



# **Individual Income Tax**

## **HB 250**

**Presentation to the House Finance Committee**  
**April 5, 2016**

# *Individual Income Tax*

"An Act relating to the taxation of income of individuals; repealing tax credits applied against the tax on individuals under the Alaska Net Income Tax Act; and providing for an effective date."

## *Income Tax History*

- Began in 1949 at 10% of federal tax liability
- By 1961, the tax was 16% of federal tax liability
- In 1975, Alaska switched from federal tax liability to its own tax brackets
  - Ranged from 3% to 14.5% on taxable income
- Alaska repealed personal income tax in 1980 after oil revenue boom

# *Tax Proposal*

- Creates a tax on an individual's income. The proposed rate is 6% of a person's federal income tax liability

| Federal Income Rate | Effective Alaska Rate |
|---------------------|-----------------------|
| 10%                 | 0.60%                 |
| 15%                 | 0.90%                 |
| 25%                 | 1.50%                 |
| 28%                 | 1.68%                 |
| 33%                 | 1.98%                 |
| 35%                 | 2.10%                 |
| 39.6%               | 2.38%                 |

# *Income Tax Proposal (Continued)*

## **2016 Federal Tax Brackets and Proposed Alaska Effective Rates on Fed. Taxable Income (FTI) <sup>1</sup>**

| <b>Fed / AK Rate</b> | <b>Single Filers</b>   | <b>Married Joint Filers</b> | <b>Head of Household</b> |
|----------------------|------------------------|-----------------------------|--------------------------|
| 10% / 0.60%          | \$0 to \$9,275         | \$0 to \$18,550             | \$0 to \$13,250          |
| 15% / 0.90%          | \$9,275 to \$37,650    | \$18,550 to \$75,300        | \$13,250 to \$50,400     |
| 25% / 1.50%          | \$37,650 to \$91,150   | \$75,300 to \$151,900       | \$50,400 to \$130,150    |
| 28% / 1.68%          | \$91,150 to \$190,150  | \$151,900 to \$231,450      | \$130,150 to \$210,800   |
| 33% / 1.98%          | \$190,150 to \$413,350 | \$231,450 to \$413,350      | \$210,800 to \$413,350   |
| 35% / 2.10%          | \$413,350 to \$415,050 | \$413,350 to \$466,950      | \$413,350 to \$441,000   |
| 39.6% / 2.38%        | \$415,050+             | \$466,950+                  | \$441,000+               |

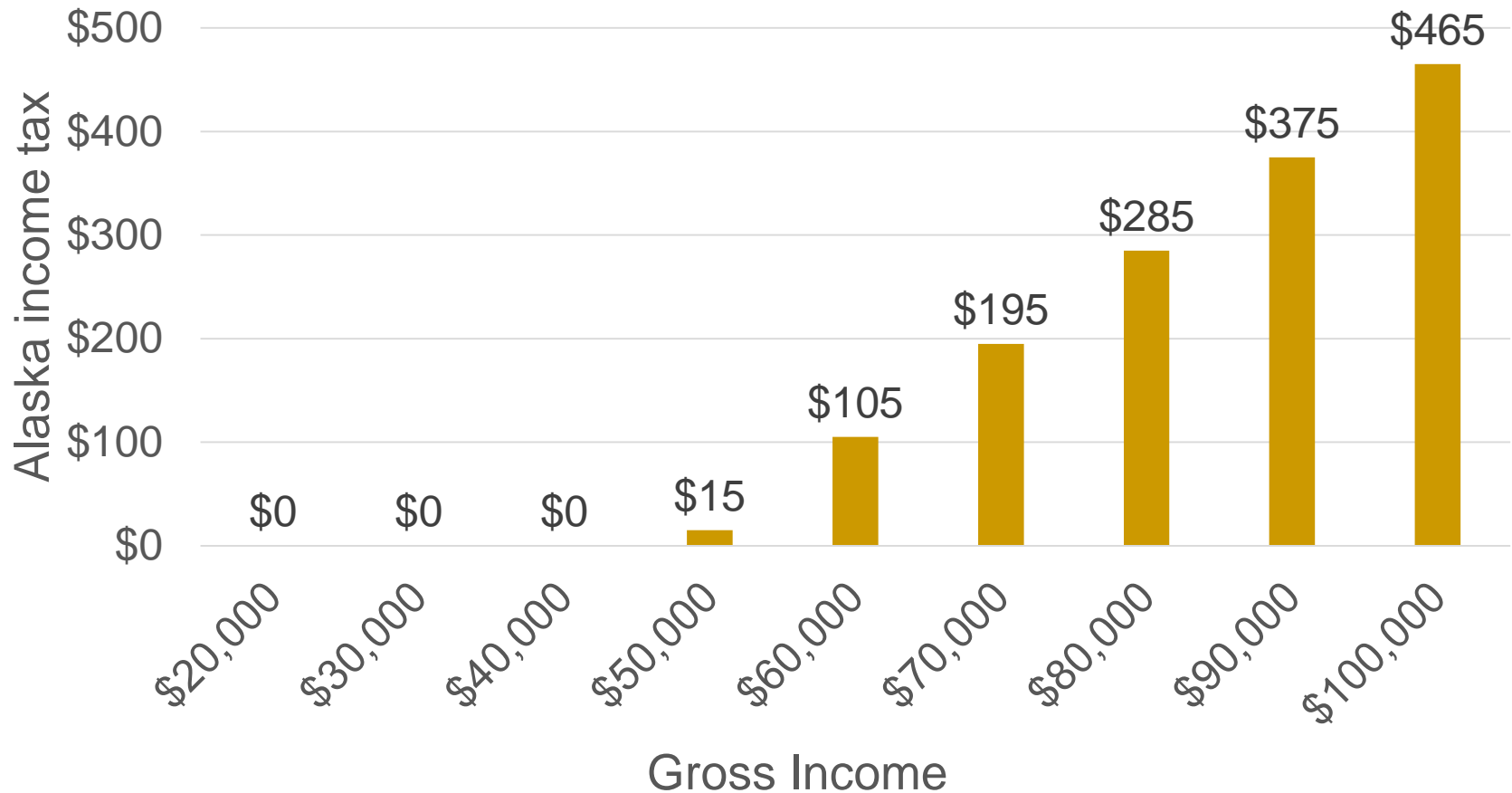
<sup>1</sup>FTI is and individuals gross income minus allowable deductions, exemptions, and other adjustments. FTI is always less than gross income.

## *Income Tax Proposal (Continued)*

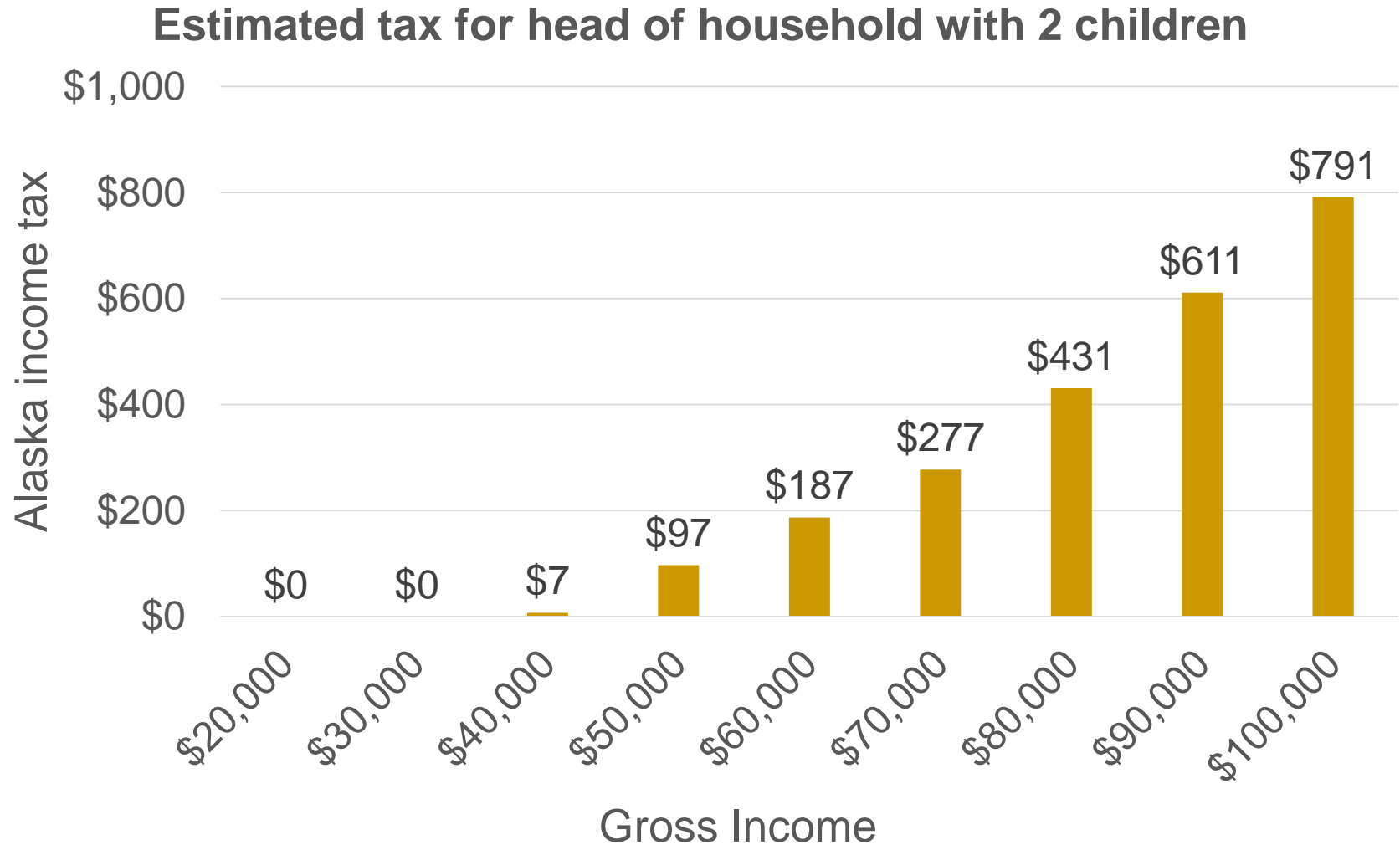
- Tax applies to nonresidents' income from a source in Alaska
- Residents receive credit for taxes paid in other states
- Provides for employers to withhold taxes and remit them to the state

# *Income Tax Estimates*

**Estimated tax for married couple filing jointly  
with 2 children**



# *Income Tax Estimates*





# *Relative Tax Rate*

- 43 states currently have an income tax
- Among states with an income tax, Alaska's rate would be lowest
  - North Dakota would be second-lowest
  - Average state income tax is about 30% of federal liability, five times Alaska's proposed rate
- Six states would still have zero state income tax<sup>1</sup>
- Two states tax only dividends and interest<sup>2</sup>

<sup>1</sup>Florida, Nevada, South Dakota, Texas, Washington, Wyoming

<sup>2</sup>New Hampshire, Tennessee

# *Impacts of Tax Proposal*

- Income from subchapter S corporations and partnerships will be taxed
  - Taxed on income with a source in Alaska
  - Not currently subject to state Corporate Income Tax
- Income earned in Alaska by both non-residents and residents will be taxed
- **Rough** estimate: 20% - 30% of Alaskans would pay zero tax

## *Revenue Impact*

- DOR estimates \$100 million in FY17 due to the tax taking effect in January 2017
  - This amount is from withholding
  - No tax returns filed until April 2018
- DOR estimates \$200 million in FY18 based on modeling using aggregated federal income data for Alaska residents

# *Implementation Cost*

- Implementing an individual income tax in 18 months will be a significant challenge
  - Need to draft regulations
  - Need to design, develop, and test technology to administer tax that would have estimated 450,000 tax returns filed annually.
- Estimated \$250,000 supplemental appropriation for a contractor to work with DOR on an implementation plan
- Estimated \$14,000,000 one time capital appropriation to build income tax into our current tax revenue system
  - Includes withholding and online filing
- Annual staffing cost of about \$6,000,000 for 52 FTE employees

# *Closing the Budget Gap*

|                    |                 |
|--------------------|-----------------|
|                    | (Millions)      |
| <b>FY16 Budget</b> | <b>\$ 5,200</b> |

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## **FY17 Baseline Revenue (after proposed legislation)**

|  |                 |
|--|-----------------|
| AK Permanent Fund Protection Act (annual draw) | \$ 3,300        |
| Revenue from existing taxes and fees           | \$ 850          |
| Earnings on Savings                            | <u>\$ 135</u>   |
|  | <b>\$ 4,285</b> |

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## **FY17 Spending Reductions**

|                          |                |
|--------------------------|----------------|
| Continue Cuts            | \$ 140         |
| Reform O&G Tax Credits   | \$ 400         |
| Net Priority Investments | <u>(\$ 40)</u> |
|                          | <b>\$ 500</b>  |

# *Closing the Budget Gap (Continued)*

| <b><u>New Revenue Components (estimated)</u></b>                 | <b>(Millions)</b>           |
|--|-----------------------------|
| Mining (starting in FY 2018)                                     | \$ 6                        |
| Fishing  | \$ 18                       |
| Tourism  | \$ 15                       |
| Motor Fuel   | \$ 49                       |
| Alcohol  | \$ 40                       |
| Tobacco  | \$ 29                       |
| Oil and Gas (strengthening minimum tax)                          | \$ 100                      |
| <b><i>Income Tax (half in FY17; first full year is FY18)</i></b> | <b><i><u>\$ 200</u></i></b> |
|  | <b>\$ 457</b>               |
| <b>Total with reductions and new revenue</b>                     | <b>\$ 5,242</b>             |

# *Sectional Analysis*

**Sec. 1.** Adds a new chapter 22 in AS 43 for individual income taxes.

43.22.010 Imposes an income tax on both resident and nonresident individuals. The tax is six percent of a resident's federal tax liability. The tax for a nonresident is six percent of the portion of federal tax liability that is from a source in the state.

43.22.020 Provides a credit to residents for taxes paid to another state based on income earned in that other state.

43.22.030 Provides for annual returns to the Department of Revenue with taxes due on the date the federal tax return is due. The taxpayer must provide a copy of their IRS return. The department is authorized to pay refunds of overpaid taxes.

43.22.040 Defines sources of income within Alaska that are subject to the tax.

## *Sectional Analysis (Continued)*

43.22.050 Provides for withholding from wages and salaries by employers, with those withheld taxes periodically remitted to the state.

42.22.060 Authorizes DOR to administer the tax.

42.22.190 Adds definitions for specific terms used in this section.

**Sec. 2.** Repeals statutes related to a former tax credit for political contributions that existed under Alaska's prior individual income tax which was repealed in 1980.

**Sec. 3.** Applicability section establishing that the new tax applies to income received on or after the effective date of the bill.

**Sec. 4.** Authorizes DOR to adopt regulations.

**Sec. 5.** Immediate effective date for Section 4, so that regulations can be drafted immediately.

**Sec. 6.** Effective date of 1/1/17 for the rest of the bill.





**Thank You!**

**Contact Information**

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