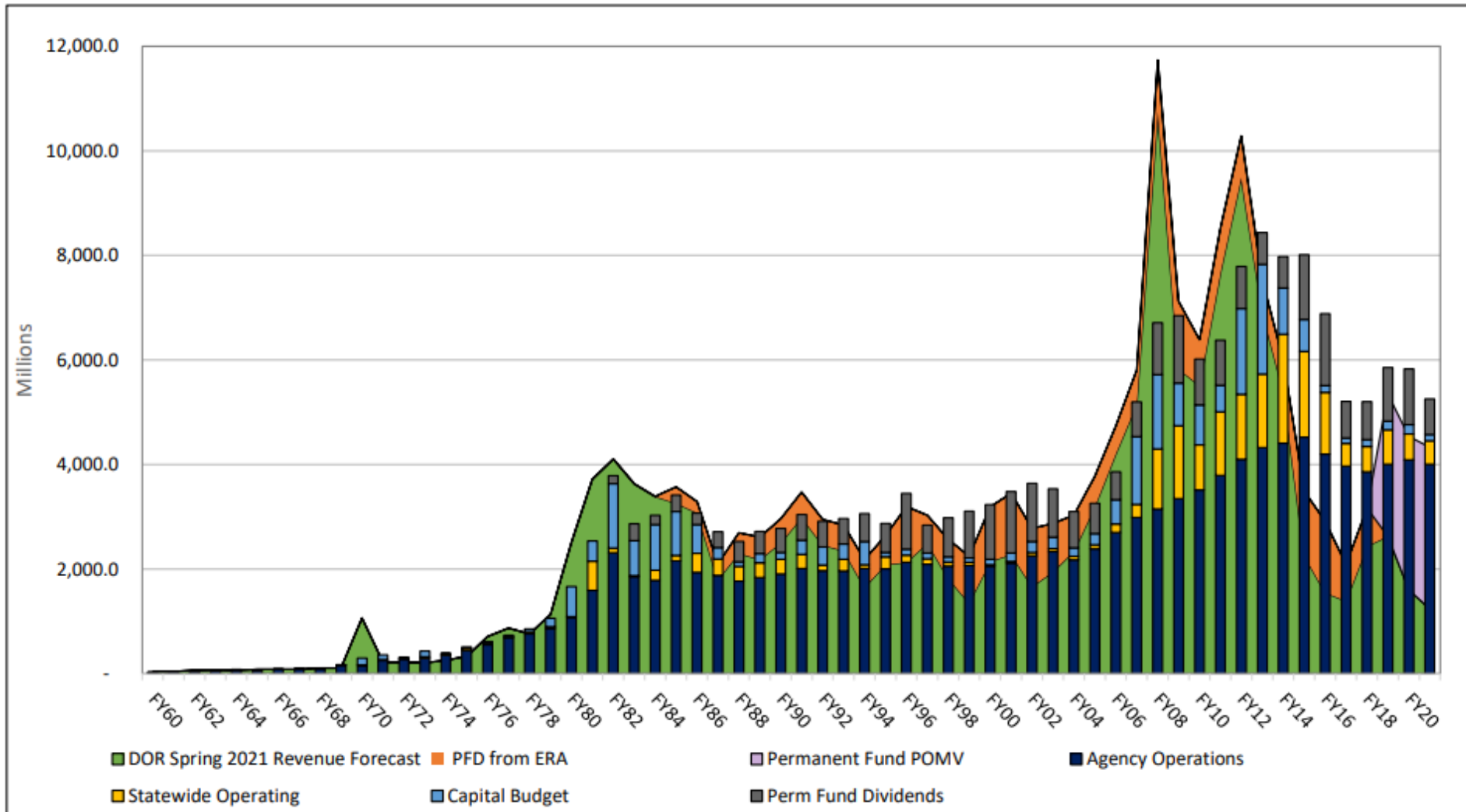
Ways and Means Committee Process Told the Story

- Revenue declines, beginning in 2014
- Budget cuts
- Introduction of POMV as a central revenue feature
- Ongoing structural deficits
- Lack of resolution of the Dividend question
- Alaskans pay the lowest state and local taxes among the 50 states

Once a consensus is reached that we need additional revenue, new questions emerge:

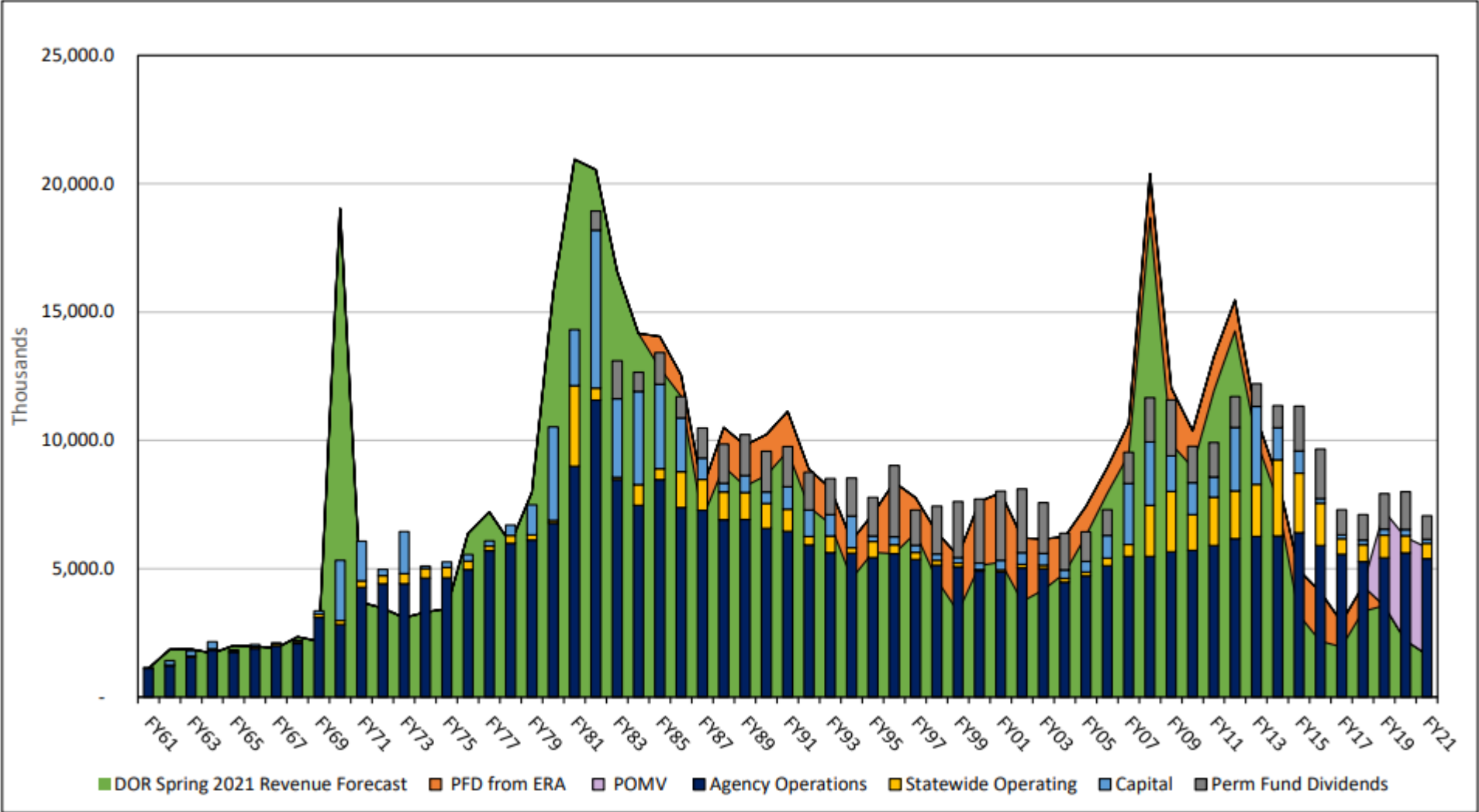
- Pros and Cons of Income Tax vs. Sales Tax vs. Other
- How much revenue to raise / how large should the dividend be?
- Structural and technical details of the bill

UGF Spending and Revenue Since Statehood: Nominal



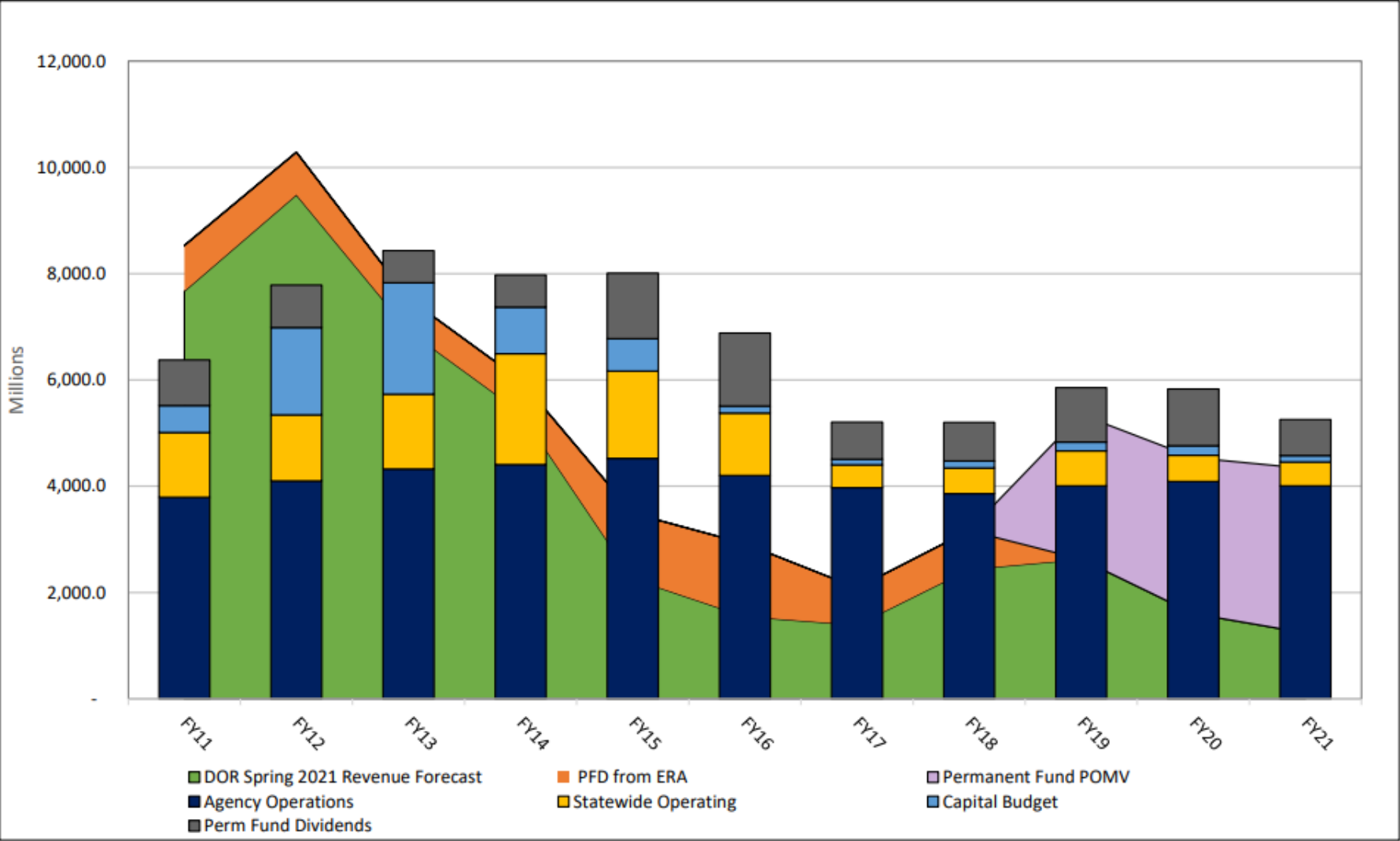
Source: Legislative Finance Presentation to House Ways and Means, 3/30/21

UGF Spending and Revenue: Real Per Capita



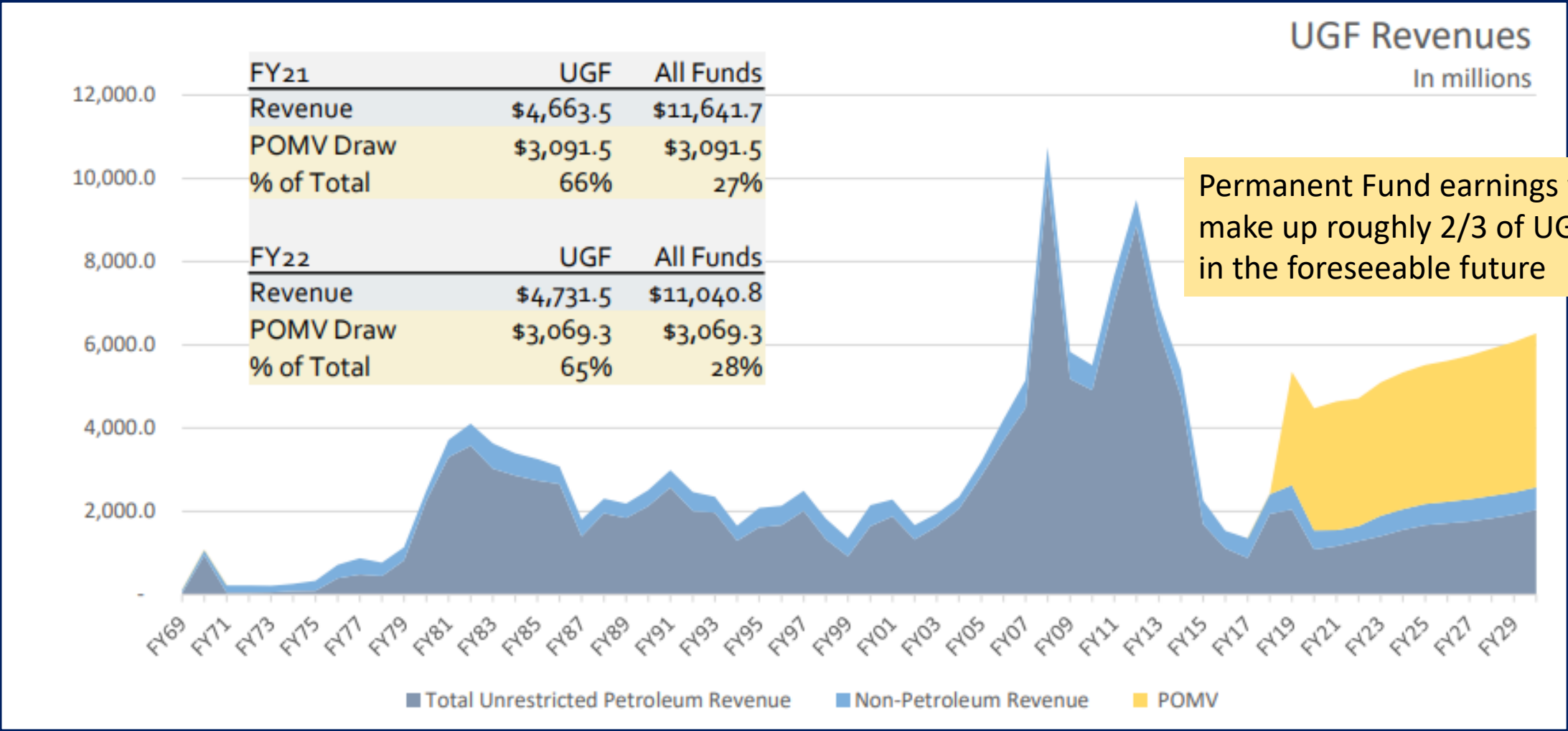
Source: Legislative Finance Presentation to House Ways and Means, 3/30/21

Focusing on just the last 10 years



Source: Legislative Finance Presentation to House Ways and Means, 3/30/21

Permanent Fund Corporation's Forecast



Even with higher oil revenue in the Spring forecast, the 10-year plan shows large ongoing shortfalls

Fiscal Year 2022 Ten Year Outlook - March 2021									
(Amounts in millions)									
Unrestricted Revenues	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
Traditional UGF Revenue	1,662.2	1,921.0	2,085.1	2,223.9	2,282.8	2,346.9	2,436.5	2,531.5	2,658.5
Permanent Fund POMV GF Draw	3,069.3	1,596.9	1,621.0	1,625.9	1,630.4	1,647.1	1,672.2	1,708.7	1,747.7
Other Revenue Sources		787.9	497.4	403.9	397.9	378.8	328.5	257.2	148.4
Total Revenue	4,731.5	4,305.9	4,203.5	4,253.7	4,311.0	4,372.8	4,437.2	4,497.4	4,554.6
Unrestricted General Fund Expenditures	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
Agency Operations	3,821.4	3,712.7	3,612.7	3,666.9	3,721.9	3,777.7	3,834.4	3,891.9	3,950.3
Statewide Items	483.1	466.3	462.1	456.1	456.4	460.4	466.2	466.7	463.5
Operating Budget	4,304.5	4,179.0	4,074.8	4,123.0	4,178.3	4,238.2	4,300.5	4,358.7	4,413.8
Capital Budget	62.2	126.9	128.8	130.7	132.7	134.7	136.7	138.7	140.8
Total General Fund Appropriations	4,366.7	4,305.9	4,203.5	4,253.7	4,311.0	4,372.8	4,437.2	4,497.4	4,554.6
Budget change from previous year	(294.6)	(60.8)	(102.3)	50.2	57.3	61.8	64.4	60.2	57.2
Surplus/(Deficit)	364.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings draw from Constitutional Budget Reserve									
Permanent Fund Dividend	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
PFD Fund Sources									
Permanent Fund POMV for PFD (50%)		1,596.9	1,621.0	1,625.9	1,630.4	1,647.1	1,672.2	1,708.7	1,747.7
Permanent Fund Earnings Reserves	2,023.9								
PFD Appropriation	2,023.9	1,596.9	1,621.0	1,625.9	1,630.4	1,647.1	1,672.2	1,708.7	1,747.7
Per capita PFD	\$3,057	\$2,382	\$2,416	\$2,410	\$2,404	\$2,417	\$2,441	\$2,482	\$2,527

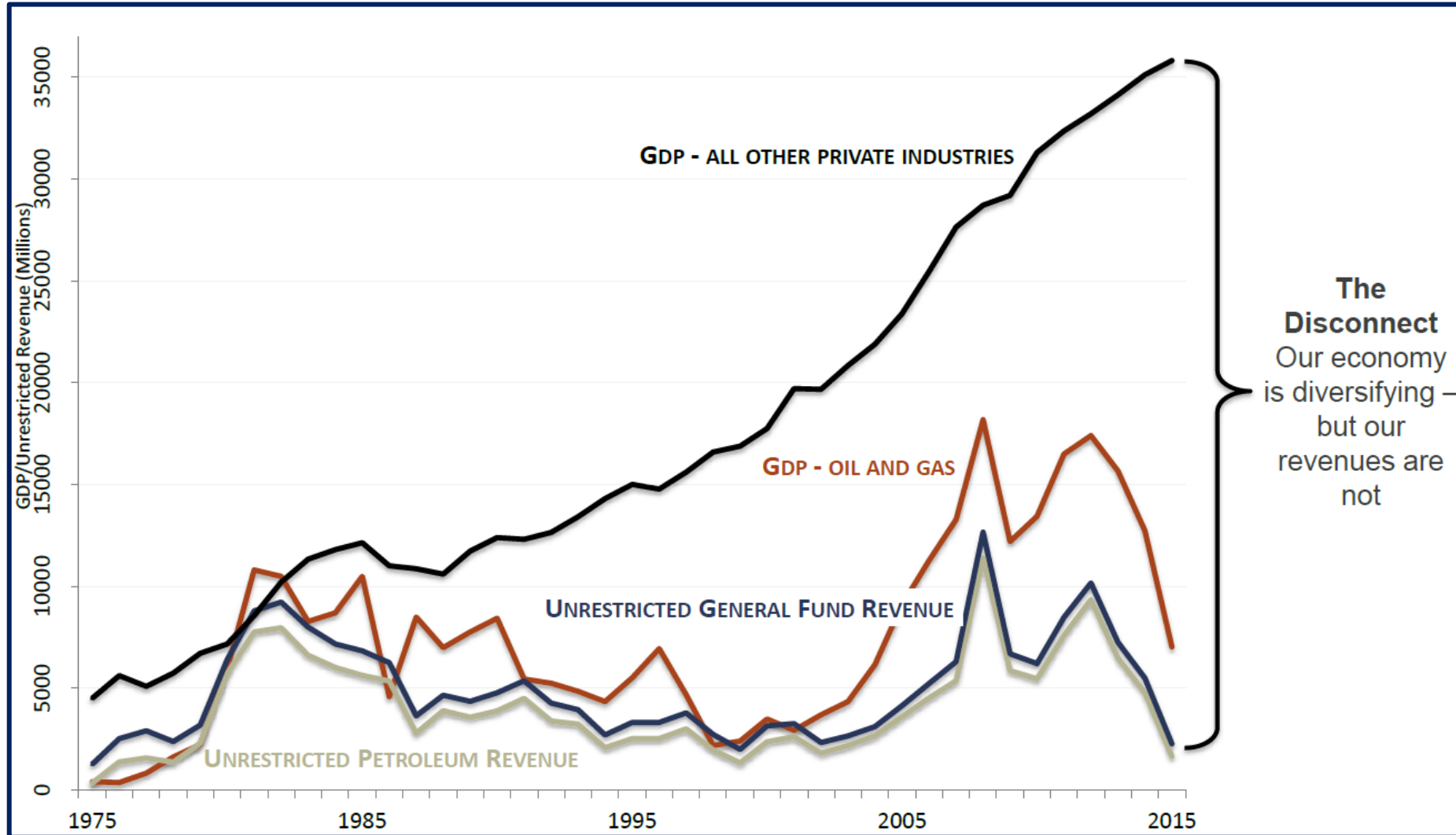
Source: Office of Management and Budget Presentation to House Ways and Means, 3/30/21

Even with higher oil revenue in the Spring forecast, the 10-year plan shows large ongoing shortfalls

There are several assumptions in the 10-year plan that, if not met, would increase (or decrease) these future-year shortfalls

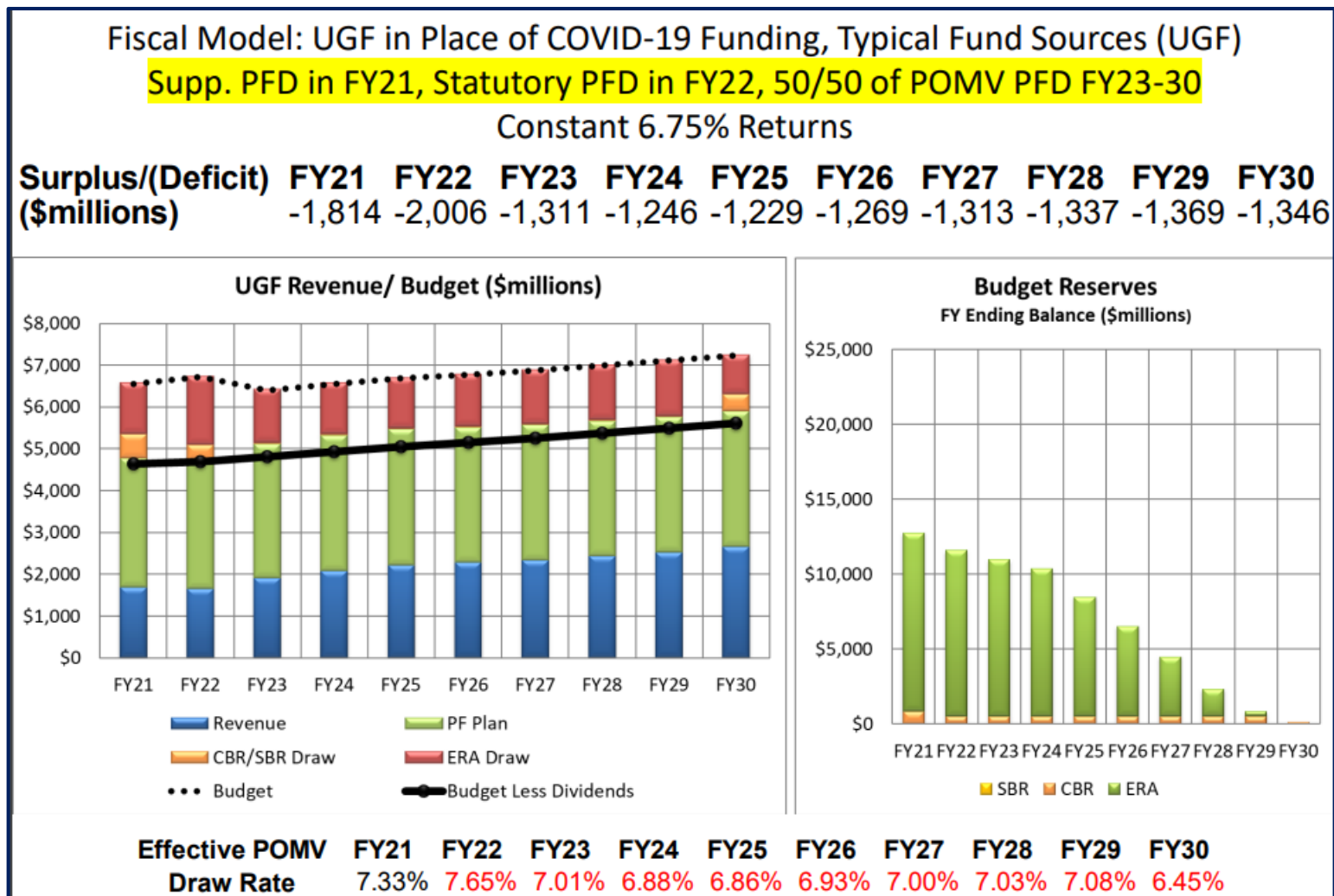
- Oil prices steadily increasing towards \$71 / bbl in 2030
- Three more years of likely unobtainable operating budget cuts and ongoing minimal capital budgets
- Governor's proposed change to a 50/50 POMV split beginning in FY2023 (~\$2,400 dividends)

Alaska's current revenue structure hasn't kept pace with our changing economy



Source: DCCED Commissioner Mike Navarre, Presentation to House Finance 3/20/18

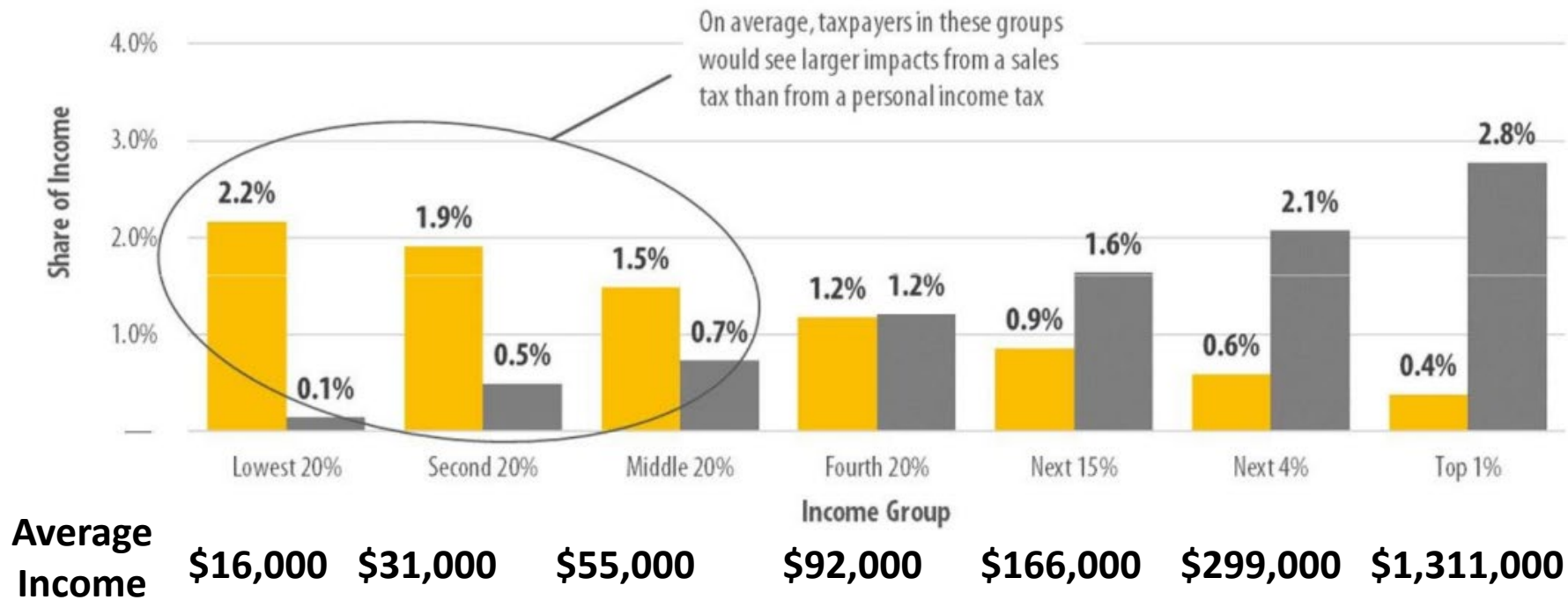
Lack of New Revenue Crashes the System



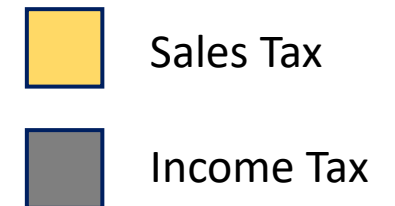
Revenue Options: Sales vs Income

Sales tax tends to disproportionately impact lower income households

Comparing a \$500m Alaska sales tax to a \$500m Alaska personal income tax

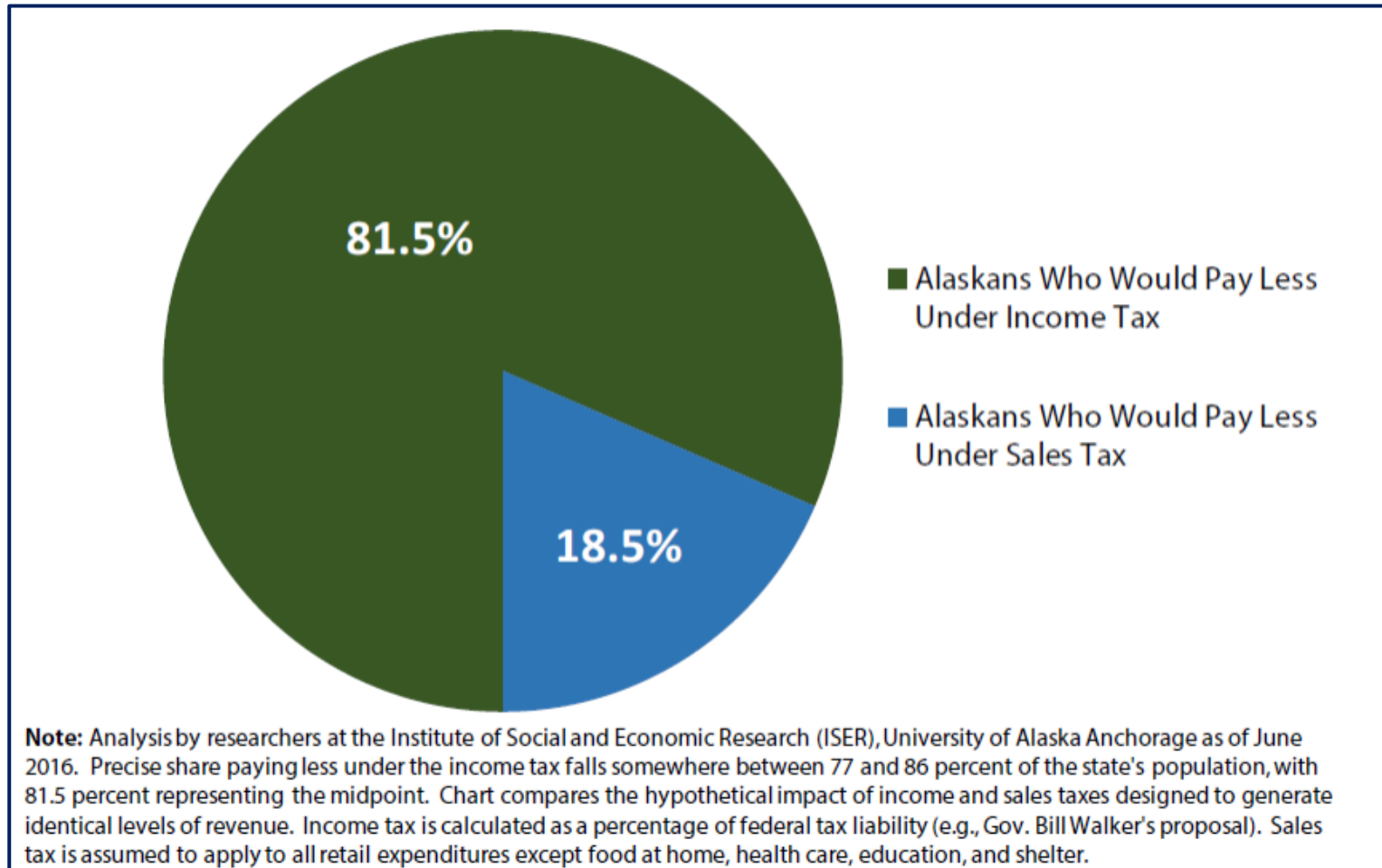


From ITEP's 2017 Study



Revenue Options: Sales vs. Income

The great majority pay less with an income tax vs. a sales tax



The 81st percentile Alaska household makes about \$100,000 / year

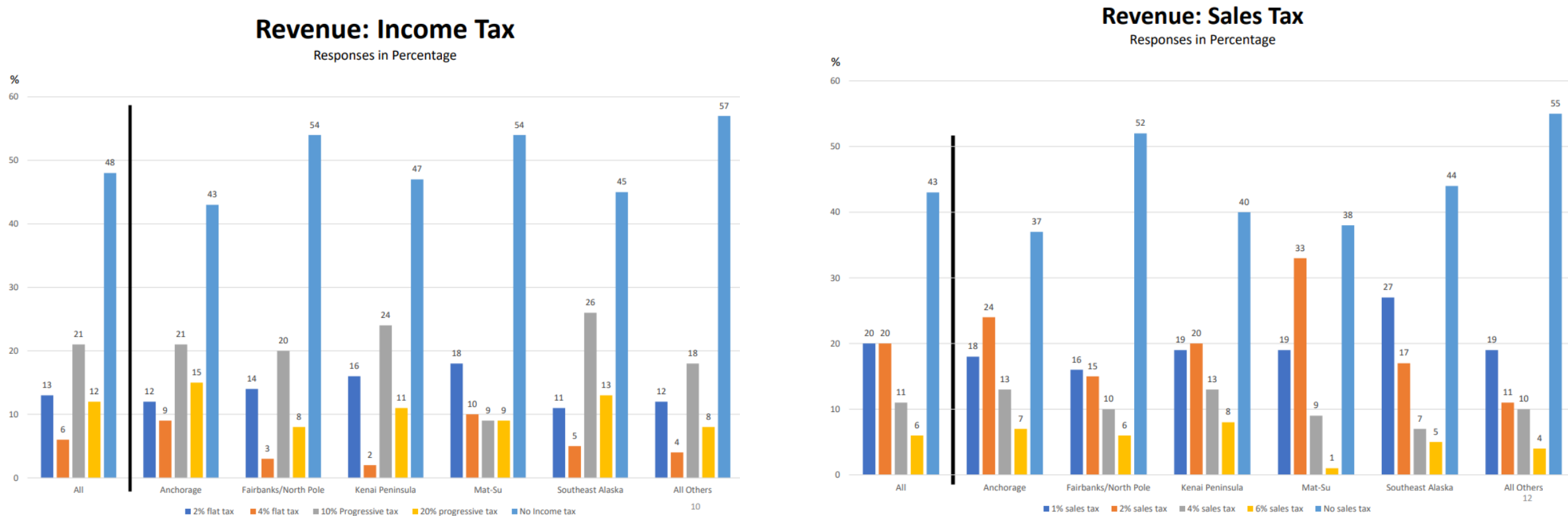
Revenue Options: Sales vs. Income

There are several reasons an income tax might be preferable in Alaska

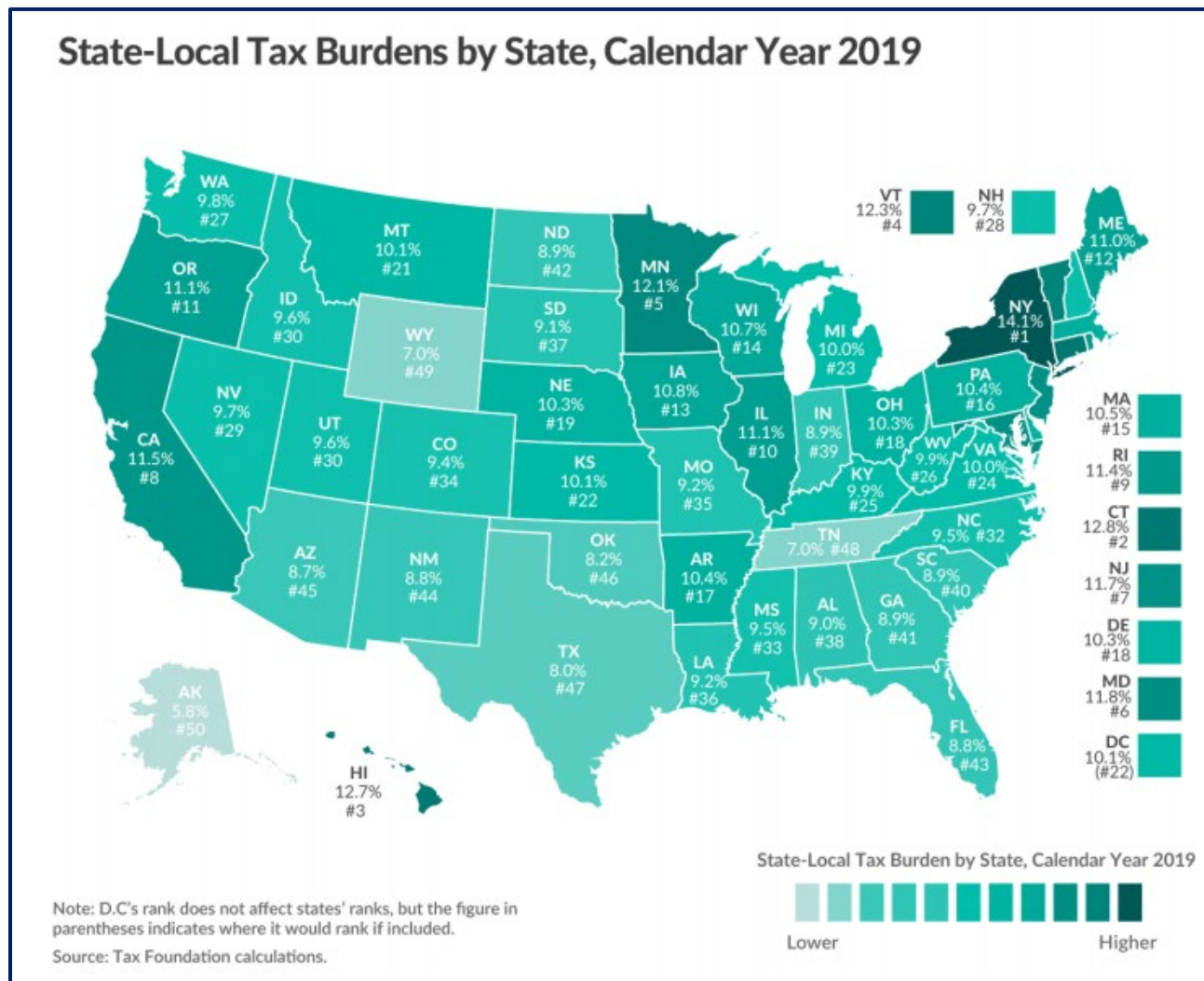
1. A sales tax tends to be regressive; as incomes increase people use more of their earnings for savings, investment and out-of-state travel. A flat rate tax on income might be a better counterbalance to dividend cuts, which has the most impact on low-income Alaskans and children
2. Sales taxes are relied on by ~105 municipalities each with different rules. Adding a state tax introduces a lot of questions: Does the state take over statewide collection? Do we force caps on local rates, unified exemption rules, transaction caps, etc.?
3. Regional price disparities, which are a relatively unique Alaska phenomenon, would disproportionately hurt rural residents
4. Our history with sales tax legislation included aggressive exemption seeking by various interest groups

Revenue Options: Sales vs. Income

The Commonwealth North study showed a small preference for sales taxes although a majority of responses supported both options



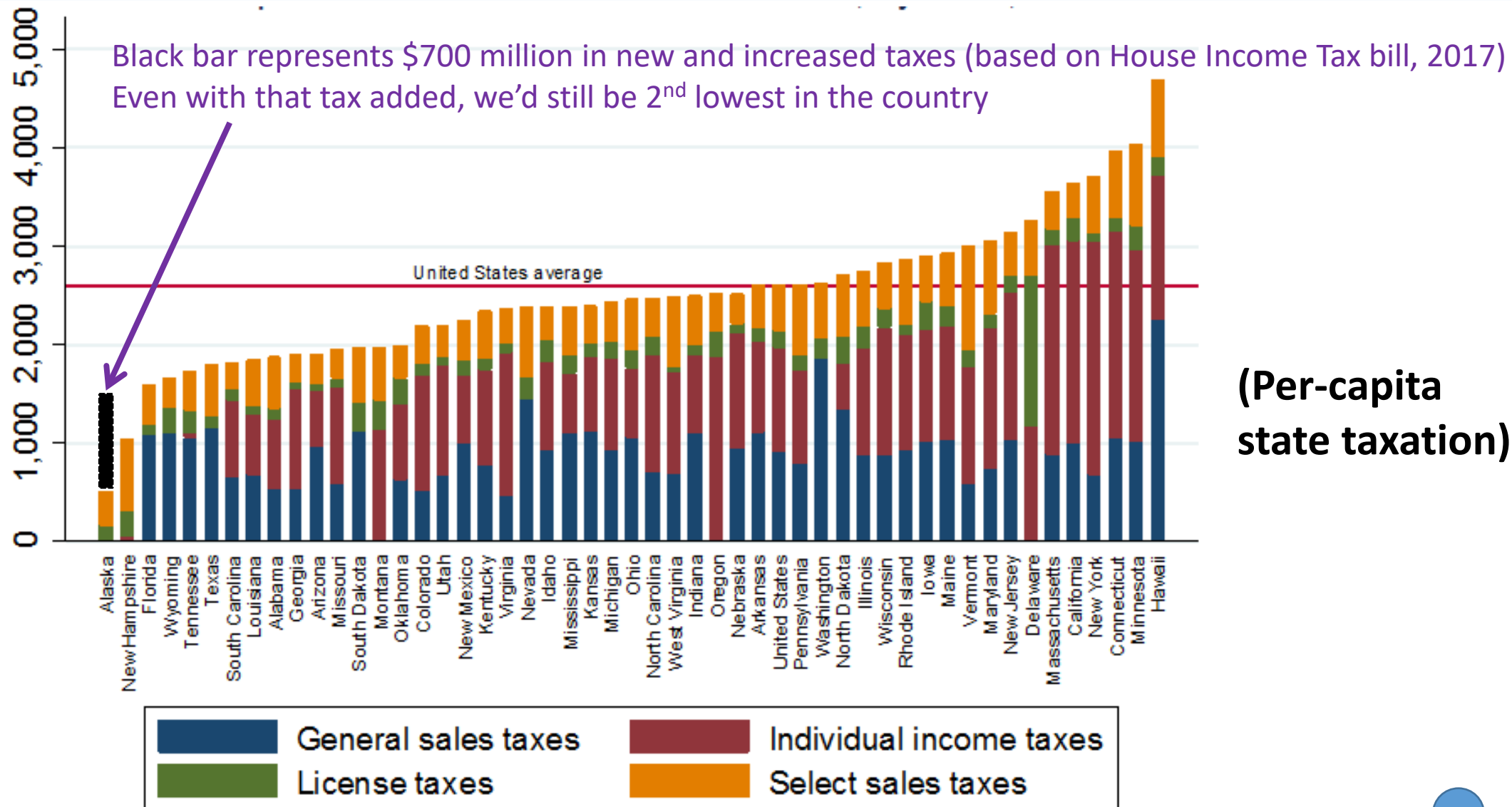
Alaskans pay less state and local tax than any other state



Alaska is 5.8% in combined state and local taxes

**Next lowest are
Wyoming and
Tennessee at 7.0%**

Adding a moderate tax would not change that much



Source data: Mouhcine Guettabi, ISER

Details of HB37

Income Tax- What is Taxed?

Flat rate 2.5% tax based on federal “Adjusted Gross Income” (AGI)

- Metric that is the most widely used among states with income taxes
- Includes all income: wages, self employment, earnings of partnerships and S-corps, capital gains, retirement, etc.
- “Adjustments” to income (i.e. non-taxed items) include retirement contributions, student loan interest, and alimony payments.
- So-called “itemized” deductions, like mortgage interest, are taken after AGI and would therefore be taxed

“Standard Deduction”: First \$10,000 of income (\$20,000 for joint filers) is not taxed

- PFD payments are also non-taxable income

Income Tax- Technical Provisions

- Tax paid by Alaska residents on all their income regardless of where earned
 - Credit is given for income taxes paid to other states for income earned in that state
- Tax paid by nonresidents on income earned in the state
- Tax also applies to trusts and estates, who would be separate taxpayers
- Detailed provisions to establish what income is “from a source in the state”
- Employer withholding from wages with periodic payments from employers to the state
- Employers send employees annual wage statement similar to the federal W-2
- Annual tax returns due same day as federal return
- Department of Revenue to establish regulations to prevent tax avoidance
- Income tax exempted from general DOR requirement to file electronically

Most state income tax payments are deductible from federal taxes for those who itemize; thus a portion of taxes paid will be saved due to reduced payments to the IRS

Permanent Fund Changes

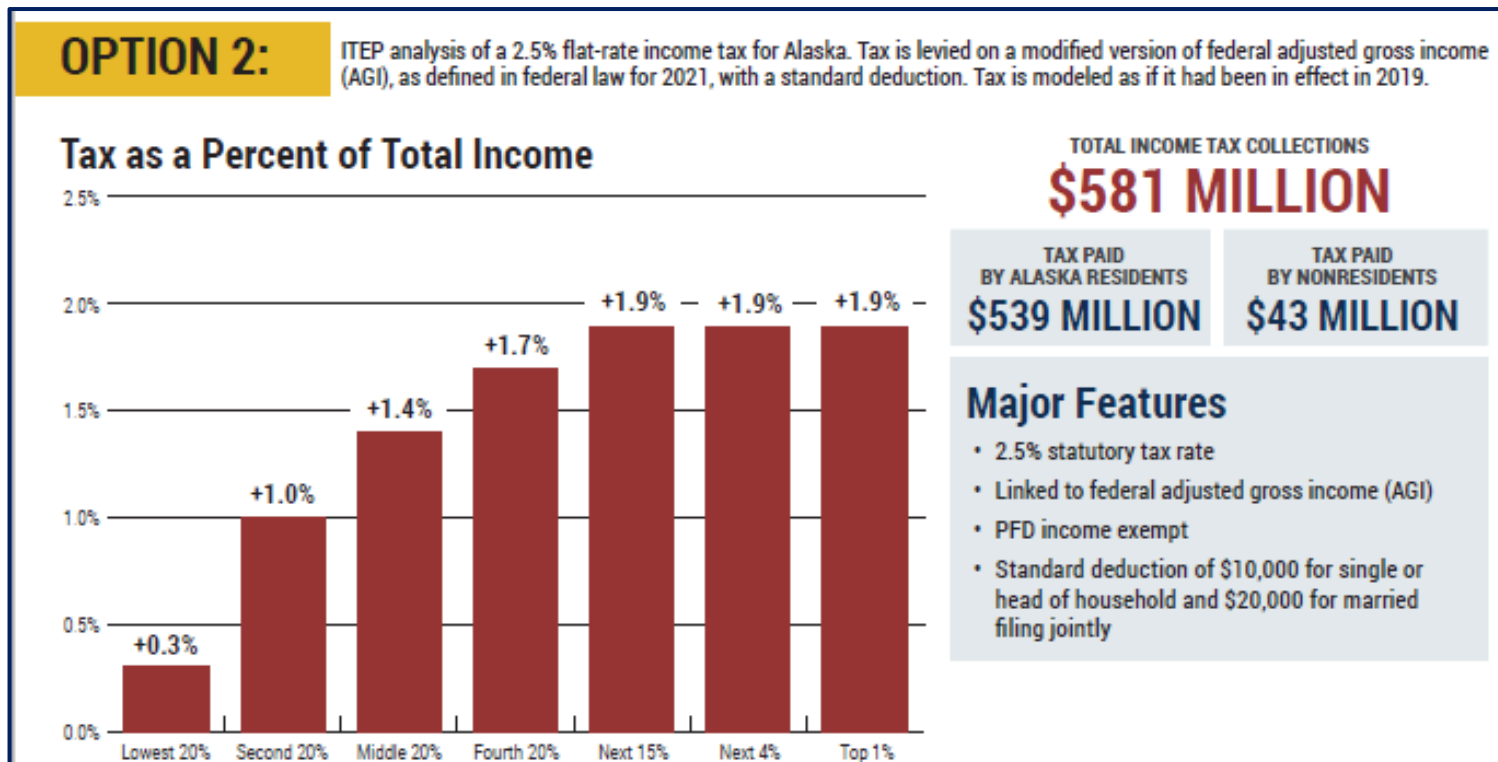
- Replaces the current Dividend formula to one based on 20% of the annual Percent of Market Value draw
- Repeals the statutory 50% “corpus” deposit of royalties from leases signed after 1979
 - The 25% constitutional requirement remains: 25% of all royalties, bonus payments, etc. will continue to be deposited
 - The additional 25% is approximately \$57 million in FY2021; this amount would remain in the general fund available for appropriation
- Repeals the “Amerada Hess” set-aside, where the annual earnings on a specific \$420 million settlement from the early 1990s are excluded from the POMV and dividend calculations
 - About \$27 million / year which currently goes to the Capital Income Fund
- HB37 allows an Alaskan, as part of their PFD application, to apply some or all of their dividend towards their income tax obligation

Implementation and Costs

- Bill as written has an effective date of January 1, 2022
- Major implementation effort for the Department of Revenue:
 - Software procurement / programming of system into Tax Revenue Management System / working with national tax software vendors such as TurboTax
 - Forms development
 - Staff recruitment
 - Public education
- Likely the withholding system will be set up first, so employers are able to begin withholding next year
- First annual returns will be due in early 2023
- Fiscal note includes an initial capital cost of \$8.5 million, plus 69 additional staff at an annual cost of about \$8.3 million / year (1.4% of revenue)

Revenue and Impacts

- The LB&A Committee hired the Institute on Taxation and Economic Policy (ITEP) last fall, to look at several different “flat rate” income tax options
- This bill (2.5%, \$10k/\$20k standard deduction) was “Option 2”
- The consultant estimated \$581 million annual revenue (**Fiscal note: \$580 million**)



Dividend Impact

- The forecasted FY2023 POMV draw is just under \$3.2 billion
- A dividend based on 20% of that would be a \$640 million appropriation, working out to roughly a \$960 dividend per person
- For the majority of Alaskans, their tax burden will be less than their dividend, meaning they will still receive a net payment from the state

Tax Liability in 2023 for Different Household Types and Income Levels

Taxpayer Type		\$25,000	\$50,000	\$100,000	\$200,000
Single Person	Dividend	\$960	\$960	\$960	\$960
	Tax	\$350	\$975	\$2,225	\$4,725
	<i>Net Dividend</i>	\$610	(\$15)	(\$1,265)	(\$3,765)
Single Parent / 1 Kid	Dividend	\$1,920	\$1,920	\$1,920	\$1,920
	Tax	\$325	\$950	\$2,200	\$4,700
	<i>Net Dividend</i>	\$1,595	\$970	(\$280)	(\$2,780)
Married Couple	Dividend	\$1,920	\$1,920	\$1,920	\$1,920
	Tax	\$75	\$700	\$1,950	\$4,450
	<i>Net Dividend</i>	\$1,845	\$1,220	(\$30)	(\$2,530)
Married / 2 Kids	Dividend	\$3,840	\$3,840	\$3,840	\$3,840
	Tax	\$30	\$650	\$1,900	\$4,400
	<i>Net Dividend</i>	\$3,810	\$3,190	\$1,940	(\$560)

Conclusions

HB37 is the only bill that has been introduced this year that resolves the entire fiscal deficit

- Adds approximately \$640 million / year in new revenue
 - \$580 million in tax revenue plus \$57 million in additional UGF royalties
- Clarifies and reduces the state's commitment to PFDs
- New dividend payment will be about \$640 million
- Budget would be balanced at any oil price greater than about \$50

With these two pieces roughly equal, it means that the net effect is about the same as not having a tax and paying zero dividend

- This enables us to afford the dividend into the future while maintaining a stable state budget

THANK YOU



Feel Free to Call or Email with Any Questions

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