FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: SB 151
(S) Publish Date: 4/25/05

Revision Date/Time (Note if correction):
Title: Qualified Production Activity Income
Sponsor: Governor
Requester: Sen. Finance

Dept. Affected: Revenue 04
RDU: Tax and Treasury
Component: Tax
Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	**FY 2006**	**FY 2007**	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	*	*	*	*	*	*
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	**8,230.0**	**9,420.0**	**10,635.0**	**10,590.0**	**9,995.0**	**14,955.0**

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	*	*	*	*	*	*

Estimate of any current year (FY2005) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

* See page 2

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Division: Tax Division — Date/Time 4/19/05 2:12 PM
Approved by: Tom Boutin, Deputy Commissioner — Date 4/19/2005
Agency: Revenue

FISCAL NOTE # 2

STATE OF ALASKA **BILL NO.** SB 151

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ANALYSIS CONTINUATION

Included in the American Jobs Creation Act of 2004, codified as Internal Revenue Code Section 199 effective 1/1/2005, is a federal tax deduction for Qualified Production Activity Income (QPAI). Alaska's corporate income system is based on Federal law and we automatically adopt federal changes unless a legislative act directed otherwise. Thus, the QPAI is now an allowable deduction for Alaskan corporate income taxes. This bill decouples from the Internal Revenue Code with respect to section 199, and does not allow the QPAI deduction in computing the Alaska corporate net income tax.

The purpose of the federal QPAI deduction is to improve the competitiveness of US manufacturers in international markets. Broadly speaking the federal QPAI deduction is a partial exclusion of income earned from U.S. manufacturing activity. The deduction rate is 3% for 2005, increasing to 6% in 2007 and 9% for 2010 and thereafter. Affected industries with an Alaskan presence include oil and gas production, refining and marketing, construction, fishing and fish processing and mining.

At the federal level, the effect of the QPAI deduction is to tax profits from US production activity at a lower rate than profits earned from foreign production activity. This policy result cannot be replicated at the state level. In order to avoid impermissible discrimination against economic activity outside of the state, taxpayers will be allowed the QPAI deduction on their Alaska return for all production profits whether the activity occurred in Alaska, another state, or in a foreign country. Production activity conducted in-state, domestic out of state, or in a foreign country will be awarded an equal deduction. Alaska's QPAI deduction will reduce the amount of state corporate income taxes paid by targeted industries, but will not mirror federal tax policy to favor Alaska production activity over non-Alaskan production activities.

Cost Discussion

The bill will avoid future operating costs. The department can rely heavily on IRS audit and enforcement with respect to QPAI activities conducted in the US and reported on federal tax returns. However, the department must independently monitor QPAI deductions claimed for foreign production activities. This new challenge may be met with additional resources, redirected resources, both, or simply ignored. Ultimately the deduction will produce additional costs and/or revenue losses in addition to the revenue losses from the exclusion itself. The cost of administering the QPAI deduction will begin to present themselves in FY07. We estimate that the cost of administering the QPAI deduction could exceed $500 thousand per fiscal year in FY09, but may decline as filing methodologies and audit techniques are refined and stabilize. This bill would avoid these costs or alternate consequences.

Revenue Discussion

The chart below reflects our estimate of revenue losses ($ millions) resulting from the QPAI deduction against our forecast of corporate tax revenues taking into account the gradual phase in of the deduction:

	High	Low	High	Low
FY 2005	(5.40)	(4.85)	FY05-07	
FY 2006	(8.65)	(7.81)	(23.92)	(21.63)
FY 2007	(9.87)	(8.97)		
FY 2008	(11.16)	(10.11)	FY08-010	
FY 2009	(11.10)	(10.08)	(32.75)	(29.69)
FY 2010	(10.49)	(9.50)		
FY 2011	(15.71)	(14.20)	FY11-13	
FY 2012	(16.12)	(14.56)	(48.17)	(43.56)
FY 2013	(16.34)	(14.80)		
FY05-13	(104.84)	(94.88)		