

House Bill 37: Income Tax and POMV Allocation Towards a Sustainable Fiscal Solution



Representative Adam Wool
Presentation to the House State Affairs Committee
January 27, 2022

Where We Are

After oil prices collapsed in late 2014, Alaska needed to accomplish four things in order to establish a sustainable budget:

1. Major budget cuts (mostly implemented 2015-2018).
2. Structured use of Permanent Fund earnings (SB26 passed for FY2019).
3. Revised Permanent Fund Dividend formula that works with new POMV and our fiscal reality. (Formulas were passed by both the House and Senate in separate versions of SB26, but neither survived the conference committee. Other formulas have been since proposed in several bills.)
4. New revenues to fill any remaining gap.

**Thus far, only #1 and #2 have been accomplished.
My proposal resolves the rest.**

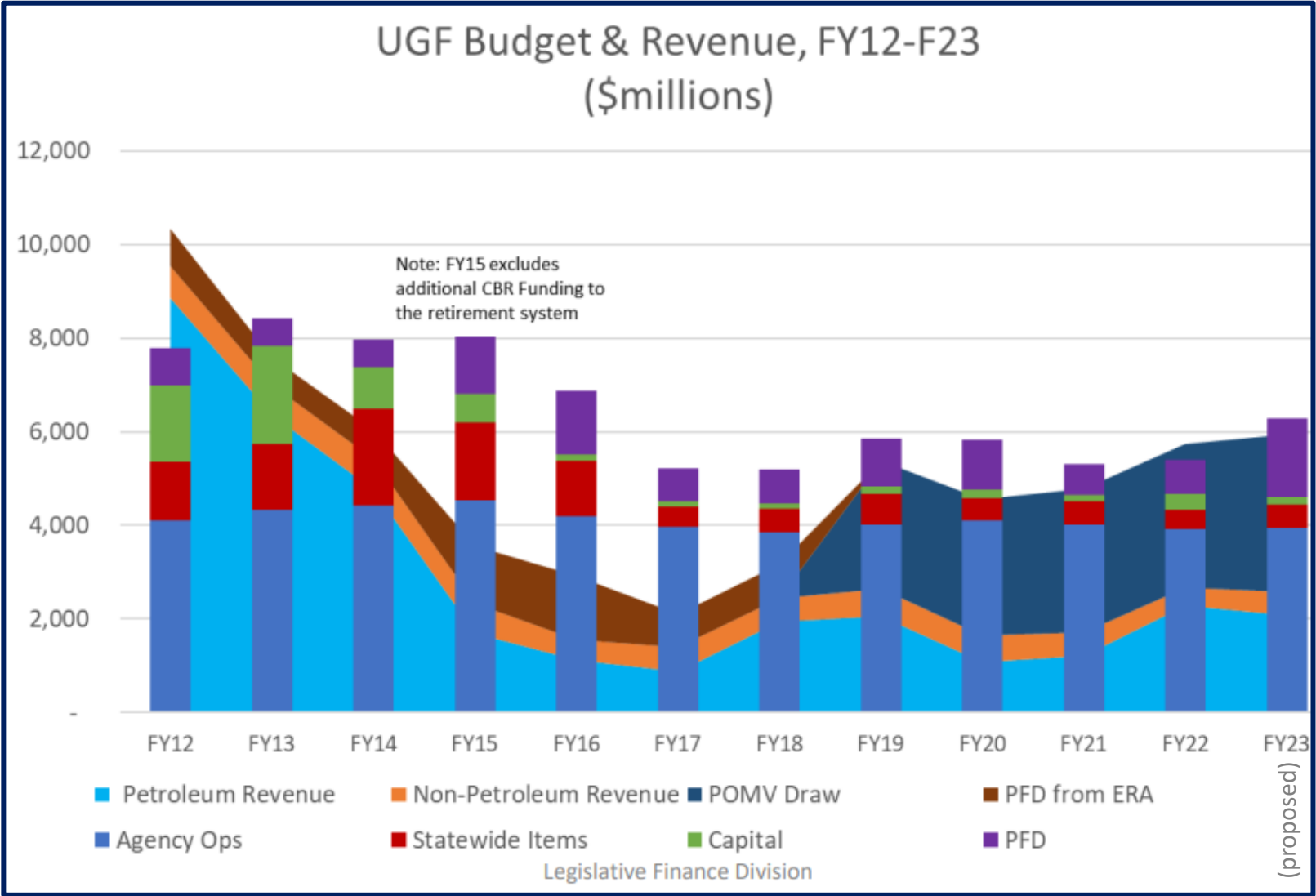
2021 Committee Process Told the Story

- Revenue declines, beginning in 2014
- Budget cuts and major draw-down of savings
- 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:

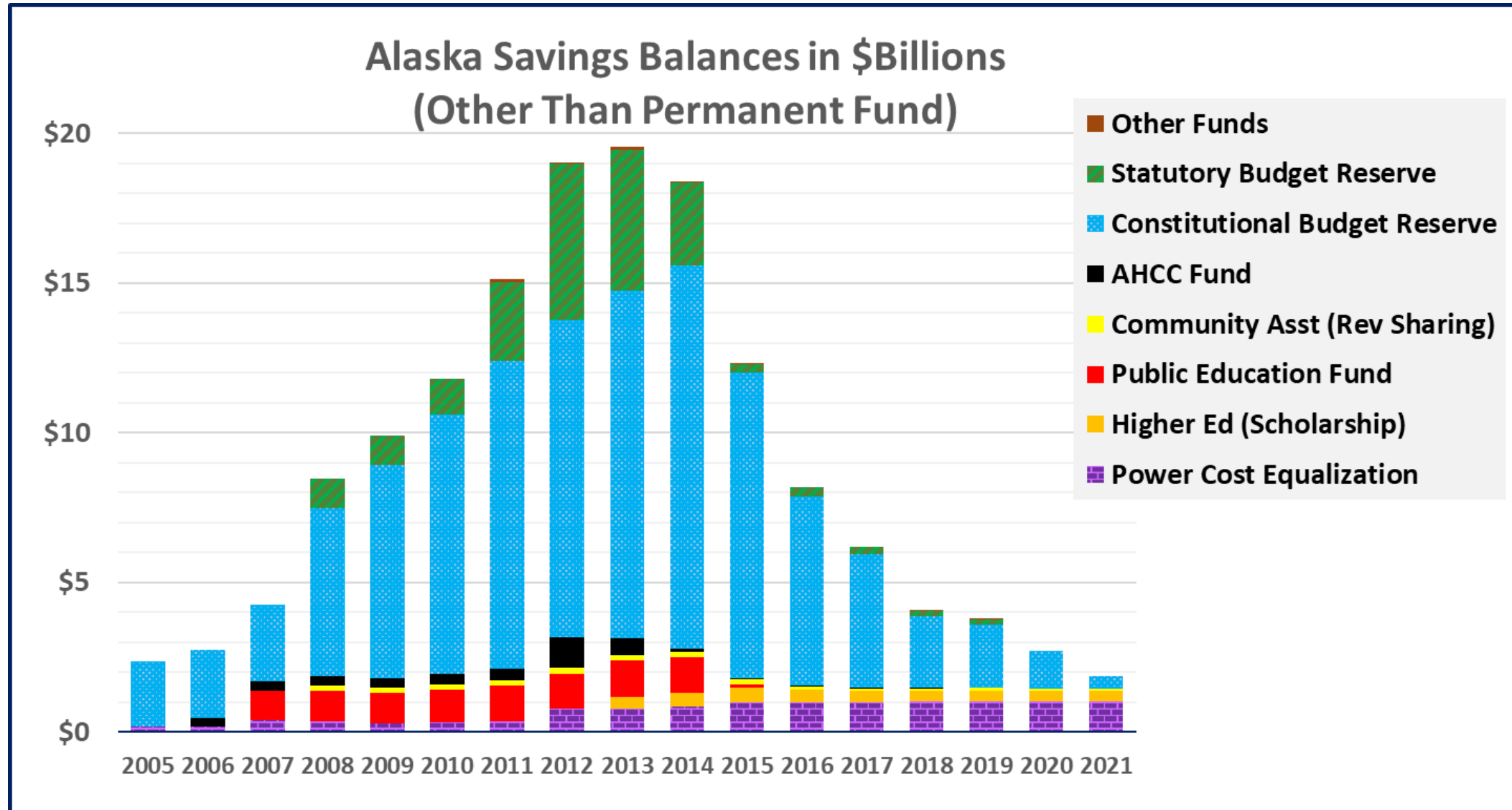
- Pros and Cons of Income Tax vs. Sales Tax vs. Other
- How much revenue to raise / how large should the dividend be?
- Structural and technical details of the bill

Last 10 years: revenue declines, budget cuts, and (beginning in FY19), use of Permanent Fund earnings



Source: Legislative Finance Presentation to House Finance, 1/24/22

Most of the savings that were drawn down 2014-2021 were set aside during the high oil price years 2007-2013



The Situation Last Year

When HB37 was introduced in 2021, the forecasts were that the next several budgets could be approximately balanced with a relatively small (\$500 or less) Permanent Fund Dividend.

HB37 made two major changes to balance Alaska's budget for the foreseeable future and form the centerpiece of a sustainable fiscal plan:

1. Restructuring the annual dividend formula to set future dividends to about \$1,000-\$1,200 per Alaskan
2. New broad-based revenues raising approximately \$500 million

The two pieces are dependent on each other: if higher dividends are desired, revenues would similarly need to be higher.

What is Different since Last Year?

Three major changes have distorted the short-term budget discussion:

1. Record FY2021 Permanent Fund earnings increased the end-year fund balance to \$82 billion. The forecast a year ago was \$66 billion. This increases expected POMV draws substantially, by \$150 million this year (from \$3.21b to \$3.36b) increasing to \$830 million in FY2028 (from \$3.51b to \$4.34b)
2. Oil prices have reached the highest levels since the 2014 crash, increasing forecasted FY23 unrestricted petroleum revenue by \$1,160 million (from \$0.92b to \$2.08b)
3. Much of the latest round of federal COVID funding can be used for "revenue replacement" rather than just for direct pandemic impact; that's about another \$1,000 million of available one-time funding

So do we still need revenue?

Probably.

1. The governor's 10-year plan (which includes a "50/50" dividend) still shows deficits starting in FY24

Fiscal Year 2023 Ten Year Outlook											
(Amounts in millions)											
Permanent Fund Dividend	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032
50-50 Permanent Fund Dividend Transfer	1,534.7	1,680.3	1,800.0	1,904.0	2,009.5	2,128.5	2,172.5	2,214.5	2,254.0	2,291.5	2,328.5
Per capita PFD (dollars)	\$2,330	\$2,564	\$2,712	\$2,855	\$3,000	\$3,164	\$3,212	\$3,258	\$3,300	\$3,338	\$3,375
Unrestricted General Fund Expenditures	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032
Agency Operations	3,927.9	3,933.6	3,932.1	3,987.8	4,043.3	4,100.6	4,157.8	4,217.7	4,277.6	4,339.3	4,401.8
Statewide Items	462.6	517.8	453.2	412.2	242.0	217.9	222.5	221.9	224.5	217.9	222.4
Operating Budget	4,390.5	4,451.4	4,385.3	4,400.0	4,285.3	4,318.6	4,380.2	4,439.6	4,502.1	4,557.2	4,624.2
Capital Budget	335.9	154.7	154.7	154.7	154.7	154.7	154.7	154.7	154.7	154.7	154.7
Total General Fund Appropriations	4,726.4	4,606.1	4,540.0	4,554.7	4,440.1	4,473.3	4,535.0	4,594.3	4,656.8	4,711.9	4,779.0
Unrestricted Revenues	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032
Traditional UGF Revenue	2,662.5	2,577.2	2,464.5	2,429.9	2,340.0	2,314.2	2,340.8	2,297.1	2,402.8	2,549.7	2,549.7
POMV Draw for Government	1,534.7	1,680.3	1,800.0	1,904.0	2,009.5	2,128.5	2,172.5	2,214.5	2,254.0	2,291.5	2,328.5
Revenue Adjustments	672.7	375.4									
Total Revenue	4,869.7	4,632.9	4,264.5	4,333.9	4,349.5	4,442.7	4,513.3	4,511.6	4,656.8	4,841.2	4,878.2
Pre-Draw Surplus/(Deficit)	143.3	26.7	(275.5)	(220.8)	(90.6)	(30.6)	(21.7)	(82.7)	0.0	129.3	99.2
Savings Draw			275.5	220.8	90.6	30.6	21.7	82.7			
Final Surplus/(Deficit)	143.3	26.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	129.3	99.2

So do we still need revenue?

Probably.

2. Legislative Finance implies that the governor's 10-year plan is undercounted by \$200 to \$400 million / year

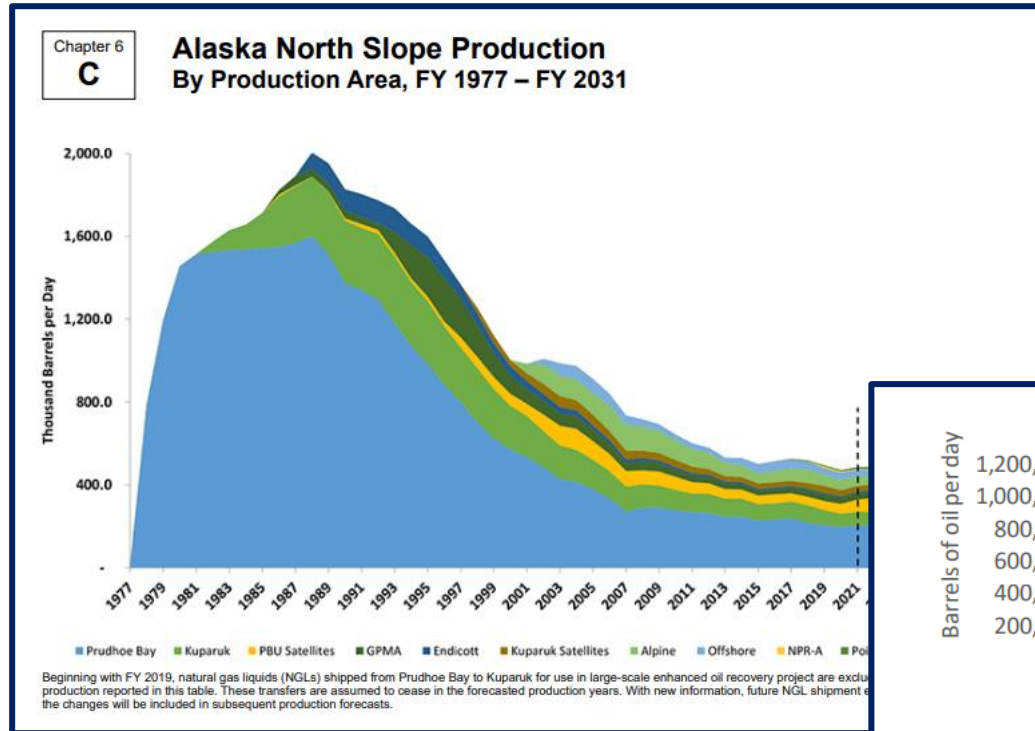
Comparison of LFD Baseline to the Governor's 10-Year Plan (\$ millions)									
	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31
Baseline	4,655.9	4,747.5	4,774.5	4,672.3	4,735.3	4,833.6	4,926.5	5,025.1	5,127.8
Governor	4,606.2	4,540.0	4,554.7	4,440.0	4,473.2	4,535.0	4,594.3	4,656.8	4,711.9
Difference	(49.7)	(207.5)	(219.8)	(232.3)	(262.1)	(298.6)	(332.2)	(368.3)	(415.9)

Source: Legislative Finance Presentation to House Finance, 1/24/22

3. Beyond that, base education funding hasn't been increased in 7 years. The capital budget is also highly constrained for years
4. Markets can crash. Oil prices can go down
5. Once a major tax bill passes, it will likely take about 18 months to begin collecting revenue

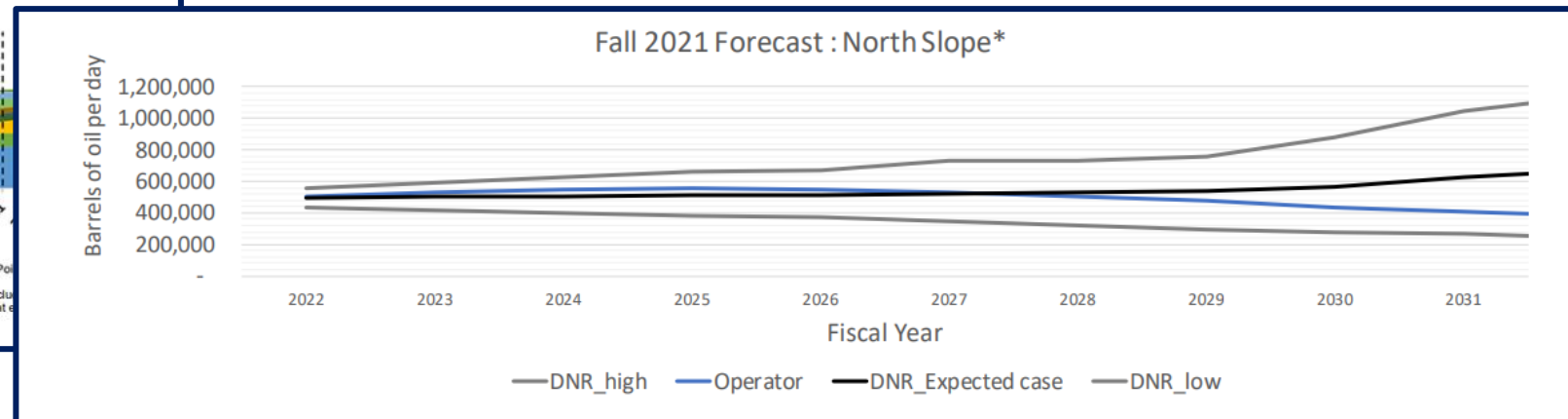
So do we still need revenue?

- Many local and global factors are working against oil.
- We can't rely on it for the long-term future.



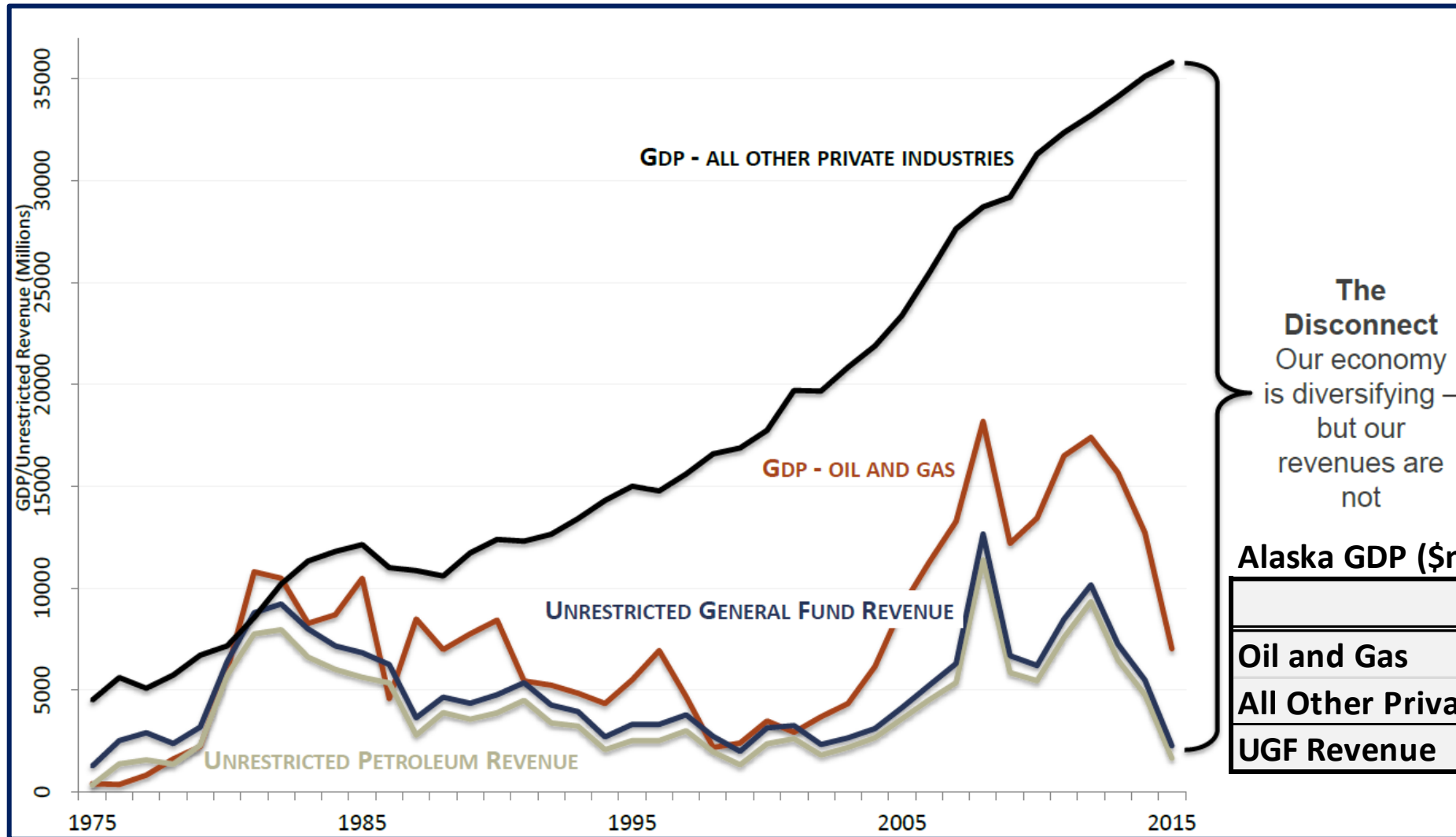
Source: Fall 2021 Revenue Sources Book

- Production is down 75% from our peak
- The official state production forecast is extremely volatile and uncertain.



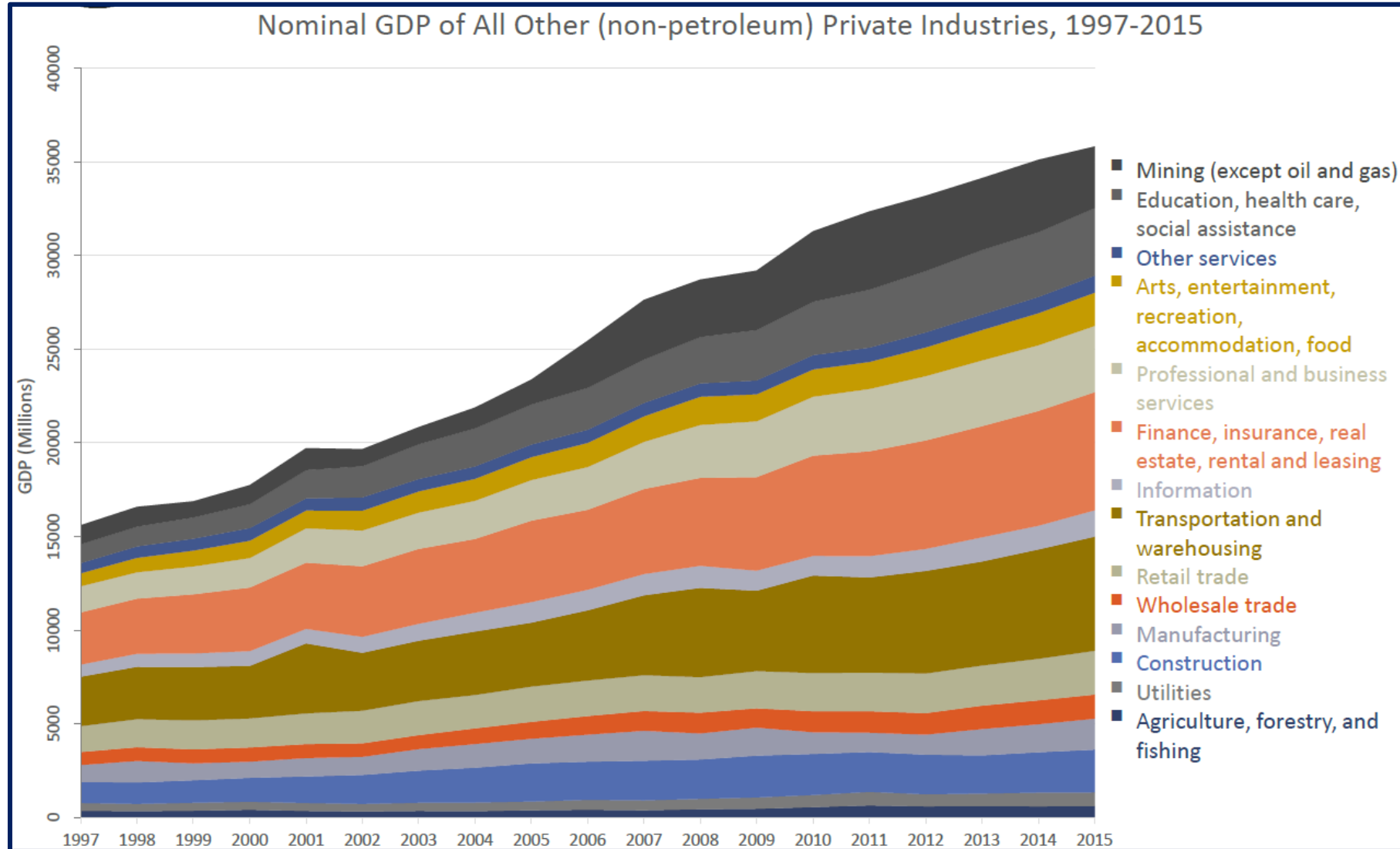
Source: DNR Presentation to House Finance, 1/19/22

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



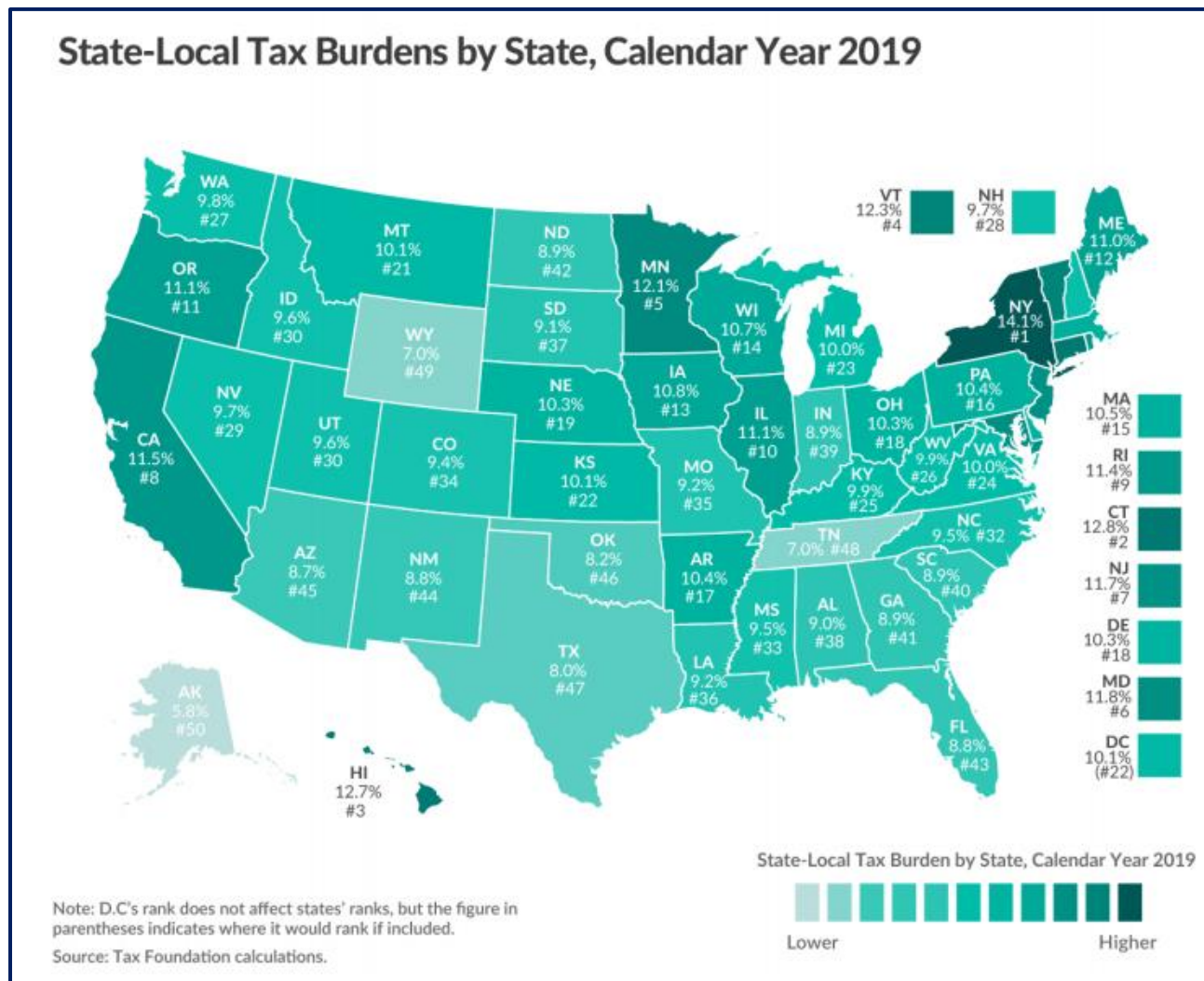
Source: DCCED Commissioner Mike Navarre, Presentation to House Finance 3/20/18

Detail on which sectors have grown the most in the last 20+ years



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

Alaskans pay less state and local tax than any other state

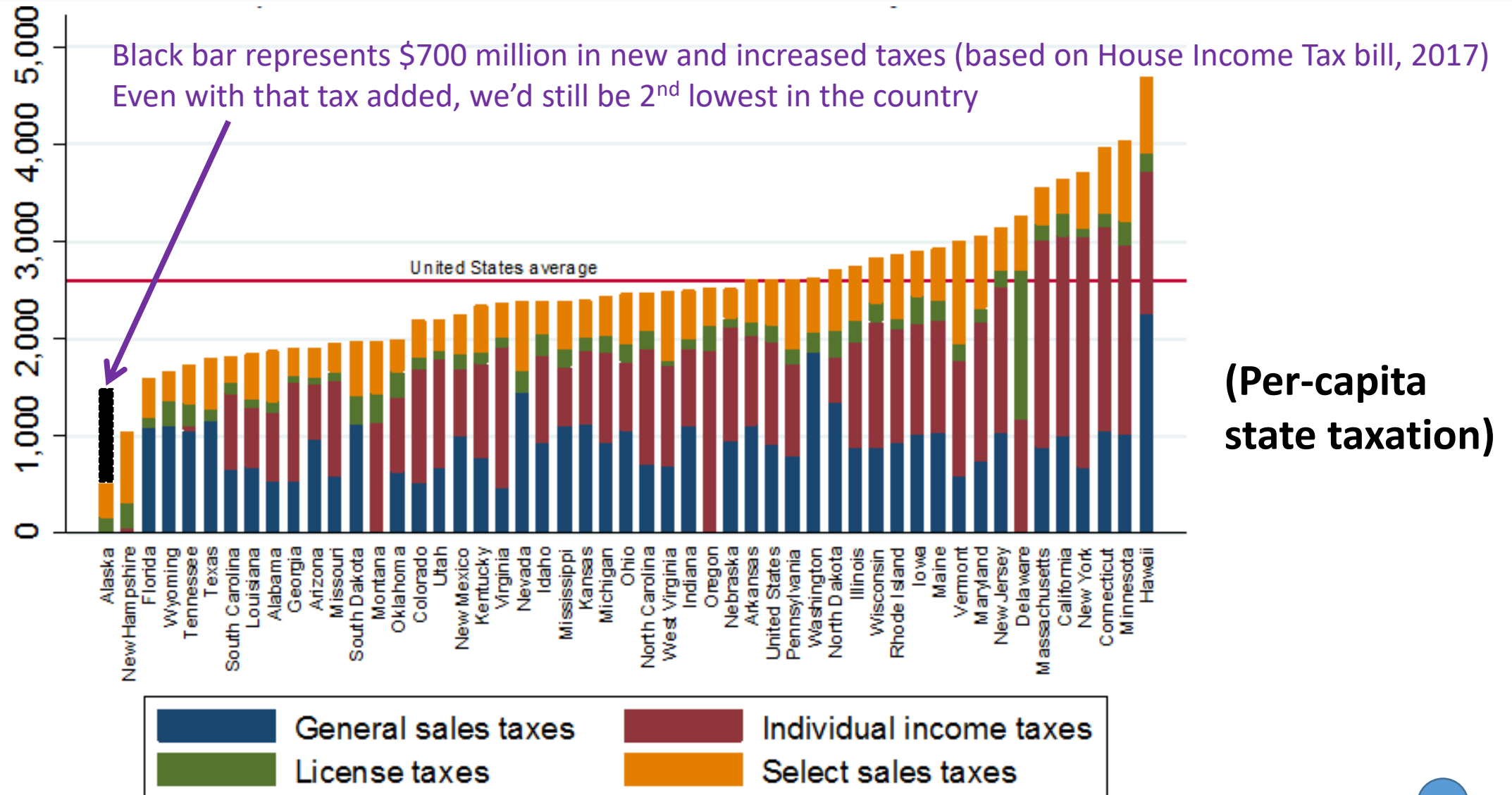


Alaska is 5.8% in combined state and local taxes

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

**If the PFD (\$1,606 in 2019)
was included as a “negative tax”,
Alaska’s effective state and local
tax rate would be about 1.7%**

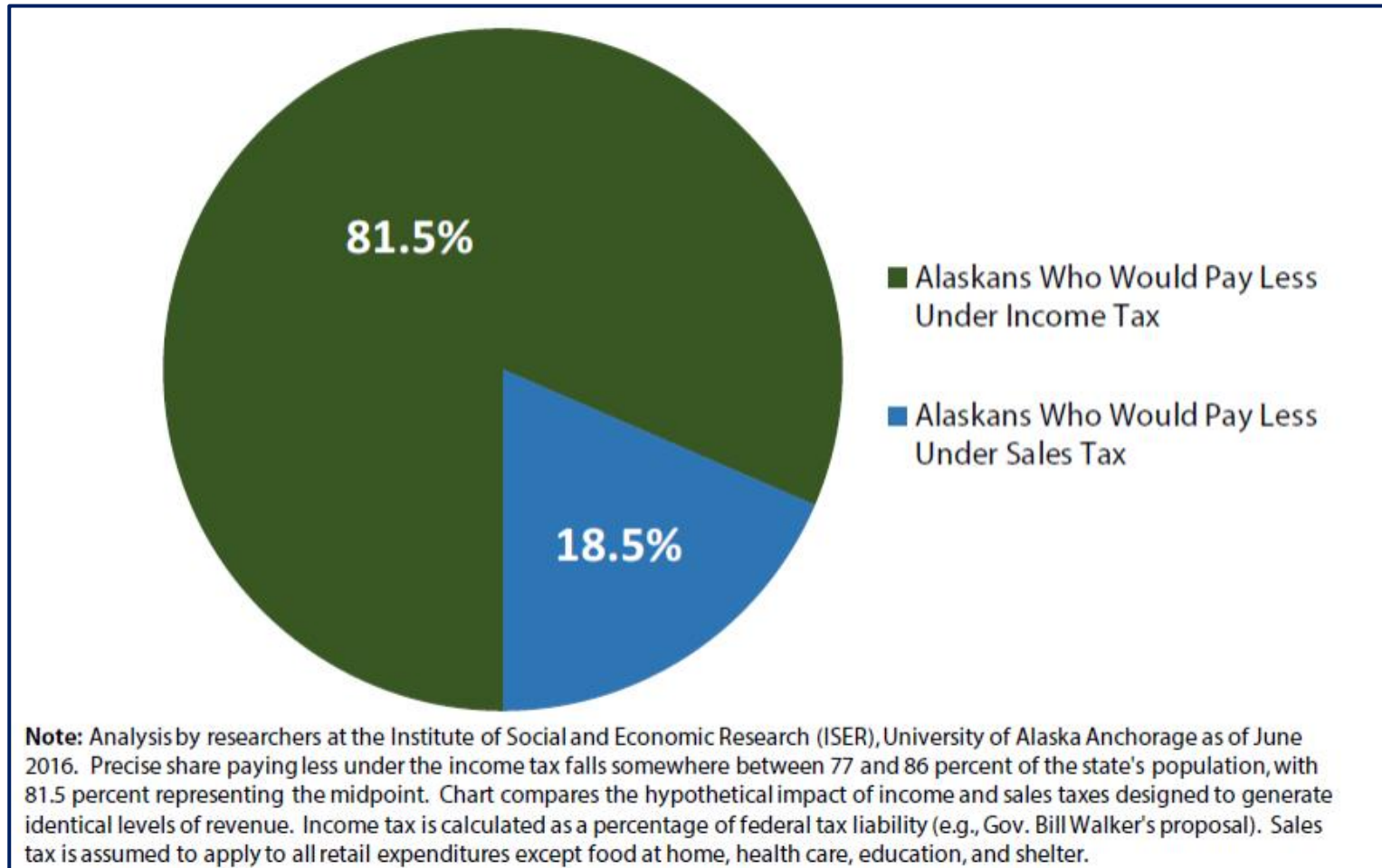
Adding a moderate tax would not change that much



Source data: Mouhcine Guettabi, ISER

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

Who Would Pay Income Tax?

Almost everyone.

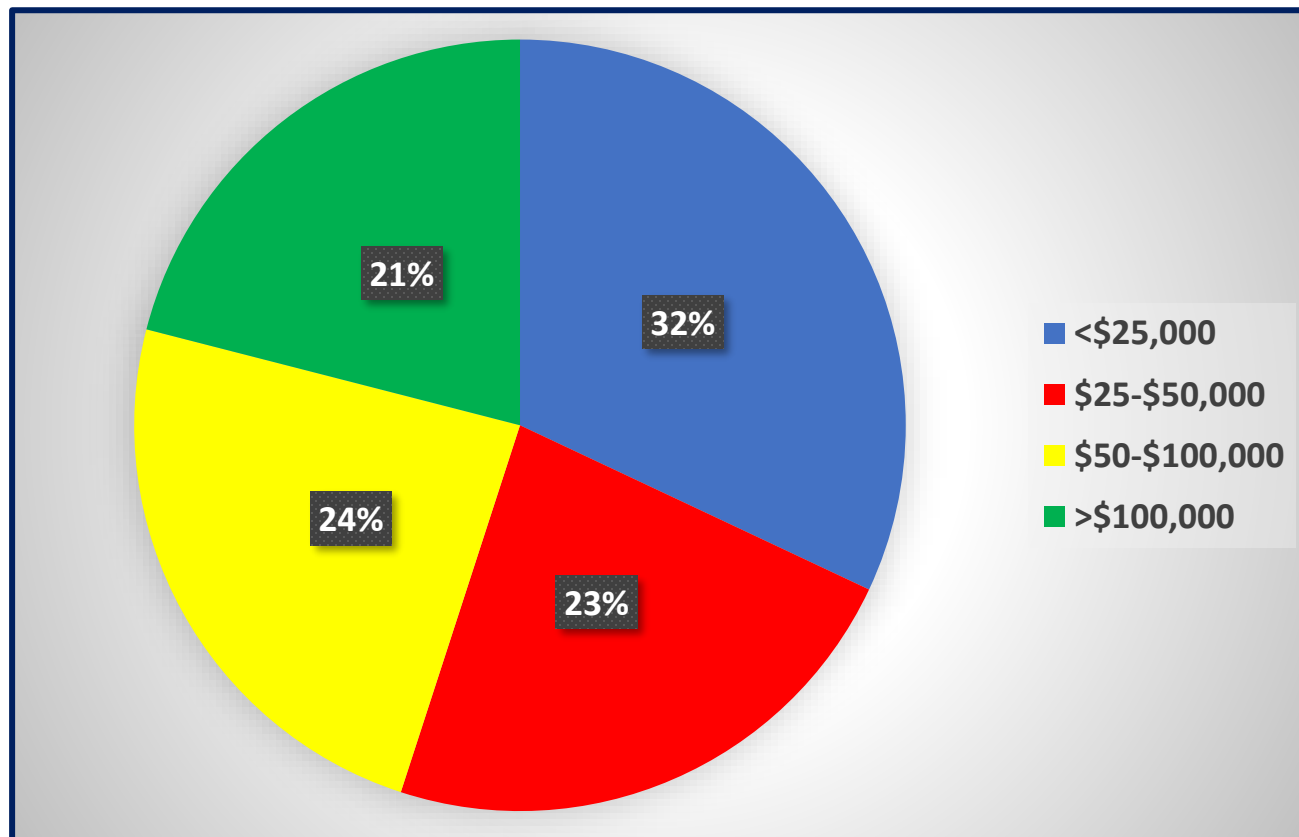
Number of Tax Filers from Alaska (IRS 2017)

Single	177,250
Joint	125,830
Head of Household	37,190
Other	8,790
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Total Filers	349,060

Total Adult Filers

(assume 2 per joint filer) at least 474,890
Adult Population (2020 census) 549,075
(at least 87%)

Income level of Alaska resident taxpayers



Source: IRS Data for Alaska resident filers, 2017

Details of My Proposal

Permanent Fund Changes

Replaces the current Dividend formula to one based on 10% of the annual Percent of Market Value draw plus 30% of oil and gas royalties

	FALL 2021	FALL 2020
FY2023 POMV Draw:	\$3,361	\$3,206 million
10% towards the dividend	\$336	\$321 million
 FY2023 Royalty Forecast	 \$1,461	 \$843 million
<u>30% towards the dividend</u>	<u>\$438</u>	<u>\$253 million</u>
 Total Dividend Funding	 \$774	 \$574 million
Per Capita Dividend	\$1,148	\$834

Per current forecasts, the dividend will grow to \$1,400-\$1,500 by 2030

Permanent Fund Changes

Future dividends are tied to both our accumulated savings (the permanent fund itself) as well as the health of the industry (oil royalties)

Other Permanent Fund changes in the bill

- 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 \$75 million in FY2023; 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 currently goes to the Capital Income Fund

Income Tax

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

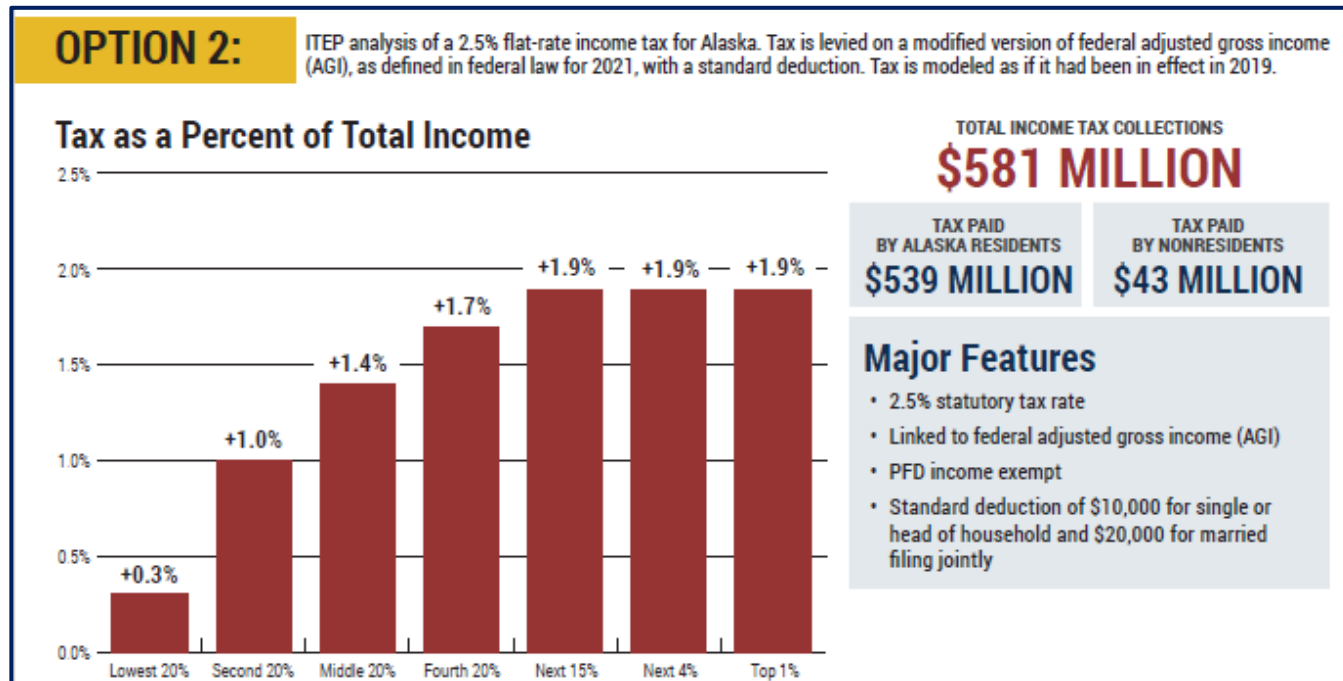
- Metric that is the most widely used among states with income taxes
- Includes all income Alaska-source: wages, self employment, earnings of partnerships and S-corps, capital gains, retirement, etc.
- “Adjustments” to income (i.e. non-taxed items) include retirement contributions, student loan interest,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

“Standard Deduction” tied to federal code: First \$12,550 (single), \$18,800 (head of household), and \$25,100 (joint) is not taxed

- PFD payments are also non-taxable income
- Largely eliminates the tax burden on lower-income Alaskans and provides a form of “means testing” for the dividend

Revenue and Impacts

- The LB&A Committee in 2020 hired the Institute on Taxation and Economic Policy (ITEP) last fall, to look at several different “flat rate” income tax options
- The original bill (2.5%, \$10k/\$20k standard deduction) was “Option 2”
- The consultant estimated \$581 million annual revenue (**Fiscal note: \$580 million**)
- The amended bill, with a higher standard deduction, is estimated at **\$545 million**



Even after paying a tax, most Alaskans would still receive a dividend

- The forecasted FY2023 POMV draw is about \$3.36 billion
- A dividend based on 10% of that plus 30% of oil royalties would be a \$774 million appropriation, working out to roughly a \$1,148 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

Tax Liability in 2023 for Different Household Types and Income Levels

Taxpayer Type		\$25,000	\$50,000	\$100,000	\$200,000
Single Person	Dividend	\$1,148	\$1,148	\$1,148	\$1,148
	Tax	\$283	\$908	\$2,158	\$4,658
	<i>Net Dividend</i>	\$865	\$240	(\$1,010)	(\$3,510)
Single Parent / 1 Kid	Dividend	\$2,296	\$2,296	\$2,296	\$2,296
	Tax	\$98	\$723	\$1,973	\$4,473
	<i>Net Dividend</i>	\$2,198	\$1,573	\$323	(\$2,177)
Married Couple	Dividend	\$2,296	\$2,296	\$2,296	\$2,296
	Tax	\$0	\$565	\$1,815	\$4,315
	<i>Net Dividend</i>	\$2,296	\$1,731	\$481	(\$2,019)
Married / 2 Kids	Dividend	\$4,592	\$4,592	\$4,592	\$4,592
	Tax	\$0	\$508	\$1,758	\$4,258
	<i>Net Dividend</i>	\$4,592	\$4,084	\$2,834	\$334

Conclusions

A \$2,500 dividend, as proposed by the governor, is risky and unaffordable.

A \$500 dividend, which is what we can afford without taxes or major budget cuts, is too low to be acceptable to most Alaskans.

A moderate tax bill, such as the one I introduced, is the cleanest way to resolve the entire fiscal deficit.

The two pieces are roughly equal in size and impact:

- Adds approximately \$600 million / year in new revenue
 - \$545 million in tax revenue plus \$75 million in additional UGF royalties
- Clarifies and reduces the state's commitment to PFDs
- New dividend payment would be about \$774 million in FY2023
- Budget would be balanced at any oil price greater than about \$50 / bbl

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

Representative Adam Wool
Rep.Adam.Wool@Akleg.Gov
(907) 465-4976

