

LEGAL SERVICES

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10/26/17: Corrected pg. 3, footnote 8, last line -- inserted "not".

MEMORANDUM

September 14, 2017

SUBJECT: PFD Taxation (Work Order No. 30-LS0997)

TO: Representative Les Gara

FROM: Emily Nauman 
Legislative Counsel

You asked three questions related to the permanent fund dividend payment (the "dividend").

To begin, it is important to recognize that each individual federal tax filer has a unique set of circumstances that affect his or her tax filings, status, and income categorization. The following discussion is provided to aid in your general understanding of federal income tax rules and regulations related to the taxability of certain types of payments. However, no memo from this office could definitively determine how an individual would treat the dividend for his or her tax purposes.

1. How could the dividend be restructured so that the recipient of the dividend would not be liable for federal income tax on the amount of the dividend?

Without implementing a restructuring of the dividend and having the new law tested by the IRS it is impossible to know whether a certain restructuring program would result in a tax-free dividend for its recipients. However, there are a few types of government distributions that are not included as income for federal income tax purposes. They are described below.

Tax credits. A recent case clarified that "portions of a refundable credit used to offset [state] taxes were not income, but that amounts refunded as cash to the taxpayer did constitute income for federal tax purposes."¹ However, if a taxpayer is given any dominion over the disbursement before it is applied as a credit, it would be included in taxable income.² Because the state does not have an individual income tax, converting the dividend into a tax credit is not an option currently available.

¹ *Maines v. Commissioner*, 144 T.C. 123, 136 (2015).

² For instance, if the Pick.Click.Give program allowed a taxpayer to donate a portion of the value of a tax credit before it was applied against the individual's income, the entire amount of the credit would be taxable by the federal government. (Constructive receipt doctrine). See *Maines*, footnote 4; *Lawson v. C.I.R.*, 97 T.C.M. (CCH) 1830 (T.C. 2009)

Needs-based payments. If the dividend was restructured to be a welfare payment it may qualify for a federal tax exemption and thus not be subject to the federal income tax. To qualify for the general welfare exclusion, a payment must (1) be made from government funds, (2) promote the general welfare (generally based on need), and (3) not be compensation for services. Grants from welfare programs that do not require recipients to show need have not qualified for the general welfare exclusion.³

There are other types of payments considered to be exempt from taxation by the federal government,⁴ however, they do not readily apply to the dividend payment.

2. Could the dividend be structured so that those who opt not to receive the dividend not be subject to federal income taxes on that amount?

Possibly, yes. 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 the 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.⁵ The same is true for a dividend amount later donated, including a donation back to the state.⁶ One method I can think of to account for dividends opted out of is for the state to survey or estimate the number of residents eligible for the dividend and subtract 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. Again, 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.⁷

("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.]").

³ *Maines*, footnote 4, at 138.

⁴ *Gifts*. Gifts, with important limitations, are not taxed by the IRS. However, the IRS has ruled that the PFD is not a gift. See *Beattie Through Beattie v. United States*, 635 F. Supp. 481, 490 (D Alaska 1986).

⁵ The check is a cash equivalent in possession of that recipient.

⁶ See footnote 2.

⁷ Where a taxpayer has an "unqualified, vested right to receive immediate payment," federal law requires a taxpayer to recognize the amount as income. 26 CFR 1.451-2. This is the doctrine of constructive receipt. Although the doctrine itself is about the timing of

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3. If an individual opts not to receive a dividend, could those funds be directed into the earnings reserve account (ERA) or the general fund, instead of being redistributed to others who collect the PFD?

I cannot think of an impediment that would prevent legislation directing that dividends donated or not applied for be appropriated into the ERA⁸ or remain in the general fund. As noted above however, the law does not currently have a method for accounting for the number of residents who do not apply for the dividend. Presumably this issue could be resolved in legislation.

If I may be of further assistance, please advise.

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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.

⁸ However, money appropriated into the ERA that is not earnings of the fund might be seen as a deposit into the principal of the fund because it does not fall within the Art. IX, § 15 exception for income of the fund. If seen as principal, these appropriations to the ERA could not be withdrawn.