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CORPORATE INCOME TAXATION IN ALASKA

PREPARED FOR REPRESENTATIVE LES GARA

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You asked several questions about Alaska's corporate income tax. We provide answers to your questions in the order they were posed below.

Do Subchapter S corporations and LLCs pay the state's corporate income tax? If not, are they exempted from all state taxation (apart from property taxes, license fees, etc.)?

Neither Subchapter S corporations (hereinafter called S corporations) nor limited liability companies (LLCs) pay the Alaska corporate income tax under current law. Like that of most other states, Alaska income tax law incorporates provisions of the Internal Revenue Code that specifically exempt S corporations from federal corporate taxation, unless they elect to be taxed as C corporations.¹ Shareholders of S corporations who receive pass-through income from those corporations are taxed at the federal level, however, by way of the individual income tax. The same is true for limited liability companies, partnerships, and sole proprietorships—the various types of business entities also recognized in Alaska law. Other states typically tax the income of these business entities through individual income tax programs.

According to officials at the Alaska Department of Revenue (DOR), S corporations and limited liability companies pay the same taxes and fees as would any other unincorporated businesses in the state. There is no special tax applicable to these entities that is not also applicable to other types of business organizations.

¹ In very basic terms, a Subchapter S corporation is a small domestic business corporation consisting of 75 or fewer shareholders with only one class of stock outstanding. A complete definition of the term "Subchapter S corporation" is found in I.R.C. § 1361. A corporation that meets these criteria and that elects the S corporation status has the all the limited liability rights of C corporations, but is taxed like a partnership (income is "passed through" to shareholders, who report the income on individual tax returns). When Congress added the S corporation designation to the Internal Revenue Code in 1958, one of the objectives was to minimize taxes as a factor in the selection of the form of business organization. The Internal Revenue Code defines a "C corporation" as any corporation except a Subchapter S corporation, I.R.C. § 1361(a)(2).

List the 20 largest Subchapter S corporations. List the 10 largest limited liability companies. Alternatively, provide a list of all S corporations and limited liability companies.

For tax year 2002, over 6,200 S corporations having a nexus with the state of Alaska filed information returns with the I.R.S. (989 of these are reported to be out-of-state corporations).² Limited liability companies, a relatively new type of business entity, must elect to be treated as either corporations or as partnerships for federal tax purposes. It is impossible, therefore, to determine from federal tax information how many LLCs exist and how much income they report. Sources at the Department of Community and Economic Development, however, report a total of 6,737 active limited liability companies registered with the state as of February 2004.

Pursuant to AS 43.05.230, the Department of Revenue is prohibited from disclosing certain information, including highly proprietary income tax information. Although we can obtain statistical information in an aggregated form, such as counts of business entities and totals of income and taxes paid, department officials cannot release lists of any type of corporation, nor can they specify which business entities are the largest.

What rate of corporate income tax do companies pay at different revenue or income levels? That is, does the rate change depending upon revenue or income levels?

Yes, the Alaska corporate income tax is graduated—that is, the rate of taxation changes with the amount of taxable income reported. Current law provides ten tax rates based on ten levels of taxable income, with incomes of \$90,000 or more taxed at the highest rate of 9.4%. Under this rate structure, corporations netting \$500,000 in taxable income, for example, would pay \$43,040 in corporate income tax to the state. Table 1 below shows the Alaska corporate income tax rate schedule, as provided at AS 43.20.011.

Table 1: Alaska Corporate Income Tax Rate Schedule				
<i>If your Alaska taxable income is:</i>				
At least	But less than	Your Tax is	Plus	Of the Amount Over
-0-	10,000	-0-	1%	-0-
10,000	20,000	100	2%	10,000
20,000	30,000	300	3%	20,000
30,000	40,000	600	4%	30,000
40,000	50,000	1,000	5%	40,000
50,000	60,000	1,500	6%	50,000
60,000	70,000	2,100	7%	60,000
70,000	80,000	2,800	8%	70,000
80,000	90,000	3,600	9%	80,000
90,000	or more	4,500	9.4%	90,000
Source: AS 43.20.011.				

² Corporations or other business entities that have a presence in the state are considered to have a “nexus” with Alaska. Although they do not have to pay the federal corporate income tax, S corporations, limited liability companies, and partnerships must file what is called an “information return” with the I.R.S., which basically details the business entity income information for the tax year.

Are Native corporations exempt from state taxation by any state or federal law?

Although Native corporations may be exempt from taxation for other reasons (such as having a non-profit status), the mere fact that they are owned by Native shareholders does not exempt them from paying the state corporate income tax. That is not to say that there are no federal and/or state tax benefits offered specifically to Native organizations. For-profit Native corporations that meet the same criteria as other taxable corporations are nonetheless subject to the state corporate income tax.

What is the best estimate of revenue from a 3% tax on all taxable business income exceeding \$200,000 annually, exempting fisheries related businesses and any businesses that already pay the state corporation income tax?

Table 2 lists the types of business entities operating in the state, the number of each type, the aggregate amount of taxable income of each type, the taxable income of those reporting more than \$200,000 in earnings, and the amount of revenue a 3% flat tax on income over \$200,000 would generate.³ **The revenue estimates shown in Table 2 should be regarded as maximums.** The tax revenue estimates would likely be adjusted downward by application of methods to account for apportionment of income, and tax revenues already captured through business affiliates.

³ Mike Williams, Auditor, DOR, provided information relative to this question, based on information returns filed by S corporations, limited liability companies, and partnerships, and on tax returns filed by sole proprietors with the I.R.S. in tax year 2002. Mr. Williams can be reached at (907) 269-6632.

Table 2: Number of Filers, Income, and Estimated Annual Tax Revenue, by Business Entity Type, with 3% Flat Tax on Taxable Incomes Over \$200,000

Internal Revenue Service Reported Information	Business Entity Type ^(a)			
	S Corporation	Partnership	Sole Proprietorship	Total, All Business Entity Types
Total Filers, No Income Criteria				
Number of Filers	6,210	2,981	53,956	63,147
Number of Filers with Positive Income	3,341	1,494	36,327	41,162
Total Positive Income Reported	\$ 399,227,529	\$ 265,077,331	\$ 707,833,190	\$ 1,372,138,050
Filers with Income Greater than \$200,000				
Number of Filers	440	205	421	1,066
Total Income, All Filers	\$ 272,064,342	\$ 220,919,569	\$ 142,018,820	\$ 635,002,731
Number of Fisheries Businesses	12	16	11	39
Total Income, Fisheries Businesses	\$ 3,674,051	\$ 60,566,528 ^(b)	\$ 2,827,540	\$ 67,068,119
Total Income Non Fisheries Filers	\$ 268,390,291	\$ 160,353,041	\$ 139,191,280	\$ 567,934,612
Total Taxable Income, Non Fisheries Filers ^(c)	\$ 180,390,291	\$ 119,353,041	\$ 54,991,280	\$ 354,734,612
Flat Tax of 3%	0.03	0.03	0.03	0.03
Total Revenue Estimated with Application of Flat 3% Tax	\$ 5,411,709	\$ 3,580,591	\$ 1,649,738	\$ 10,642,038
<p>Notes: (a) Limited liability companies may elect to file as an S Corporation or as a partnership, and are, therefore, not reported separately. (b) Total income includes approximately \$50 million of partnership income already taxed through the state corporate income tax (the partnerships have corporate partners). (c) Total taxable income for only the portion of income greater than \$200,000 is calculated by subtracting the total number of filers multiplied by \$200,000, from total taxable income for non fisheries filers. For example, for S corporations, we multiplied 440 filers by \$200,000 and subtracted that amount (\$88,000,000) from \$268,390,291. These estimates assume all reported income above \$200,000 is subject to flat 3% tax, and should therefore be regarded as the maximum estimated revenue. Actual revenues would likely be adjusted downward for other criteria. For example, the estimates do not include adjustments for any apportionment of income resulting from multi-state operations, nor do they reflect yearly fluctuations for operating losses carried forward.</p> <p>Source: Mike Williams, Auditor, Alaska Department of Revenue, (907) 269-6632.</p>				

Several other interesting aspects about businesses and income can be gleaned from this information. They are as follows:

- ◆ Not all businesses had net income in tax year 2002. Roughly 30% each of S corporations and sole proprietorships reported a net loss to the I.R.S.; almost 50% of partnerships similarly reported a net loss for the year.
- ◆ The average income per filer for S corporations, partnerships, and sole proprietorships was approximately \$120,000, \$178,000, and \$20,000 respectively. Among those netting over \$200,000 in taxable income, the averages are \$618,000, \$1.08 million, and \$337,000 respectively.

- ◆ About 7% of the S corporations and partnerships filing information returns in 2002 reported taxable incomes of more than \$200,000; less than 1% of sole proprietorships reported incomes of more than \$200,000.⁴
- ◆ Successful partnerships do very well in the state—although about 50% of partnerships reported a net loss for the year, the 7% reporting taxable incomes in excess of \$200,000 account for over 83% of the total income generated by partnerships in the state.⁵

TAXATION OF S CORPORATIONS UNDER CURRENT RATE STRUCTURE

Governor Murkowski recently presented several tax proposals to the Legislature. One of these proposals is to tax S corporations under the same rate structure that the state uses to tax C corporations. This rate structure is delineated at AS 43.20.011, and is reprinted in Table 1 of this report. The proposal, which taxes all the taxable income of all business entities electing to be taxed as S corporations regardless of income and type of business, is estimated by the Department of Revenue to generate close to \$30 million in new tax revenue for the state.⁶

The DOR shared with us some of the materials prepared for the Governor in conjunction with the proposal. We include four tables prepared by the DOR—the first two detailing S corporation projections and the second two on current and historical taxation of C corporations—as Attachment A.

I hope you find this information to be useful. Please do not hesitate to contact us if you have questions or need additional information.

⁴ Sole proprietors, like any individuals, may have other sources of income.

⁵ Although those partnerships exceeding \$200,000 in taxable income in 2002 *averaged* over \$1 million apiece in income, it is important to note that, without a full examination of the individual partnership returns, averages are not necessarily the most reliable indication of the population in question. One or several partnerships netting substantial incomes may dramatically skew the averages for the entire population of partnerships.

⁶ Tax revenue estimates include 76 LLCs that have elected to be taxed as S corporations, for which projected tax revenue is estimated to be \$469,000. The proposal also includes fisheries-related S corporations. According to DOR officials, providing tax credits for fisheries taxes paid is an alternative to exempting the businesses from the corporate tax liability.

Attachment A

Two tables on the Potential Corporate Income Tax on
S-Corporations; and two tables on
Corporate Income Tax Liabilities by Sector,
Prepared by the Alaska Department of Revenue,
Tax Division

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Potential Corporate Income Tax
on S-Corporations

Where positive taxable income is:	# Returns	Projected Taxable Income	Projected Revenue	Revenue from Top 100	Top 25
< 10,000	629	2,806,257	28,063		
< 20,000	454	6,722,386	89,048		
< 30,000	374	9,287,565	166,427		
< 40,000	255	8,942,698	204,708		
< 50,000	211	9,005,408	239,270		
< 60,000	166	9,150,806	300,048		
< 70,000	135	8,047,575	279,830		
< 80,000	97	6,786,970	271,358		
< 90,000	113	9,022,430	405,219		
Over 90,000	907	329,455,434	27,377,091	14,227,352	7,248,734
Totals	3,341	399,227,529	29,361,061	14,227,352	7,248,734
				48%	25%

Notes:

Revenue based on all entity types that elect treatment as an S Corporation under Internal Revenue Code and Treas Reg 301.7701-1 to -3. 76 entities above are LLC under state law electing S-corp. Projected revenue from LLC = \$469,000.

Revenue is stated after apportionment. Factor estimated by applying weighted factor of domestic C corporations for that group, under the assumption that domestic S-corporation would have similar amount of outside business.

Revenue includes all returns with income greater than zero filed within reporting period. Although some returns are for prior years, we have included the revenue under the assumption that the State would not have received the revenue for a late return until filed. Amount does not include net operating losses. 1,880 S corporations had losses. NOL's will cause fluctuation in revenue for any given year. Data is not presently available to estimate the impact of losses carried forward.

Revenue estimate based on returns with an Alaskan address. 989 additional entities file with an address outside Alaska, for which we do not have readily available data. However, we expect \$1 - 3 million additional revenue from outside corporations.

Compare Top 25 & 100 S-Corp to C-Corp: Top 25 C-Corp = 93% of corporate revenue. Top 100 C corp = 97% corporate revenue. [Table 5, Tax Division Annual Report FY 02.]. Thus S-Corp income base much broader than C-Corp.

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Potential Tax on S-Corporations
by industrial classification

Industry Group	# of Returns in Top Tier	Projected Taxable Income	Top Tier Potential Revenue
Construction	172	56,149,207	4,600,865
Retail Trade	133	50,037,437	4,176,839
Professional, Scientific & Technical	106	36,026,905	2,966,769
Transportation & Warehousing	59	28,479,712	2,443,453
Health Care & Social Services	101	30,170,737	2,436,089
Finance & Insurance	42	27,353,215	2,404,882
Wholesale Trade	44	20,579,257	1,760,210
Manufacturing	19	16,867,118	1,510,269
Real Estate, Rental & Leasing	43	16,957,625	1,423,737
Other Services	43	1,378,919	1,125,896
Accommodation & Food Services	51	13,348,054	1,052,757
Agriculture, Forestry, Fishing	58	9,803,330	691,833
Administrative & Support	16	7,975,581	686,345
Arts, Entertainment, Recreation	13	4,245,632	347,609
Information	*	505,561	43,563
Utilities	*	1,664,427	152,496
Management of companies	*	-	-
Mining, Oil & Gas	*	-	-
Educational Services	*	-	-
Top Tier Revenue by Industry	907		27,627,554
Estimated apportionment factor			99.0934%
Estimated apportioned revenue, top tier			27,377,091

Note:

* Not shown if number of corporations in the top tier is less than 10.

**Alaska Department of Revenue
Tax Division**

Draft Non-Petroleum Corporation Income Tax Liabilities by Sector¹

	FY 2002		FY 2001		FY 2000		FY 1999		FY 1998		FY 1997	
Business Activity	%	<u>Tax Liability</u>	%	<u>Tax Liability</u>	%	<u>Tax Liability</u>	%	<u>Tax Liability</u>	%	<u>Tax Liability</u>	%	<u>Tax Liability</u>
Airlines	5%	2,145,349	4%	1,829,425	5%	2,705,322	2%	1,157,714	2%	1,735,467	2%	618,619
Construction	4%	1,935,919	3%	1,357,780	3%	1,673,615	3%	1,638,376	3%	2,050,289	3%	2,219,986
Finance	21%	9,300,503	9%	3,690,786	19%	10,636,659	20%	10,161,632	20%	9,170,326	20%	8,020,635
Fish ²	5%	2,077,476	7%	3,039,414	4%	1,966,142	3%	1,359,905	3%	1,483,496	3%	2,107,843
Manufacturing ³	4%	1,727,297	4%	1,755,109	3%	1,782,218	6%	3,081,797	6%	3,784,507	6%	1,952,470
Mining ⁴	0%	18,665	1%	285,815	0%	75,900	1%	398,435	1%	246,792	1%	195,043
Real Estate	1%	539,347	4%	1,525,122	3%	1,427,584	3%	1,745,832	3%	1,330,113	3%	1,222,270
Retail	14%	6,319,374	11%	4,601,219	11%	6,067,087	10%	5,040,997	10%	5,241,579	10%	5,069,714
Services ⁵	18%	8,186,279	21%	8,704,506	17%	9,481,634	21%	11,118,228	21%	7,657,407	21%	6,831,259
Transportation ⁶	7%	3,242,384	7%	2,828,536	6%	3,120,394	7%	3,669,637	7%	3,157,115	7%	3,453,949
Utility & Comm.	6%	2,782,964	18%	7,373,389	17%	9,172,989	12%	6,241,187	12%	9,178,023	12%	4,958,299
Wholesale	13%	5,823,224	10%	4,359,367	10%	5,670,993	9%	4,571,731	9%	4,999,215	9%	4,616,875
Other Sectors ⁷	1%	540,349	1%	568,676	2%	1,164,398	3%	1,310,741	3%	2,841,659	3%	4,619,170
Total⁸	100%	<u>\$44,639,129</u>	100%	<u>\$41,919,145</u>	100%	<u>\$54,944,935</u>	100%	<u>\$51,496,211</u>	100%	<u>\$52,875,988</u>	100%	<u>\$45,886,132</u>

¹ Reporting a tax liability on an original corporate income tax return. Liabilities may differ from amounts remitted by the taxpayer during the fiscal year due to timing differences resulting from estimated tax payments, credits and final payment of taxes. Based upon information provided on tax returns as interpreted by DOR. Prior years have been updated for consistency purposes.

² Includes fish processors that are usually classified under manufacturing.

³ Fish processing, and wood products manufacturing included under fisheries and forestry sectors.

⁴ Does not include oil and gas extraction.

⁵ Includes oil and gas services.

⁶ Airline transportation is included in its own sector above.

⁷ Forestry and insurance sectors combined for confidentiality reasons.

⁸ In FY 1997 and FY 1999, total general corporation income tax liabilities were updated and, consequently, do not match the liabilities shown in our annual reports.

Draft Corporation Income Tax Liabilities by Sector¹

FY 2002		
<u>Business Activity</u>	<u>%</u>	<u>Tax Liability</u>
Airlines	1%	2,145,349
Construction	1%	1,935,919
Finance	3%	9,300,503
Fish ²	1%	2,077,476
Manufacturing ³	1%	1,727,297
Mining ⁴	0%	18,665
Oil & Gas ⁵	87%	290,496,501
Real Estate	0%	539,347
Retail	2%	6,319,374
Services ⁶	2%	8,186,279
Transportation ⁷	1%	3,242,384
Utility & Comm.	1%	2,782,964
Wholesale	2%	5,823,224
Other Sectors	0%	540,349
Total	100%	<u>\$335,135,630</u>

¹ Reporting a tax liability on an original corporate income tax return. Liabilities may differ from amounts remitted by the taxpayer during the fiscal year due to timing differences resulting from estimated tax payments, credits and final payment of taxes. Based upon information provided on tax returns as interpreted by DOR.

² Includes fish processors that are usually classified under manufacturing.

³ Fish processing, and wood products manufacturing included under fisheries and forestry sectors.

⁴ Does not include oil and gas extraction.

⁵ Only includes liabilities from companies that filed as oil and gas corporations.

⁶ Includes oil and gas services.

⁷ Airline transportation is included in its own sector above.

⁷ Forestry and insurance sectors combined for confidentiality reasons.