House Bill 156
Income Tax

Representative Alyse Galvin
Presentation to the House Ways and Means Committee
April 17, 2023

HB 156 Introduction - Agenda

- **High Level Overview of HB 156**
  - What it Does and What it Doesn't Do
- **Why HB 156 Should be Considered**
  - A Broad-Based Revenue Source Should Be Part of a Sustainable Fiscal Plan
  - An Income Tax is the best choice for a Broad-Based Revenue Source
- **Income Tax Structure in General**
  - What income can be included
  - What are the options for structuring an income tax
  - Fiscal Impact of various income tax options
- **HB 156 Details**
  - Structure and Technical Provisions
  - Implementation and Costs
  - Public comments received
  - Sectional Analysis
- **Question and Answers**

What HB156 Does Do

- Proposes a 2% income tax on high earning Alaskans (only applies to income above $200,000 per year), and a $20 head tax on all other Alaska wage and income earners.
- Is estimated to generate approximately $120M to $150M per year in revenue
- Provides a legislative vehicle to discuss the merits of
  - A broad-based tax to raise revenue rather than more cuts to the PFD;
  - An income tax rather than a sales tax;
  - The options (levers) that can be adjusted with an income tax to best fit the Alaska economy and state revenue needs.
- Can function as a component of a sustainable fiscal plan, as a broad-based stabilizer of our currently unpredictable revenue stream based on oil prices.

What HB156 Does Not Do

- Raise any revenue for the FY24 Budget year.
- Solve Alaska's fiscal crisis on its own.
- Significantly burden Alaska's economy.

Why HB156 Should Be Considered

- Our long-term structural budget deficit can no longer be filled solely by draws from savings and/or PFD cuts.
- A broad-based revenue source should be considered as part of a sustainable fiscal plan.
- A broad-based revenue source will provide a stabilizing source of revenue, not dependent on volatile oil prices, and will grow with our economy.
- An Income tax has benefits over other broad-based tax options, such as a sales tax.

Agreement that a Broad-Based Revenue Source is Needed

**FISCAL POLICY WORKING GROUP
FINAL REPORT**

32nd ALASKA LEGISLATURE

NEW REVENUES

The FPWG recommends the legislature consider additional annual revenues, working towards revenues on the order of $500-$775 million, as a part of a comprehensive solution.

Though the FPWG was not able to make a specific recommendation for type of revenue, the FPWG generally recommends adoption of a broad-based revenue measure, in addition to other revenue measures, as a part of a comprehensive solution.

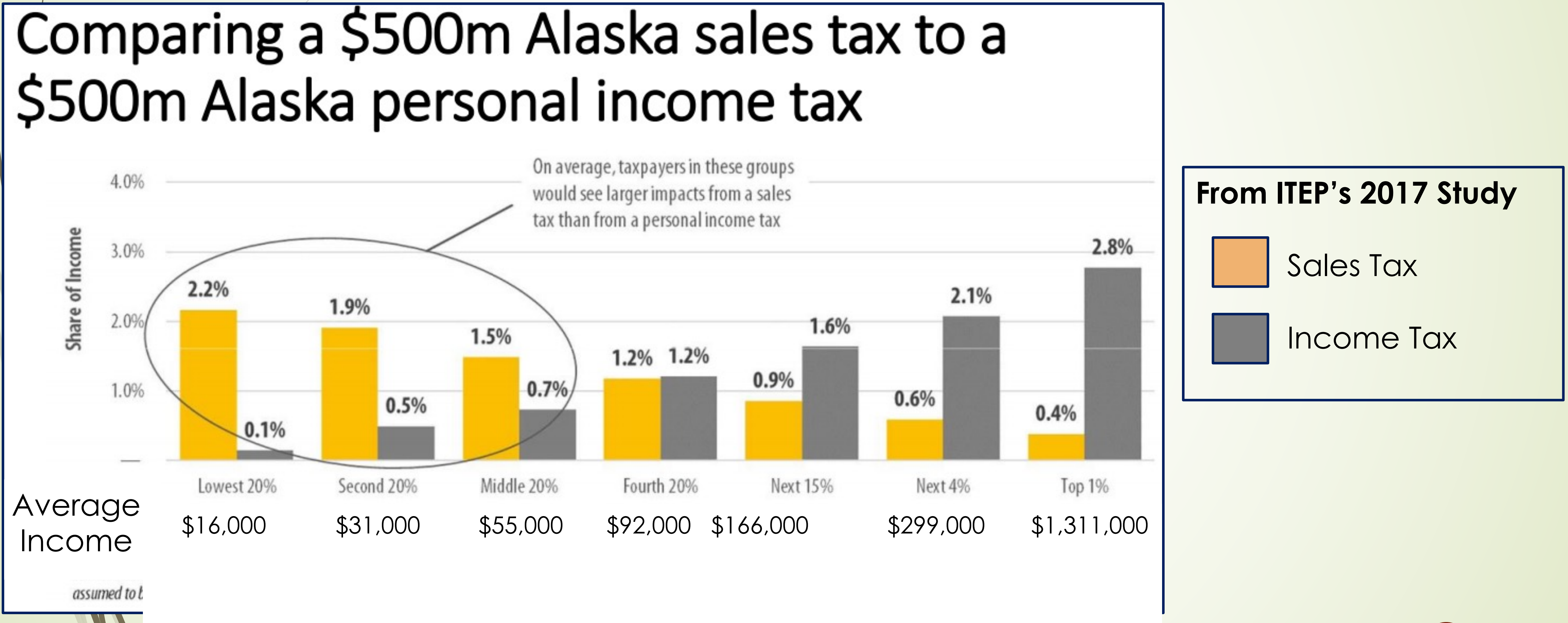
Broad-based Tax Options: Income Tax vs. Sales Tax

There are several reasons an income tax should be preferable in Alaska

1. Sales taxes are more regressive than income taxes – hitting poorer families hardest
2. Sales taxes creates complication with the over 100 municipalities with current local sales taxes.
3. Regional price disparities would disproportionally hurt rural residents if a sales tax is put in place.
4. The burden on non-residents is different:
    1. <u>Income tax</u>: *Visiting Workers* – tax on wages and earnings generally not subject to income tax in their resident state;
    2. <u>Sales tax</u>: *Tourists* - placing a competitive disadvantage on tourist industry's marketing efforts.

Revenue Options: Sales Tax vs Income Tax

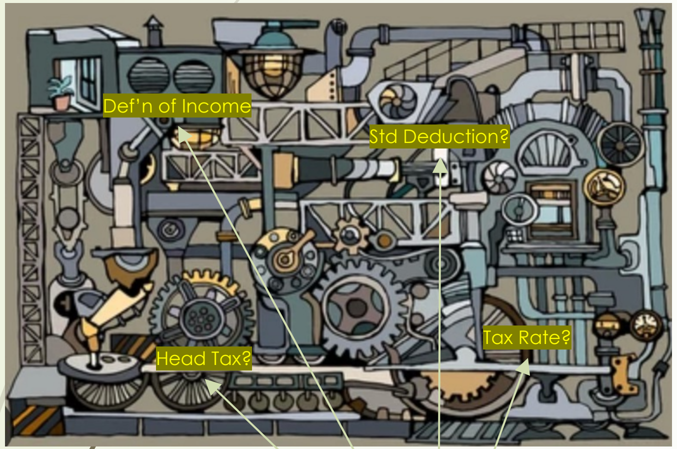
Regressive: Sales tax tends to disproportionally impact lower income households

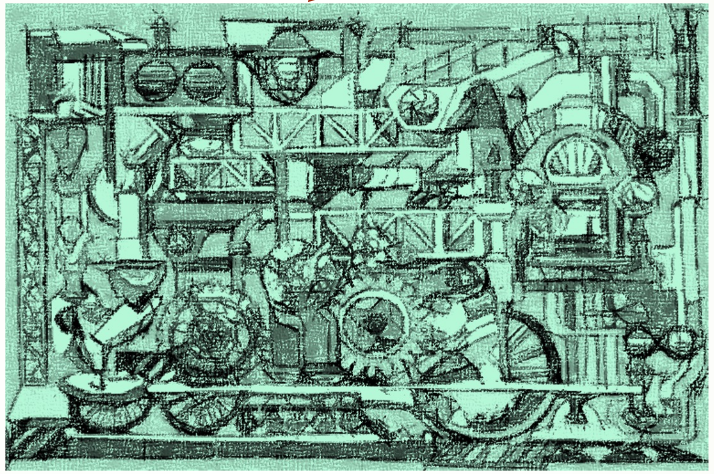


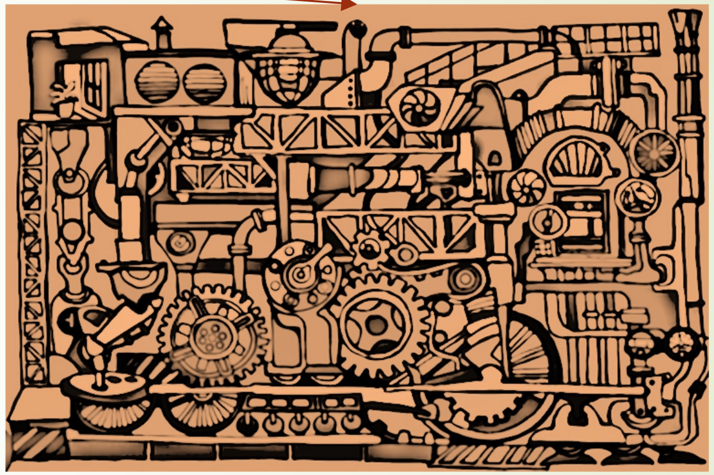
Source: Institute on Taxation and Economic Policy, Presentation to House Ways and Means, 4/10/21

State Income Tax – Many Models and Options

1. Choose a Model



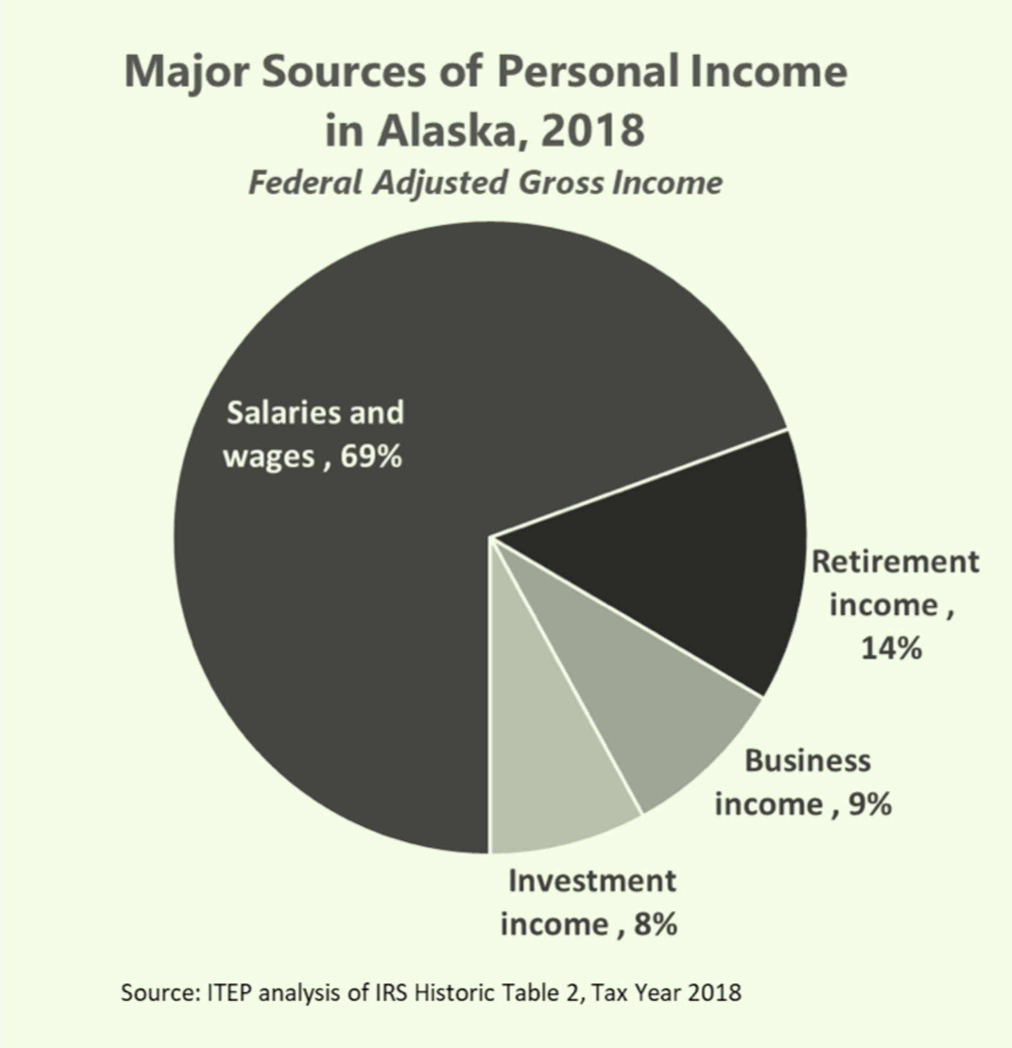




2. Tweak the Gears

Income – What Could Be Included?

- Wages, salaries
- Retirement income
  - IRA, pension, annuities, Social Security
- Business income
  - Sole proprietorship, Partnerships (LLC, Limited partnerships, S-corporations)
- Investment income
  - Capital gains, Dividends, Interest
- Other
  - PFD, Unemployment, Farm



Simplifying – Build off the Federal Tax

Federal Tax Calculation

All Income

- Less Federal Adjustments

= Adjusted Gross Income

- Less Federal Exclusions

= Federal Taxable Income

X Times Federal Tax Rate

= Federal Taxes Due

Options for identifying the income that will be subject to a state income tax

Option 1: Adjusted Gross Income

Option 2: Federal Taxable Income

Option 3: Federal Taxes Due

Income Tax – Structural Options

- What Income is Taxed?
  - Option 1: Federal Adjusted Gross Income (AGI), with adjustments*
  - Option 2: Federal Taxable Income (TI), with adjustments*
  - Option 3: Federal Tax Obligation
- Standard Deduction? (Yes or No)
- Flat Tax Rate or Graduated Tax Rate
- Include a Head Tax? (Yes or No)

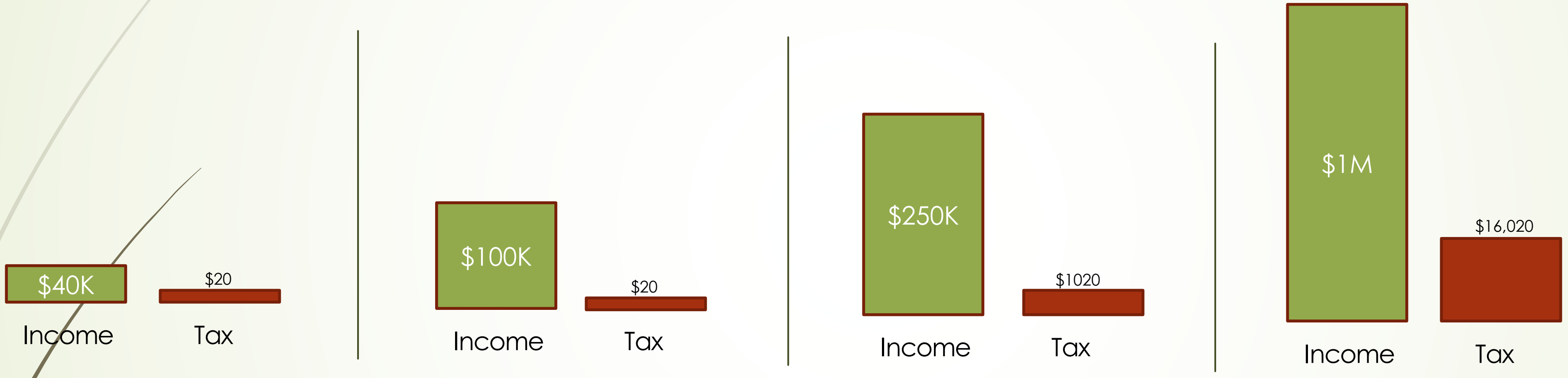
**adjustments are made to exclude income that is exempt from State taxation, and can add back income that is excluded from federal income tax but eligible for State taxation*

Introduced Version of HB156

- This version is responsive to what I'm hearing from other legislators
- In discussions with others in the building, it seems a lighter income tax take is needed to attain passage
- This lighter version would need to be paired with more revenue from other sources (e.g. Oil Tax Reform and/or greater PFD reduction) to create a sustainable fiscal plan (not my preferred outcome, but a compromise that could gain the votes needed to pass)

HB156 – Current Structure

Flat rate 2% tax based on federal "Adjusted Gross Income" (AGI) on income above $200,000, plus $20 per person head tax



"Standard Deduction": First $200,000 of income is not taxed

- The standard deduction language [Sec. 43.22.030(b) in the current version] should be removed, it is a carryover error from the previous version. The $200,000 standard deduction is contained in Sec. 43.22.010(b).

Income Tax - Technical Provisions

- Tax paid by nonresidents on income earned in the state
- Tax is paid by Alaska residents on all their income regardless of where earned
  - A credit is given for income taxes paid to other states for income earned in that state (so no double taxing of income)
- Tax also applies to <u>income</u> earned by trusts and estates, not on their asset value
- Detailed provisions to establish what income is "from a source in the state"
- Employer withholding from wages with periodic payments from employers to the state
- Employers send employees annual wage statement similar to the federal W-2
- Annual tax returns due same day as federal return
- Department of Revenue to establish regulations to provide further details
- Income tax exempted from general DOR requirement to file electronically

Most state income tax payments are deductible from federal taxes for those who itemize; thus a portion of taxes paid will be saved due to reduced payments to the IRS

HB156 – DOR Implementation and Costs

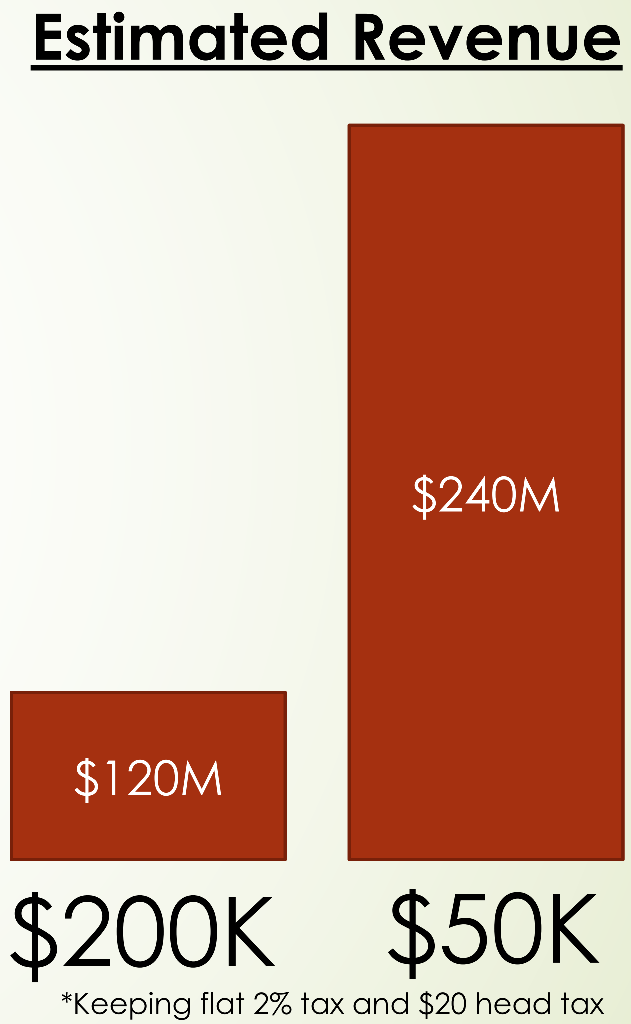
- Bill as written has an effective date of January 1, 2025
- Major implementation effort for the Department of Revenue:
  - Software procurement / programming of system into Tax Revenue Management System / working with national tax software vendors such as TurboTax
  - Forms development, staff recruitment, public education
- Likely the withholding system will be set up first, so employers are able to begin withholding next year
  - Burden on employers will be minimal, as they already report SSN and other employee data to DOL
- First annual returns will be due in early 2026
- Fiscal note includes an initial capital cost of $9.5 million, plus 70 additional staff at an annual cost of about $10.5 million / year (~91.5% net revenue)

HB156 – Minimizing paperwork burden on Alaskans

- 86% of Alaskans will have no paperwork associated with this tax
  - They will just see a $20 reduction note on their first paycheck of the year
- The 14% who will pay the 2% tax will likely use the same tax preparation method they currently use for their federal taxes (i.e. Turbo Tax, CPA, etc.)
- Some taxpayers can choose to pay their income tax as a reduction of their PFD

Possible Amendments-Standard Deduction Decrease

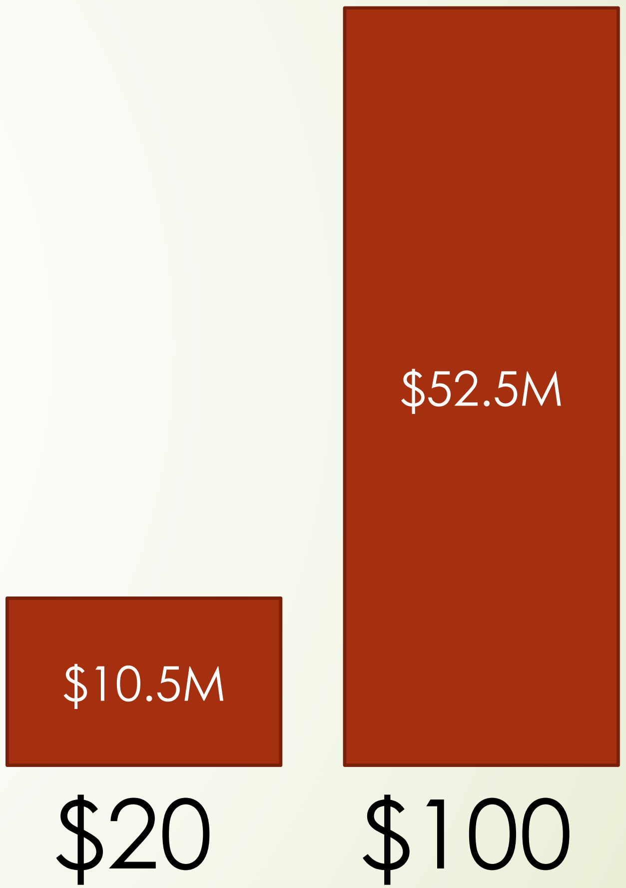
- The $200K deduction limits the impact of the income tax to about 14% of Alaska income earners
- A $50K standard deduction would limit the impact to 50% of Alaska income earners



Possible Amendments - Head Tax Increase

- The $20 per person head tax is estimated to raise approximately $10.5M
- If the head tax were $100 per person it would raise $52.5M
- The current bill makes the head tax in addition to the income tax; it could me a minimum paid only if you don't pay any income tax (i.e. your income is less than $200K)

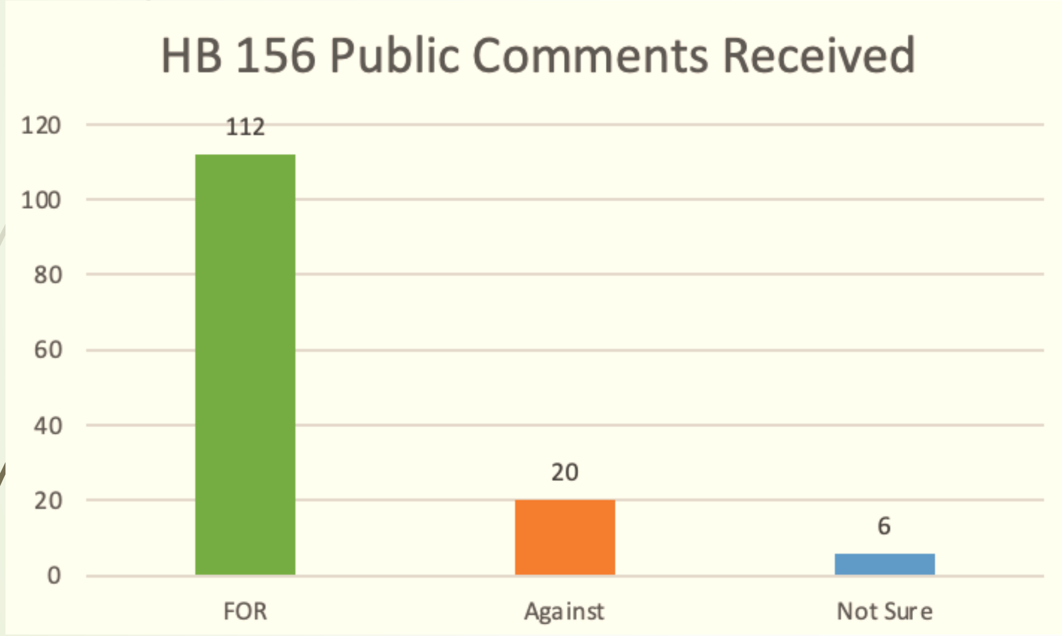
Estimated Revenue

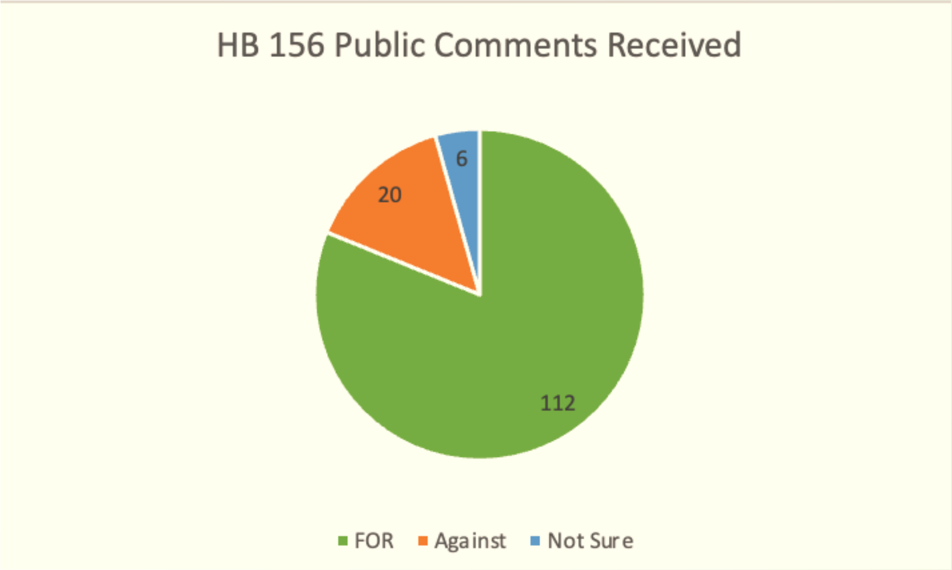


*Only showing the tax revenue from the Head Tax portion of the bill.

Public Comments Received on HB 156

Emailed Comments Received Through April 16, 2023





Conclusions

- A sustainable fiscal plan for Alaska should include a broad-based tax
- An income tax is preferable to a sales tax for a variety of reasons
- HB156 can serve as a useful component to a sustainable fiscal plan
- I am open to work with the House Ways and Means Committee to amend HB156 to fit the preferences of the committee members

THANK YOU

Feel Free to Call or Email with Any Questions

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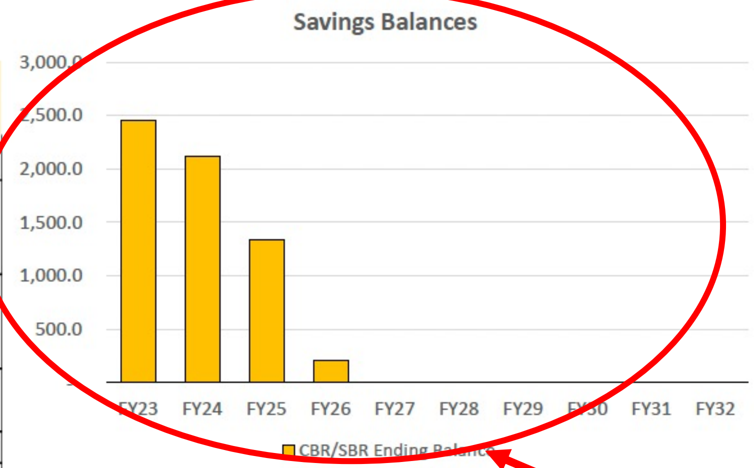
Appendix

We’re Rapidly Approaching a Fiscal Cliff

Fiscal Plan Working Group Spreadsheet - 2023 Update

Scenario Summary

Revenue Summary	**FY23**	**FY24**	**FY25**	**FY26**	**FY27**	**FY28**	**FY29**	**FY30**	**FY31**	**FY32**
Baseline Traditional Revenue	3,865.2	3,410.1	3,124.4	2,965.3	2,797.7	2,806.1	2,679.9	2,688.9	2,757.1	2,850.5
POMV Revenue	3,360.6	3,526.1	3,664.6	3,810.8	3,988.5	4,021.6	4,131.3	4,239.9	4,349.9	4,462.1
New Revenue/Adjustments	13.7	(0.9)	-	-	-	-	-	-	-	-
Total Revenue	**7,239.5**	**6,935.3**	**6,789.0**	**6,776.1**	**6,786.2**	**6,827.7**	**6,811.2**	**6,928.8**	**7,107.0**	**7,312.5**
Budget Summary	**FY23**	**FY24**	**FY25**	**FY26**	**FY27**	**FY28**	**FY29**	**FY30**	**FY31**	**FY32**
Budget Baseline	5,666.8	4,866.9	4,966.9	5,063.8	5,211.6	5,343.2	5,470.3	5,606.6	5,737.1	5,881.5
Scenario Changes	-	-	-	-	-	-	-	-	-	-
Total Budget before PFD	**5,666.8**	**4,866.9**	**4,966.9**	**5,063.8**	**5,211.6**	**5,343.2**	**5,470.3**	**5,606.6**	**5,737.1**	**5,881.5**
Surplus/(Deficit) before PFD	**1,035.5**	**2,057.5**	**1,821.8**	**1,712.0**	**1,574.3**	**1,484.1**	**1,340.6**	**1,321.9**	**1,369.5**	**1,431.0**
PFD Appropriation	**2,100.4**	**2,463.7**	**2,649.5**	**2,870.6**	**2,596.2**	**2,694.8**	**2,807.8**	**2,880.8**	**2,954.9**	**3,030.7**
Per Person	$ 3,284	$ 3,790	$ 4,062	$ 4,392	$ 3,948	$ 4,096	$ 4,260	$ 4,361	$ 4,466	$ 4,573
Pre-Transfer Surplus/(Deficit)	**(527.7)**	**(395.4)**	**(827.4)**	**(1,158.3)**	**(1,021.6)**	**(1,210.4)**	**(1,466.9)**	**(1,558.6)**	**(1,585.1)**	**(1,599.7)**
Fund Transfers	537.2	10.9	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Savings Deposit/(Draw)	(340.8)	(384.5)	(827.1)	(1,158.0)	(1,021.3)	(1,210.1)	(1,466.6)	(1,558.3)	(1,584.8)	(1,599.4)
CBR/SBR Ending Balance	2,452.4	2,112.9	1,336.5	202.8	-	-	-	-	-	-
Remaining Gap after CBR/SBR	-	-	-	(955.3)	(1,021.3)	(1,210.1)	(1,466.6)	(1,558.3)	(1,584.8)	(1,599.4)



Exhausted Savings!

Average Surplus/(Deficit)
(1,202.6)

Ongoing Deficits!

Cumulative Gap
(9,395.7)

Source: Legislative Finance presentation to Sen Finance, Feb. 23, 2023

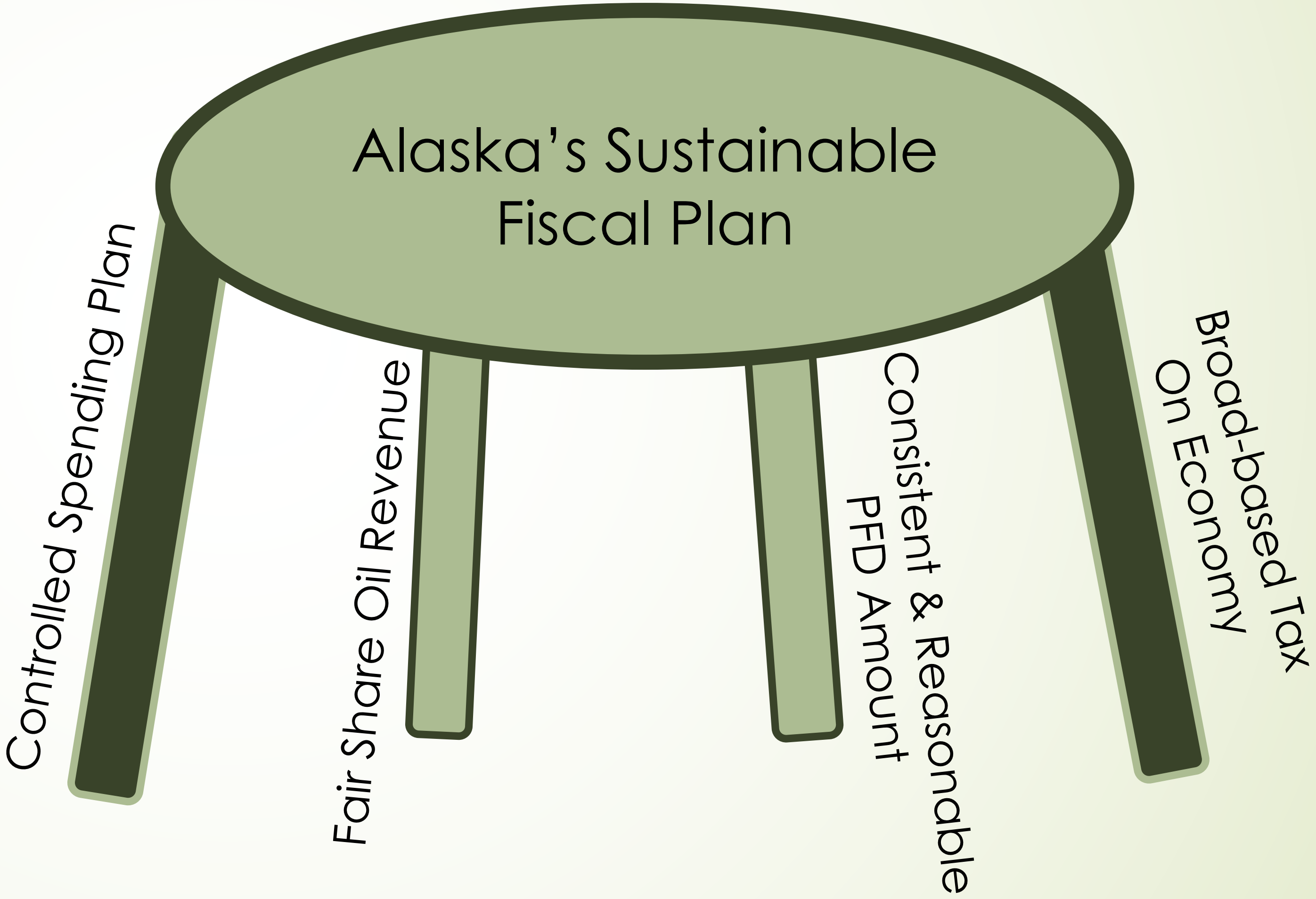
And this projection was prepared before the Spring Revenue Forecast further reduced estimated forward revenues!!

Sustainable Alaska Fiscal Plan – A Four-Legged Stool

Balancing the Budget

<u>*Components of a Sustainable Fiscal Plan:*</u>

- Stable Spending
- Fair Oil Share
- Reasonable PFD Amount
- Broad-based Tax



It's a Numbers Challenge AND Political Challenge

Pick rates here	Check to apply revenue source
	◉ No Income Tax
10.0%	○ % of Federal Liablity
2.5%	○ % Flat Tax on AGI
	○ Progressive (2017 House bill)
	◉ No sales tax
2.0%	○ Narrow-base sales tax
2.0%	○ Broader-based sales tax
2.0%	○ Broadest-based sales tax
$ 0.16	☐ Motor Fuel Tax
	☐ S-Corp Tax
	☐ Cap Per-Barrel Credit at $5
	☐ Gaming Revenues
	☐ Highly Digitized Business Tax
	☐ Carbon Offsets
	☐ HB 109 (Corporate Income Tax Reduction)
	☐ SB 114 (Oil & Gas Production Tax)
10	☐ Petroleum Property Tax (enter additional mills)
	☐ Custom

- Sit 60 Legislators down with the fiscal model and you would get 60 different proposals.
- The real challenge is how to find an approach that balances AND gets the votes needed to pass.

Each Fiscal Approach Has Downsides

Legislators represent a wide variety of Alaskans with a broad spectrum of strong opinions on which options should be avoided at all costs. A political solution will likely leave nobody fully satisfied. One thing we know is there is no "silver bullet".

Keep high statutory PFDs, but impose high broad-based taxes

"I will not support taxing working wage earners and job creators just so we can send more money to others."

Avoid broad-based taxes, just cut the PFD

"I will not support a regressive system that balances the budget solely on the backs of poor and working-class Alaskans."

Just take it from the Oil Companies

"At projected oil prices and production, in order to balance the State budget on oil revenue alone, we would have to tax oil at the highest rates in the world, destroying our investment attractiveness."

Just wait, oil prices will save us, again

"Hope is not a fiscal strategy."

Example: Rep. Galvin's Proposed Plan

If I could build it all myself, without needing to get the votes to pass, this is what I would do:

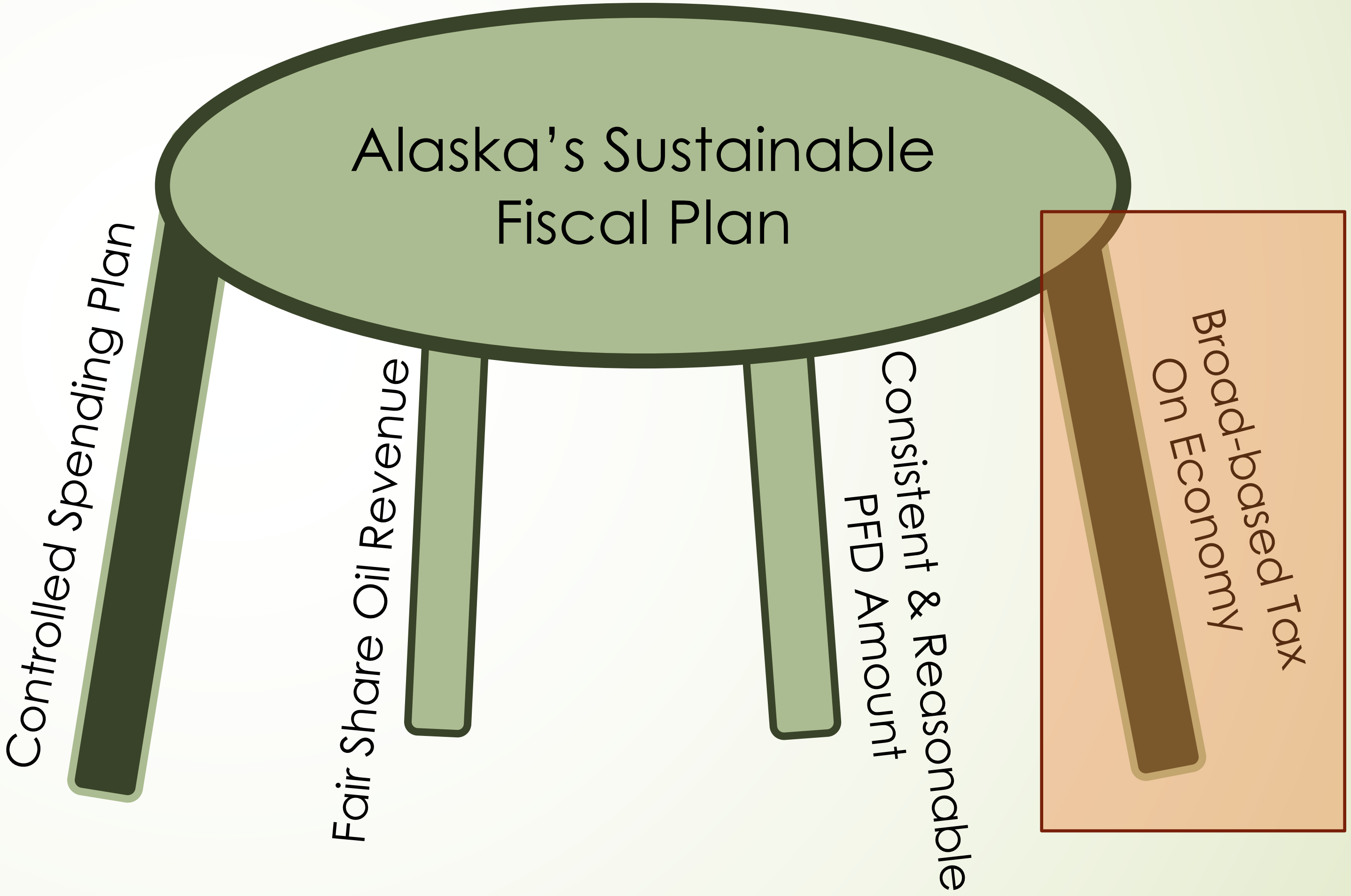
- Oil Production Tax Reform ~ $400M
- Graduated Income Tax ($50K std deduction/$20 head tax/rate from 1%-4%) ~ $220M
- 65/35 POMV Split ($2000 PFD-slightly above historical average in 2023 dollars) ~ $500M (compared to 50/50 split)
- Budget Protection Measures Bend the upward curve in operating budget through investments in early learning and Pre-K, Teacher education and development, healthcare reform, and high impact energy project

Sustainable Alaska Fiscal Plan – A Four-Legged Stool

Balancing the Budget

Components of a Sustainable Fiscal Plan:

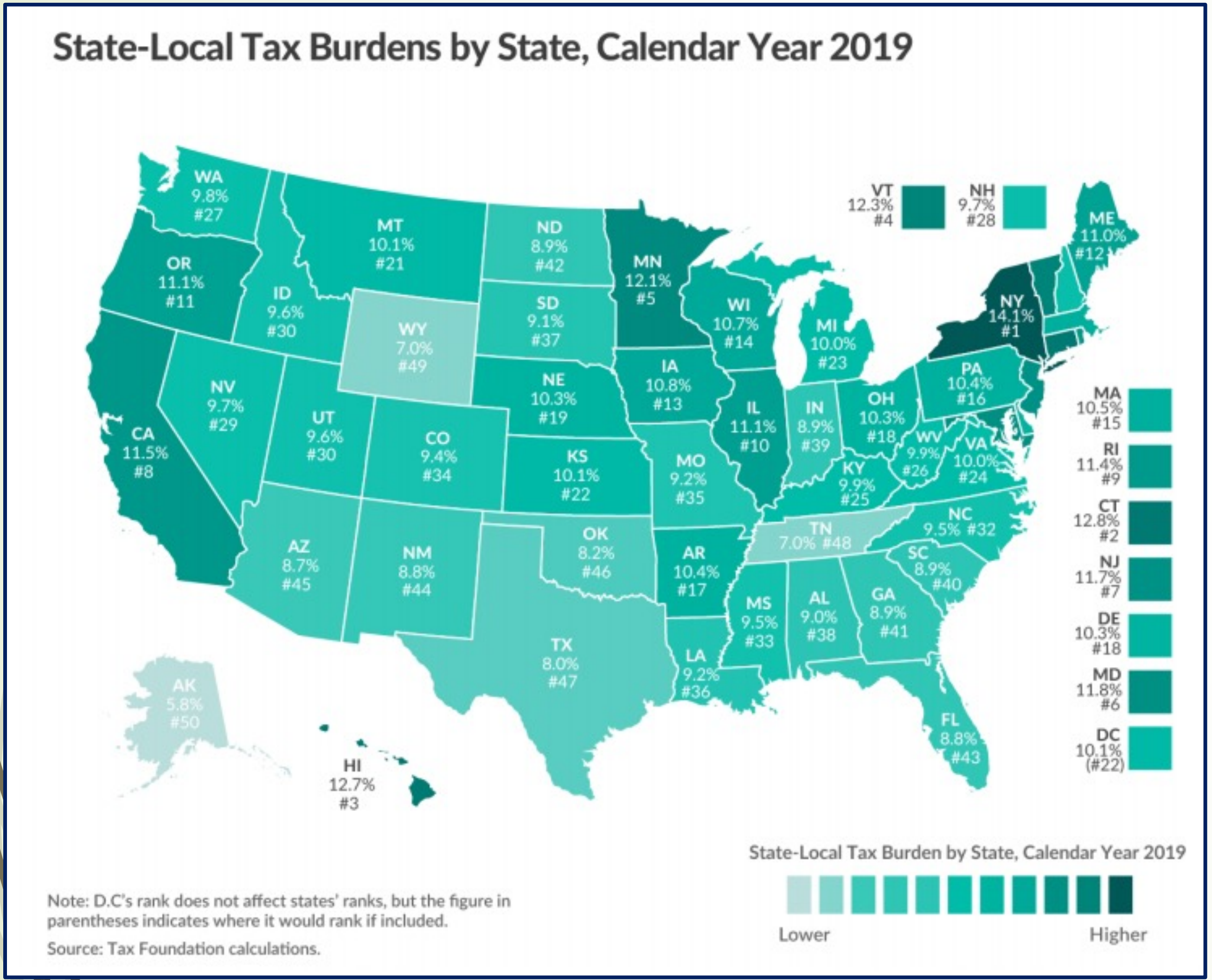
- Stable Spending
- Fair Oil Share
- Reasonable PFD Amount
- Broad-based Tax



Why a Broad-Based Revenue Source

- Stabilizing our volatile revenue streams
- Provides Shared Responsibility
  - Provides Alaskans with a sense of ownership of our government
  - Shares Burden with Non-Residents who enjoy our services and infrastructure
- Grows with the Economy
  - Automatically scales as the economy grows

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%

An income tax will not drive Alaskans to move to another State

Source: Tax Foundation, Presentation to House Ways and Means, 4/15/21

Sectional Analysis of HB 156

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SECTION ALALYSIS
HB 156 / 33-LS0699\A
Alaska Revenue Tax

Sec. 1 Creates an exception to AS 43.05.045 for individual income taxpayers, exempting them from the general requirement to file with the electronically with the Department of Revenue. The exception does not apply to paid tax preparers.

Sec. 2 Adds a new Chapter to Title 43, as follows:
***Subsection*: Sec. 43.22.010** (page 2, line 3) – Imposes a flat rate 2% tax on the income of residents and the income of non-residents derived from a source in the state above $200,000. Two individuals who file their federal income tax jointly may choose to either file individually or jointly. Also, imposes a flat $20 per person tax on any individual who has wages or net earnings from self-employment in Alaska.
***Subsection*: Sec. 43.22.015** (page 2, line 22) – Determines how the tax is calculated for nonresident individuals. Broadly, it is the tax calculation, less any eligible credits, if they were a resident, multiplied by the percentage of their total income that comes from a source in the state.
***Subsection*: Sec. 43.22.020** (page 3, line 7) – Establishes that trusts and estates also pay the 2% income tax. Nonresident trusts pay the tax on income derived from a source in the state. Trusts exempt from federal income tax, and special needs trusts established to provide for a disabled beneficiary, are also exempt from the state tax.
***Subsection*: Sec. 43.22.025** (page 4, line 4) – Provides a credit to residents for taxes paid to another state based on income earned in that other state (so someone is not taxed twice on the same income). The credit may not reduce tax liability below what it would be if the out of state income was simply excluded from total income.
***Subsection*: Sec. 43.22.030** (page 5, line 16) – Defines "taxable income" as the taxpayers federal adjusted gross income (AGI) for the tax year. This can be adjusted by adding or subtracting certain income that may not be included within AGI. The permanent fund dividend is not considered taxable income. Additionally, this section provides for a "standard deduction" of non-taxable income, which is adjusted for inflation. The standard deduction is pro-rated for nonresidents based on the portion of their income derived in-state.
***Subsection*: Sec. 43.22.035** (page 8, line 31) – Establishes that income from an individual's share of partnerships and S corporations is taxable income.
***Subsection*: Sec. 43.22.040** (page 9, line 24) – Establishes that income of estates and trusts is taxable as if the estate or trust were an individual. The department of Revenue may establish regulations regarding the allocation of tax liability between the trust itself and the beneficiaries.
***Subsection*: Sec. 43.22.045** (page 10, line 7) – Establishes a process to determine how nonresident income is derived from a source in the state. Broadly, taxable nonresident income includes income earned from a business or property located in the state, wages and other compensation for services performed in the state, earnings on stock and other securities carried on in the state, and gambling proceeds and performance fees earned in the state.
***Subsection*: Sec. 43.22.050** (page 14, line 18) – Provides that the Department of Revenue shall adopt regulations to provide more complete guidance regarding business income from a source in the state as described in AS 43.22.045. These regulations must be consistent with the Multistate Tax Compact.