

# LEGAL SERVICES

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### MEMORANDUM

February 1, 2022

**SUBJECT:** Federal Income Tax; Permanent Fund Dividend  
(HB 158; Work Order No. 32-LS0746\A)

**TO:** Representative Mike Prax

**FROM:** Emily Nauman  
Deputy Director 

You asked whether an individual returning to the state all or a portion of the individual's permanent fund dividend would be tax deductible on that individual's federal income taxes. The tax consequences of an action for any certain individual cannot be predicted with certainty; each individual may make decisions that affect the status and categorization of income and expenditures.<sup>1</sup> I hope you find this memorandum, which relates generally to income and deductions for purposes of the federal income tax, helpful.

#### Deductions

Generally, donations to government entities are tax deductible, so long as they are made for a public purpose. 26 U.S.C. 170(c)(1) defines a "charitable contribution" to include "a contribution or gift to or for the use of [a] State, a possession of the United States, or any political subdivision of any of the foregoing, . . . , but only if the contribution or gift is made for exclusively public purposes." Donations made under HB 158 appear to meet the public purpose requirement, as described in 26 U.S.C. 170(c)(1) and would therefore be tax deductible for the individual making the donation.

#### Exclusions from Income

Excluding income from federal income tax is not as straightforward. In general, the entire amount of the dividend is considered taxable income by the federal government, even if it were donated to the state, which would include the mechanism in HB 158. Under the constructive receipt doctrine, the federal government treats income as taxable when it is under the taxpayer's control.<sup>2</sup> By making an affirmative choice to donate all or

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<sup>1</sup> As an example, whether or not an individual "deducts" charitable contributions may depend on whether the individual itemizes deductions or claims the standard deduction.

<sup>2</sup> Where a taxpayer has an "unqualified, vested right to receive immediate payment," federal law requires a taxpayer to recognize the amount as income. *Jombo v. Comm'r*, 398 F.3d 661, 663 (D.C. Cir. 2005). See also 26 CFR 1.451-2 ("Income although not

a portion of the dividend, a taxpayer demonstrates that the income is under the taxpayer's control.<sup>3</sup> Currently, a person who rejects his or her dividend does so by not applying for the dividend. Individual income tax is not owed on the dividend because it is never received. Once a person has completed a dividend application and found to be eligible by the state, a dividend payment is made to that person. Even if the recipient fails to cash the dividend check, the amount of the dividend is likely includable in that individual's income for federal tax purposes.<sup>4</sup> The same is true for a dividend amount later donated, including a donation back to the state.<sup>5</sup>

You asked whether the dividend could be structured so that those who opt not to receive a dividend would not be subject to the federal income tax on that amount. As you mentioned in your inquiry, it may be possible to avoid an individual "receiving" income for federal income tax purposes by estimating the number of residents eligible for the dividend and subtracting out the number of residents actually receiving the dividend. The state could then calculate the approximate amount of dividends unclaimed and transfer that amount to the general fund. However, as previously discussed, to avoid triggering a federal income tax liability for a resident foregoing their dividend, that resident must not have possession or a right to the dividend. Giving an individual the choice to opt out of receiving a dividend, with the intent that the money instead go towards state government, likely is insufficient to exclude it from the income of the dividend recipient.

If I can be of further assistance, please advise.

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Attachment

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actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given.") This is the doctrine of constructive receipt. Although the doctrine itself is about the timing of income for tax purposes, the regulation clearly evidences that the federal tax rules impute income to a taxpayer when that money is available to them.

<sup>3</sup> See *Fetzer Refrigerator Co. v. United States*, 437 F2d 577 (6th Cir. 1971); *Lawson v. C.I.R.*, 97 T.C.M. (CCH) 1830 (T.C. 2009) ("Payments received under Alaska's Permanent Fund Dividend Program are subject to Federal income tax. Income payable to a person that is diverted before its receipt to pay a personal obligation of that person is still income to that person." (internal citations omitted)).

<sup>4</sup> The check is a cash equivalent in the recipient's possession.

<sup>5</sup> See footnote 3.