

Fiscal Note

State of Alaska
2022 Legislative Session

Bill Version:	CSHB 37(STA)
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Identifier: HB037CS(W&M)-DOR-TAX-1-23-22
 Title: INCOME TAX; PERMANENT FUND; EARNINGS RES.
 Sponsor: WOOL
 Requester: (H) State Affairs

Department: Department of Revenue
 Appropriation: Taxation and Treasury
 Allocation: Tax Division
 OMB Component Number: 2476

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2023 Appropriation Requested	Included in Governor's FY2023 Request	Out-Year Cost Estimates				
			FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
OPERATING EXPENDITURES	FY 2023	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
Personal Services	3,413.1		6,826.1	6,826.1	6,826.1	6,826.1	6,826.1
Travel	25.0		12.5				
Services	665.3		2,040.3	2,790.3	2,190.3	2,190.3	2,190.3
Commodities	182.9		72.9	6.9	6.9	6.9	6.9
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	4,286.3	0.0	8,951.8	9,623.3	9,023.3	9,023.3	9,023.3

Fund Source (Operating Only)

1004 Gen Fund (UGF)	4,286.3		8,951.8	9,623.3	9,023.3	9,023.3	9,023.3
Total	4,286.3	0.0	8,951.8	9,623.3	9,023.3	9,023.3	9,023.3

Positions

Full-time	69.0		69.0	69.0	69.0	69.0	69.0
Part-time							
Temporary							

Change in Revenues

1004 Gen Fund (UGF)	825,000.0		550,000.0	550,000.0	550,000.0	550,000.0	550,000.0
Total	825,000.0	0.0	550,000.0	550,000.0	550,000.0	550,000.0	550,000.0

Estimated SUPPLEMENTAL (FY2022) cost: 0.0 (separate supplemental appropriation required)

Estimated CAPITAL (FY2023) cost: 8,500.0 (separate capital appropriation required)

Does the bill create or modify a new fund or account? No
 (Supplemental/Capital/New Fund - discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? Yes
 If yes, by what date are the regulations to be adopted, amended or repealed? 12/31/22

Why this fiscal note differs from previous version/comments:

Updated Personal Services, Services and Commodities costs to account for updated FY2023 estimates. Updated Change in Revenues estimates based on most recent available data and to account for the increase in standard deductions.

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Division:	Tax Division	Date:	01/23/2022 09:00 AM
Approved By:	Eric DeMoulin, Administrative Services Director	Date:	01/24/22
Agency:	Revenue		

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2022 LEGISLATIVE SESSION**Analysis**

This proposed legislation creates a new broad-based income tax that would apply to resident and nonresident individuals, trusts, and estates, including partners or shareholders of partnerships or S-Corporations, who derive income from, or where income is connected with, a source in Alaska. The Department of Revenue, Tax Division (Department), estimates that there will be approximately 475,000 resident taxpayers and approximately 70,000 nonresident taxpayers. These estimates are very rough. The tax rate would be 2.5% of the taxpayer's federal adjusted gross income (AGI).

Taxes paid to other states, based on income derived in those states, can be credited from this tax. The proposed legislation would exclude from the definition of Alaska taxable income a Permanent Fund Dividend (PFD) received by the taxpayer. The proposed legislation would also allow an individual eligible for a PFD to direct the Department to hold all or a part of the amount of the PFD to pay the tax due under this bill. This tax will be effective retroactive to January 1, 2022.

Lastly, the proposed legislation would allow for another exception to the requirement that taxpayers file reports and returns electronically, which will cause an additional administrative burden on the Department.

Revenue Impact

At full implementation, revenue will be approximately \$550 million. Assuming that AGI is earned evenly across the fiscal year, revenue in FY2023 would be approximately \$825 million, representing a year and a half of revenue due to the retroactive effective date. Depending on the timing of tax implementation and estimated payments, it is possible that some of the revenue projected for FY2023 could be shifted into FY2024. As the impact is proportionate to each household's income, actual impact by household will vary widely. Any impact will be partially mitigated, as state individual income taxes are deductible from federal taxes. Thus, Alaskans who itemize their federal taxes would reduce their federal tax liability by the amount of their state tax multiplied by their marginal federal tax rate.

The Department's individual income tax revenue model is based on aggregated federal income data for Alaska residents. It is assumed that income from nonresidents will increase Alaska AGI by approximately 5%. This 5% adjustment is an estimate of the net nonresident earnings (nonresident income in Alaska less Alaska resident income taxed elsewhere) developed through consultation with the Alaska Department of Labor and Workforce Development and influenced by Bureau of Economic Analysis "adjustment for residence" historical values. The model does not address long term population growth, inflation, or impacts on the economy from implementing an income tax.

In producing this revenue estimate, the existing individual income tax revenue model was adjusted to incorporate estimated impacts of the personal exemptions and Permanent Fund Dividend exemptions in this bill. This revenue estimate does not evaluate potential impacts of this proposed legislation on Permanent Fund deposits, income, or transfers to the General Fund or Dividend Fund.

Implementation Cost

The cost and time required to implement a new broad-based tax is directly related to its complexity. For a more robust tax such as the one envisioned in this bill, a 12-month implementation process should be expected. The Department is currently using Version 9 of its Tax Revenue Management System (TRMS). The Department expects to engage FAST Enterprises, the TRMS contractor, to build an income tax module into TRMS. The \$8,500.0 capital project reflects an estimated initial implementation cost for FAST to add the income tax module and a Fast Identity Verification Services (FIVS) module.

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STATE OF ALASKA
2022 LEGISLATIVE SESSION

BILL NO. CSHB 37

Analysis

After initial implementation, continued maintenance and support by FAST for the individual income tax module is estimated to be \$2.2 million in CY 2024 and \$1 million CY 2025 and beyond. Continued maintenance and support by FAST for the FIVS module is estimated to be \$500,000 in CY 2025 and beyond.

Adding a fully functional income tax module is a multi-year process. The initial fast-track need will be to build and implement a tax withholding system, which will need to be in operation by January 1, 2023. The Department will also need to adopt regulations by December 31, 2022. Since the bill allows taxpayers to elect to apply their PFD to their tax liability, the Department will work with FAST to interface the TRMS system with the PFD Division's PFD management system in an effort to automate the PFD offset provisions of this bill. In addition to the software development, this bill will require a rapid and robust outreach to the business community throughout Alaska, and this fiscal note includes funding for travel needs. Additionally, this bill will require integration with national accounting and tax software vendors in order to update programs such as TurboTax and QuickBooks to incorporate Alaska.

Once the withholding system and PFD interfaces are in place, FAST and Tax Division staff will begin building the tax return filing and examination modules, with their associated databases, communications, and integration with our existing imaging, accounting, and collections systems. The legislation creates an annual tax, meaning that the first tax returns will be filed in January 2024, with a filing due date of April 15, 2024. Taxpayers who request and receive extensions would have filing deadlines in October 2024. The Department estimates that this bill will generate approximately 410,000 returns. This estimate is based on the number of Alaska resident individual returns and partnership/S-Corporation returns filed in 2019 as publicly reported by the Internal Revenue Service, multiplied by 15% to adjust for estimated nonresident returns.

As part of the Department's research into the potential costs to administer this tax, we spoke with tax administrators in the States of Montana and Vermont. Each have population sizes close to Alaska's and impose individual income taxes. Montana and Vermont employ approximately 102 and 60 people, respectively, to administer each state's individual income taxes. Using a simple per-capita adjustment, these numbers translate to 68 and 70 employees needed to administer an individual income tax in Alaska. Given the complexities that come with administering nonresident and pass-through corporation returns, and the sheer volume of estimated new taxpayers and returns, the Department expects to need 69 people to administer an individual income tax in Alaska. The new staff would be roughly split between the Juneau and Anchorage offices. The Department will continue to look for ways to automate administration of this tax and look for efficiencies.

We expect to replicate the online filing percentages of the PFD Division, currently at approximately 90%. However, the 10% of paper filers will require manual handling and data entry for approximately 41,000 paper returns out of the 410,000 total estimated returns. In contrast, in FY2021 the Department processed approximately 2,100 paper returns out of approximately 37,000 total returns across all tax programs the Department administered.

Additional travel is largely for public education efforts, as well as the need to train new staff on the tax management system and the new tax. The cost for Services reflects primarily internal core service rates paid to other state agencies, due to additional staff within the Tax Division, as well as ongoing maintenance and support costs for FAST. Commodities reflect the initial outfit for new employees for office and computer furnishings.

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Analysis

An initial analysis of the staff needs within the Tax Division to implement an individual income tax is as follows:

- (1) Deputy Director
- (2) Audit Supervisors
- (2) Income Tax Specialists
- (18) Auditors
- (5) Accounting Technicians
- (3) IT Analysts/Programmers
- (5) Appeals Officers
- (15) Tax Technicians
- (16) Imaging & Office Assistants
- (2) Administrative Assistants