

SCOMM

101:29

SUBCOMMITTEE MEETING ANNOUNCEMENT
LONG RANGE FINANCIAL PLANNING COMMISSION

WEDNESDAY 19 JULY , 8:30 AM TO 10:30 AM

REVENUE SOURCES SUBCOMMITTEE:

Identify potential sources of state revenue, estimate their impacts.
Examine earnings of the permanent fund.

Mary Nordale, Chair 452-1666/Fax 452-5055
Pat Pourchot 269-7450/Fax 269-7461
Mike Navarre 283-7223/Fax 283-3075
Lee Gorsuch 786-1437/Fax 786-6123
Marie Westfall 225-3561/Fax 225-8731

Please dial teleconference bridge #1-800-478-7612 from outside of Anchorage or 700-222-1000 if from inside Anchorage. (if not on Alascom dial access code 10866)

Also on line:

Brad Pierce, 465-3008
Jim Kelly, 465-2059

FAX COVER

TO:
REVENUE SOURCES SUBCOMMITTEE
MEMBERS
LONG RANGE FINANCIAL PLANNING
COMMISSION

FROM:
MELISSA FOUSE
STAFF, LONG RANGE FINANCIAL PLANNING
COMMISSION

PHONE: 258-8165
FAX: 258-9869

FOLLOWING IS MATERIAL FROM MARY
NORDALE FOR TOMORROW MORNING'S
TELECONFERENCE.

CC: Brad Pierce
Jim Kelly

**HP OfficeJet
Personal Printer/Fax/Copier**

**Fax Log Report for
LRFPC
19072589869
Jul-18-95 01:23 PM**

Last Fax

<u>Identification</u>	<u>Result</u>	<u>Pages</u>	<u>Type</u>	<u>Date</u>	<u>Time</u>	<u>Duration</u>	<u>Diagnostic</u>
Rogers	OK	09/09	Sent	Jul-18	12:42P	00:09:39	002564030022
Pourchot	OK	09/09	Sent	Jul-18	11:56A	00:06:39	002465030022
Gorsuch	OK	09/09	Sent	Jul-18	12:03P	00:07:44	002165230020
Nordale	OK	09/09	Sent	Jul-18	12:12P	00:06:39	002565030022
Westfall	OK	09/09	Sent	Jul-18	12:19P	00:10:29	002564030022
Brady	OK	09/09	Sent	Jul-18	12:30P	00:05:14	002566030022
Pierce	OK	09/09	Sent	Jul-18	12:35P	00:05:15	002566030022

19 JUNE 95, MONDAY

FROM: MELISSA FOUSE

TO: REVENUE SOURCES SUBCOMMITTEE:

Identify potential sources of state revenue, estimate their impacts.
Examine earnings of the permanent fund.

Mary Nordale, Chair 452-1666/Fax 452-5055

Pat Pourchot 465-4021/Fax 465-3147

Lee Gorsuch 786-1437/Fax 786-6123

Marie Westfall 225-3561/Fax 225-8731

Staff: Melissa Fouse/Bob Walsh-Anchorage LIO

Brad Pierce 465-4677

**THERE IS A TELECONFERENCED MEETING OF THE
REVENUE SUBCOMMITTEE SCHEDULED FOR 8:30 TO 10:30
AM, THURSDAY, 22 JUNE 95.**

**IF YOU ARE LOCATED OUTSIDE OF ANCHORAGE , CALL
1-800-478-7612**

**IF YOU ARE LOCATED IN ANCHORAGE, EITHER COME
TO THE LIO OR CALL 700-222-1000. IF YOU ARE NOT
CONNECTED WITH ALASCOM, YOU WILL NEED TO DIAL THE
ACCESS CODE 10866 FIRST.**

CC: Chairman Rogers

Fax 456-2531

CC: Vice Chair Brady

Fax: 279-8111

CC: Brad Pierce, OMB

1-907-465-3008

FAX Cover Sheet

State of Alaska
Long Range Financial Planning Commission
716 W. 4th Avenue, Suite 470
Anchorage, Alaska 99501
(907) 258-8165
Fax: (907) 258-9869

To: Lee Gorsuch, Commissioner
Mary Nordale, Commissioner
Marie Westfall, Commissioner

From: Bob Walsh, Staff

Note: This is the first report dealing with model boroughs and the feasibilities of each. Although this was completed in the late 80's, I don't think it would take much to update the numbers. I also requested the copy of the model borough boundary study, this second one doesn't have the economics attached. It only identifies areas that would be compatible. Please let me know if you wish further information and I'll pass this along.

TONY KNOWLES, GOVERNOR

**DEPARTMENT OF COMMUNITY AND
REGIONAL AFFAIRS****MUNICIPAL & REGIONAL ASSISTANCE DIVISION**

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June 15, 1995

The Honorable Representative Mike Navarre
Legislative Long Range Planning Committee
Room 521, State Capitol
Juneau, AK 99801-1182

Dear Representative Navarre:

You have asked my office to address the issue of the possibility of the State levying a statewide ad valorem property tax. In particular, you have asked for estimates of revenue which might be generated and any problems that may be involved from administering this undertaking.

The Office of the State Assessor currently calculates a Full Value Determination (FVD) annually for 16 boroughs and 27 cities located in the unorganized borough. This could not be accomplished without the cooperation of the assessors around the state assisting with those municipalities which levy a property tax. At the present time, there are 11 boroughs and 13 cities located in the unorganized borough which levy a property tax and those values are provided to me making the calculation of the FVD relatively easy for those municipalities. The values in the remaining 4 boroughs and 14 cities located in the unorganized borough are calculated by this office. As of January 1, 1994 the total Full Value Determination for those 16 boroughs and 27 cities was \$43,829,908,630. This figure includes a value of \$15,934,252,630 for all oil and gas property which is assessed by the Dept. of Revenue. This results in a value of \$27,895,656,000 for those 43 municipalities, excluding oil and gas properties.

There is no doubt that the majority of the municipalities in the rural area of the state would contain little value which would be taxable under our property tax laws. This is mainly due to mandatory exemptions, i.e., ANCSA and native allotment property, and the local economics of a region. The majority of the value would most likely rest along the road systems, Parks, Glenn and Richardson Highways, and in the areas of the state which have a good commercial fishing industry.

The Honorable Mike Navarre

June 15, 1995

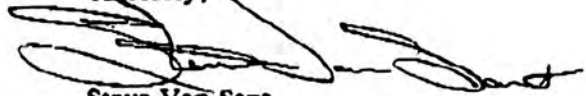
Page Two

The other areas of the state may have taxable value, but certainly not to the extent of these areas. Regardless of this fact, however, the data would have to be collected, analyzed, property record cards would have to be created and assessment rolls would have to be finalized and the appeal process would have to be in place. This entire process would be extremely expensive to set up and maintain. The initial set up process could take up to three or four years to complete, depending on the amount of revenue allocated and the total number of personnel hired or contracted for the project.

Based upon the values currently in the Full Value Determination process, the state would realize about \$28 million annually for each mill of tax levy. This amount excludes the oil and gas property, as the state already has a 20 mill levy against that property. If the state were to complete assessments on all other property which might be subject to a property tax, in my opinion, the state would probably receive no more than a total of \$30 million annually for each 1 mill of tax levy.

I hope this information is of help to you and your committee. If further information is needed, please feel free to call upon me and I will do what I can to gather it for you.

Sincerely,

A handwritten signature in black ink, appearing to read "Steve Van Sant", with a long horizontal flourish extending to the right.

Steve Van Sant
State Assessor

HP OfficeJet
Personal Printer/Fax/Copier

Fax Log Report for
LRFPC
19072589869
Jun-21-95 03:17 PM

Automatic Log

<u>Identification</u>	<u>Result</u>	<u>Pages</u>	<u>Type</u>	<u>Date</u>	<u>Time</u>	<u>Duration</u>	<u>Diagnostic</u>
Rogers	OK	02/02	Sent	Jun-21	03:04P	00:01:46	002164230020
Pourchot	OK	02/02	Sent	Jun-21	03:14P	00:01:44	002064230020
Gorsuch	No answer	00/02	Sent	Jun-21	03:07P	00:00:00	002060000000
Nordale	OK	02/02	Sent	Jun-21	03:07P	00:01:08	002565030022
Westfall	OK	02/02	Sent	Jun-21	03:09P	00:01:33	002564030022
Brady	OK	02/02	Sent	Jun-21	03:16P	00:00:53	002566030022
Pierce	OK	02/02	Sent	Jun-21	03:11P	00:00:53	002566030022

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Nwame

Agenda

BIRCH, HORTON, BITTNER AND CHEROT
A PROFESSIONAL CORPORATION

facsimile

TRANSMITTAL

to: Melissa Aber Fouse and Bob Walsh
fax #: 907-258-9869|
re: Perm. Fund work session
date: July 5, 1995
pages: 1, including cover sheet.

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MESSAGE:

Unless something really goes haywire, the July 19 meeting is still scheduled. When you send out the notices, please make sure that all members of the commission are invited to participate.

Thanks.



From the desk of...

Mary A. Nordale
Of Counsel
Birch, Horton, Bittner & Cherot
100 Cushman Street, Suite 311
Fairbanks, Alaska 99701

907-452-1666
Fax: 907-456-5055

**IF YOU DO NOT RECEIVE ALL PAGES OR ENCOUNTER ANY PROBLEMS,
PLEASE CONTACT SENDER AT (907) 452-1666 or, in Alaska only, (800) 478-1666.**

DISCUSSION PAPER: This paper is prepared in anticipation of the teleconference meeting of July 19. All Commission members and staff participating should have with them the papers presented by the Alaska Permanent Fund Corporation, Senator Rieger and Roger Cremo. The purpose of the meeting is to consider whether or not the Permanent Fund should be included as a source of funding to close the fiscal gap. As the presentation of the APFC demonstrates, the existing statutes applicable to management of the Fund would not yield excess income that could be used. It is, therefore, essential to a long-range plan that the crucial decision regarding the Fund be made early enough to allow preparation of the plan in accordance with the Commission's determination.

THE ALASKA PERMANENT FUND

Background of Fund

The Alaska Permanent Fund was established by a constitutional amendment adopted in 1976 which allowed the dedication of at least twenty-five percent (25%) of mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses to a permanent fund (Article IX, Sec. 15). The principal of the fund is required to be invested in income-producing investments and the income is required to be deposited in the General Fund.¹

In 1977 the legislature established the Alaska Permanent Fund Corporation to manage the Permanent Fund. In 1980, the legislature established the practice of issuing dividends to Alaskans who apply for them annually. In order to do this, the legislature has adopted definitions of income and has created allocations of income for the purpose of the dividend program and to permit a portion of the income to be deposited in the principal of the Fund to compensate for the erosion of value of the Fund by inflation, so-called inflation proofing. Earnings in excess of amounts for dividends and inflation proofing are held in what is called an "earnings reserve account." The sums held in the earnings reserve account are invested in the same manner as the principal of the Fund.

At the present time, the allocation of income is as follows:

1. AS 37.13.140. Net income includes income of the earnings reserve account. It is computed as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding unrealized gains and losses.² Net income available for distribution equals 21 percent of the net income over the last five years, including the fiscal year just ended, but may not exceed net income for the fiscal year just ended plus the balance in the earnings reserve account.

¹Sec. 7 of the Alaska constitution originally prohibited the dedication of any state tax or license to a specific purpose. With adoption of Sec. 15, Sec. 7 continues to prohibit dedicated funds with the sole exception being the Permanent Fund.

²"Unrealized gains and losses" are those gains and losses on investments that are calculated according to market prices. They are "unrealized" because the investments have not been sold, so the market value of the investments has no effect on income.

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2. AS 37.13.145. Fifty percent (50%) of the income available for distribution is transferred to the dividend account. The balance is used to inflation proof the Fund and, if there is a remainder, it is held in the earnings reserve account.

At the end of FY 1995 (June 30, 1995), the sum to be allocated to dividends was estimated to be \$556 million and the amount required for inflation proofing was estimated at \$344 million.

Allocation Issues

Since its creation, the Permanent Fund has been the subject of much commentary--about its purpose, about the use of its income--what role it should play in the fiscal management of Alaska. Nearly every witness appearing before the Commission included the Permanent Fund as a portion of his or her recommendations. A number of specific plans were presented and the purpose of this document is to compare the various proposals. Before doing so, however, it is important that certain concepts with respect to the Fund be understood.

Income: Article IX, Sec. 15, refers to "all income" as being required to be deposited in the General Fund. The constitution does not distinguish between ordinary income such as dividends and interest and capital gains which accrue by reason of the increase of value over the purchase price of an investment.

AS 37.13.140 does not mention income, but defines "net income" as including income earned by the earnings reserve account, but excluding unrealized gains and losses. AS 37.13.145 provides for the disposition of the net income. Net income is first deposited in the earnings reserve account. At the end of the year, sums necessary for the payment of dividends and for inflation proofing are required to be transferred and any balance remaining in the earnings reserve account is held there subject to appropriation.

Sums used to pay dividends and to provide inflation proofing include both ordinary income and capital gains as AS 37.13 does not, for these purposes, distinguish between the two classes of income.

Inflation proofing: AS 37.13.145 requires that the inflation rate determined as directed by the statute be applied "to the value of the principal of the fund on the last day of the fiscal year just ended." The term, "value," is not otherwise defined and the practice of the Alaska Permanent Fund Corporation has been to value the principal of the fund at its market value, not at cost.

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Thus the investments of the principal are inflation proofed not only against the depreciation of the dollars that originally purchased them, but also for the dollars that represent any appreciation in value. As inflation proofing occurs every year, both the original purchase value of each investment is sustained and the appreciated market value is protected.

Issues: Some of the issues that the statutory definition or treatment of income raise are:

1. Should capital gains be segregated from ordinary income and only ordinary income be used for the purpose of dividend distribution? If that were done, what would be the consequences?
2. Should capital gains be treated as appreciation of the value of the principal rather than as income available for dividends and inflation proofing? If that were done, what would be the consequences?
3. Should the principal of the Fund be calculated at cost or market for the purpose of determining the amount of money necessary to inflation proof the Fund? If that were done, what would be the consequences?

Subcommittee Scenarios

The Alaska Permanent Fund Corporation was asked by the Subcommittee on Revenue to prepare charts and graphs based on possible changes in allocations and classifications of income. The Subcommittee on Revenue appreciates the cooperation of APFC in helping to clarify the significance of a number of ways to manage the Fund and utilize its income, if necessary, for the purpose of closing the fiscal gap. None of the possible changes have been endorsed by APFC and it should be understood that the proposals were developed to explore the potential of the Fund.

Most of the scenarios proposed that the dividend fund be capped at \$500 million. Although this represents a departure from present practice, it was devised because of the concern that has been evidenced by the Commission on the consequences of population driven expenditure programs. In 1992, the dividend fund was \$488 million. By 1995, the dividend fund had risen to \$556 million. These sums represented annual dividends in amounts of approximately \$900 per applicant, give or take \$50. Capping the dividend fund would mean that a dividend of nearly the same amount would be distributed annually, slightly diminished each year because of population growth.

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All of the scenarios used the same base case based upon information at hand that has been used by the Commission in analyzing expenditures and revenues. Although the base case will be adjusted, it is unlikely that the scenarios would be altered significantly by using the revised base case adopted by the Commission. The APFC uses a different model for estimating revenues, inflation and earnings so a difference appears between the estimates based on the current statutory requirements and the same model applied to the preliminary base case used by the Commission.

Scenario No. 1

This scenario uses the base case and, instead of depositing surplus earnings in the earnings reserve account, transfers those earnings directly to the General Fund. Graphs explaining the result are attached. The amounts of money that would go to the General Fund in 1998, \$268 million; 2000, \$255 million; and in 2005, \$660 million.

Scenario No. 2

This scenario, using the base case, caps the dividend fund at \$500 million and would transfer to the General Fund all earnings in excess of inflation proofing and the dividend. This results in there being available to the General Fund in 1998, \$376 million; in 2000, \$453 million; and in 2005, \$670 million.

Scenario No. 3

This scenario departs significantly from existing law. All of the royalty and rental income received by the state would be deposited in the Fund. All of the realized gains would be added to the principal of the Fund and that amount would be deducted from the amount determined to be required to inflation proof the Fund. Unrealized gains would be excluded from the inflation proofing requirement and the dividend fund would be capped at \$500 million. This results in there being available to the General Fund in 1998, \$310 million; in 2000, \$446 million; and in 2005, \$830 million.

This scenario causes the principal of the fund to grow dramatically to slightly over \$30 billion by the end of FY 2005. However, although by 1998 the General Fund would be receiving \$310 million, it would have lost approximately \$700 million because of the loss of the royalty, rents and other mineral resources income presently being directly deposited in the General

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Fund. It appears that this would not only not make up a portion of the fiscal gap, but would increase the gap by approximately \$700 by 1993.

Scenario No. 4

This scenario is identical in its assumptions to Scenario No. 3 except that only 25 percent of the royalty and rental income would go to the Permanent Fund. This causes the principal of the Permanent Fund to grow slightly more than it would under present law, and would result in there being available to the General Fund in 1998, \$275 million; in 2000, \$339 million and in 2005, \$519 million.

Scenario No. 5

This scenario proposed a dramatic change in the structure of the Permanent Fund. Under this scenario, all rent and royalty income would be deposited in the Permanent Fund. All earnings from investments would be considered part of the principal and, as in an endowment, four percent of the total fund would be made available for dividends and for transfer to the General Fund. There would be no need for inflation proofing. Under this scenario, there would be available to the General Fund in 1998, \$305 million; in 2000, \$459 million; and in 2005 \$900 million. The principal of the Fund would grow to nearly \$34 billion by the end of FY 2005.

Scenario No. 6

This scenario is identical to Scenario No. 5 except that only 25 percent of the rent and royalty income would go to the principal of the Permanent Fund. This results in the growth of the principal of the Fund to nearly \$25 billion by 2005 and would make available to the General Fund in 1998 \$215 million; in 2000, \$296 million and in 2005, \$527 million.

Rieger Plan (SB 51)

Senator Steve Rieger introduced Senate Bill 51 in 1997. SB 51 would incorporate the concept of "real" earnings rather than "nominal" values for determining the value of the Fund and the earnings as a basis for dividend calculation. This would shift the burden of inflation from the Fund to the dividend applicants. Another aspect of SB 51 is that the amount required to inflation proof the fund would be calculated as a percentage of the average annual balance of the fund. SB 51 would not change the existing allocation formula for dividends. SB 51 would eliminate the

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need to have an earnings reserve except for a relatively small amount to insure that the dividend commitment would be met.

SB 51 would convert the Permanent Fund to an annuity fund for Alaska dividend applicants, rather than providing sums that would be available to the General Fund for the operation of government. Adoption of the SB 51 proposal would have no effect on the projected fiscal gap.

The Roger Cremo Plan

use "Base Case"

Roger Cremo has developed a proposal for use of natural resource revenue as a permanent endowment to be used to fund government. The plan relies on the existence and increase in other revenues, such as taxes, as the Cremo plan does not propose that all state spending be funded by the funds generated through his proposal.

Cremo proposes that all revenues from natural resources, the Permanent Fund and reserves be placed in a single fund, to be established, and the fund then invested aggressively to reap a ^{nominal} "real" return of about 10 percent. The legislature could withdraw up to 20 percent of the fund the first year and the amount of permitted withdrawal declines geometrically each year thereafter until it reaches the base withdrawal rate of 6 percent in 2006.

The Cremo plan would significantly reduce present revenues available for appropriation from natural resources and the decline would continue until about 2008. Thereafter, increasing amounts would be available for appropriation. In the period between 1996 and 2008, the Cremo plan requires an increase in other revenues or dramatically reduced expenditures of other revenues cannot be found.

The 40-30-30 Plan

The 40-30-30 Plan was proposed in 1987 by Sen. Jan Faiks and was incorporated in a resolution for a constitutional amendment that would have, in addition to amendment of the Permanent Fund provisions, established a constitutional appropriations limit and created a budget reserve fund. The plan would have allocated 40 percent of the Permanent Fund income to dividends, 30 percent to inflation proofing and 30 percent to a budget reserve fund. The plan was amended in 1989 to propose the allocation of Permanent Fund income 50 percent to dividends, 30 percent to inflation proofing and 20 percent to a budget stabilization fund.

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SUMMARY

The Alaska Permanent Fund must be considered in any long-range financial plan, either as a contributor to closing the gap or as a source of funds available for the generation of funds to pay for government. If the Commission determines that the Alaska Permanent Fund must contribute to closing the gap, legislative or constitutional changes must be enacted to create the revenue stream necessary to make the Fund's contribution meaningful.

LONG RANGE FINANCIAL PLANNING COMMISSION

Report of Subcommittee on Revenues

The Long Range Financial Planning Commission is charged under House Concurrent Resolution No. 1 with a number of tasks related to the revenues that are or could be available to the state to support state government at the present or at either a reduced or increased level. The Subcommittee on Revenues, composed of Mary A. Nordale, chairman, Pat Pourchot, Legislative Director in the Office of the Governor, Rep. Mike Navarre (D, Dist. 9, Kenai), Lee Gorsuch, Chancellor of the University of Alaska Anchorage, and Marie Westfall, retired Gateway Borough Finance Director, has prepared this preliminary report to present information on revenue sources and to suggest on a preliminary basis the advantages and disadvantages of existing sources and new sources.

The Long Range Financial Planning Commission is charged with, among other duties, the following:

- (2) identify and evaluate all current state income sources and assets, including recurring revenue, reserves, physical resources, and investments;
- (3) identify and prioritize systemic changes to stabilize the state's revenue stream;

- (6) identify and prioritize new sources of revenues;

- (9) consider the division of responsibility for providing services and raising revenue between the state and local governments and evaluate the effect of the long-range financial plan on local governments;

EXISTING REVENUE SOURCES

The identification of sources of revenues, while not difficult, is somewhat complicated. Some revenues are paid directly into the General Fund, such as corporate income and severance taxes. Other state revenues are not accounted for as General Fund sources, such as interest on the 4-Dam Pool which funds the Power Cost Equalization Program and repayments on mortgages received by the Alaska Housing Finance Corporation. Likewise, revenues to the Alaska Permanent Fund Corporation are not generally treated as available for appropriation in the same sense as tax receipts. The Commission must adopt a policy for the purpose of determining

Preliminary Report
Subcommittee on Revenues

*Draft #1
Superseded 29 June 95*

revenue sources of considering such fund earnings as revenue sources, considering such fund earnings as not available for appropriation or distinguishing among the various funds and accounts to specify which funds should be accounted for as revenue sources to the General Fund and which should not be considered as sources for the purposes of achieving a long-term revenue stream.

Recommendation: All funds carried as separate accounts in the General Fund that are not dedicated, the earnings of which are usually appropriated to fund specific programs, be considered General Fund reserves and the earnings classed as available for appropriation for any purpose.

Recommendation: Earnings received by Alaska Housing Finance Corporation and Alaska Industrial Development and Export Authority should not be considered as General Fund revenues but at least a portion of those earnings should be considered available for payment to the General Fund as a dividend or return of capital.

Recommendation: The earnings of the Alaska Permanent Fund Corporation should be considered as General Fund revenues, subject to existing statutory allocations.

Recommendation: All revenues required by federal law or the Alaska Constitution (including dedicated revenues carried over from territorial government) should be identified as dedicated and the program or programs for which the dedications have been made or are required should be stated explicitly in each budget document.

At the present time, the major sources of revenue to the state are oil and gas rents, royalties and bonuses; oil and gas properties tax; severance taxes; and corporate income taxes. The state has a number of small sources of revenue, generally excise taxes or charges and fees for services¹, that generate approximately \$300 million annually.²

¹Fees and charges for services are generally termed "program receipts." Federal law requires, for example, that the Alaska Department of Environmental Conservation generate enough funds through fees and charges to support the costs of administration of the state's clean air program. Other services, for example, the Recording Offices, charge fees, but the revenue received does not fully support the services. All funds from such fees are deemed revenues to the general fund and are available for appropriation for any budget category.

²An excise tax is a tax applied directly to a commodity used or consumed within the taxing jurisdiction. Examples in Alaska are: alcohol taxes, motor fuel taxes and cigarette taxes.

The Commission has adopted for its use a base-case revenue sources and projections. A copy of the base case, in both nominal and real³ terms is attached to this report. In FY 1996, the amount of revenue estimated to be received by the General Fund is as follows:

Petroleum	\$1,473.4
Other Sources	301.3
Nonrecurring Sources	197.1
Total	\$1,971.8

The base case has projected a fiscal gap, that is, a difference of \$498.3 million between revenues and expenditures, for FY1996. This fiscal gap has been filled by appropriations from the Constitutional Budget Reserve fund. The base case also projects fiscal gaps, in nominal dollars, of \$709.9 million in FY 1997 to \$1,713.9 million in 2005. The base case projects that these gaps cannot be filled entirely from the Constitutional Budget Reserve after FY 1999 and that starting in FY 2000, the amount that must be made available by expenditure cuts and new revenue sources, again in nominal dollars, will be \$390.1 million, rising to \$1,713.9 million in FY 2005.

The Subcommittee on Revenue has not, for the purposes of its work, considered expenditure cuts as a revenue source. The Subcommittee has proceeded on the basis that its responsibilities are to identify existing and new revenue sources and that the full Commission will, in the preparation of its plan, make recommendations as to what new sources of revenue will be needed if expenditure cuts alone cannot fill the budget gap.

NEW REVENUE SOURCES - TAXES

The Subcommittee on Revenues examined revenue sources utilized by other states that Alaska does not use. Most prominent among these sources are statewide property taxes, statewide sales taxes and individual income taxes. Alaska repealed its individual income tax in 1979 and has traditionally allocated to local government units use of property and sales taxes. At the same time, the state funds certain programs, notably education, that have been traditionally considered to be a local responsibility. The subcommittee noted that many states use a statewide real property tax as the primary source of revenue to fund statewide education support.

The Subcommittee considered taxes of various sorts as potential sources of revenue to fill the budget gap. In doing so, the Subcommittee recognized that taxes impose burdens on both individuals and businesses. Economic burdens on individuals and businesses can impair economic

³"Real terms" or "real dollars" means, in this report, the amount of revenue received adjusted for inflation, using FY 1996 dollars as the measure. The purpose of using "real dollars" is to portray the relative purchasing power of the amount of dollars received as compared to the FY 1996 purchasing power.

development, although it is widely known that most businesses and individuals accept the necessity of paying taxes and ask only that the burdens be imposed fairly and for important services. With respect to large economic developments, taxes generally are not a deterrent, unless they are deemed confiscatory.

In considering taxes, tax efficiency should be considered. Taxes may be efficient, neutral or inefficient. Efficient taxes are those that generate more revenue than the costs of collection. Neutral taxes collect revenue equal to the cost of collection and inefficient taxes are those that cost more to collect than the revenue received. The Subcommittee considers that if new taxes are necessary to fill the budget gap, the taxes should be efficient and should not be imposed to accomplish social engineering purposes rather than to raise revenue.

This preliminary report considers only three major new taxes, all of which are considered to be efficient to one degree or another. They are a statewide real property tax, a statewide sales tax and an individual income tax.

Statewide Real Property Tax

Local government units do not exist throughout vast areas of the state. The urban areas are organized into home rule, first and second class boroughs. Some boroughs have been formed in the so-called bush areas after introduction of a property base of sufficient size to support local government. In those areas where economic development has not occurred to such a degree, local government formation is weak or nonexistent.

The Department of Community and Regional Affairs publishes a report annually entitled, "Alaska Taxable." This report attempts to set forth the real property values of all parts of the state, within organized boroughs and cities as well as within the unorganized borough. This report reveals that substantial values would appear to exist in the rural areas to support in part local government functions such as education. Closer examination reveals, however, that vast areas of the state could not support a local, let alone a statewide, property tax. In these areas, although values in property exist, incomes of property owners are insufficient to bear the burden that the payment of real property taxes would cause. Moreover, a number of people in rural areas who can place their real property in restrictive titles⁴ have done so, so that any real property tax levied would be paid only by those who are ineligible for such protective status.

The Subcommittee requested the assistance of Mr. Steve Van Sant, the State Assessor, in determining the availability of a statewide real property tax. Attached is a copy of his response which more clearly sets out the difficulty a statewide real property tax would pose in those areas

⁴Alaska Natives may place legal title to their real property in the federal government, while retaining beneficial or equitable title. When the federal government holds legal title, the property is not taxable.

of the state where job opportunities and employment are limited and, consequently, where cash income for the payment of such taxes is very limited. After concluding that the major values in real property that would support a statewide real property tax lie along the road system and in Southeastern Alaska, he pointed out that:

The other areas of the state may have taxable value, but certainly not to the extent of these areas. Regardless of this fact, however, the data would have to [be] collected, analyzed, property record cards would have to be created and assessment rolls would have to be finalized and the appeal process would have to be in place. This entire process would be extremely expensive to set up and maintain. The initial set up process could take up to three or four years to complete, depending on the amount of revenue allocated and the total number of personnel hired or contracted for the project.

Notwithstanding the difficulties, Mr. Van Sant stated that the state could expect to receive approximately \$28 million annually based on a real property tax levy of one mill in addition to the amount the state receives presently from the real property tax levied on oil and gas properties.

AS 29.45.090 presently limits local governments to a property tax of not more than three percent (3%) of value. This is the equivalent of 300 mills.⁵ A tax of 300 mills levied against a residence valued at \$100,000 would yield \$3,000 in revenue. A tax of one mill levied against the same residence would yield \$100 in revenue. AS 29.45.090 further limits the tax levy to \$1,500 per person if more than one taxing entity can levy a tax on the same property. Alaska Taxable shows that millage rates vary among Alaska's taxing jurisdictions, from *** to ***.

The Subcommittee considered the real property tax as a potential new source of state revenues on the basis that each one-mill levy would yield \$28 million in revenue. In order to fill the fiscal gap solely on the basis of state real property taxes, a levy of 30 to 100 mills would be necessary. In doing so, the Subcommittee considered the advantages and disadvantages as follows:

⁵A mill is one one-hundredth of a cent. Real properties are traditionally taxed at rates of mills instead of percentages: the millage rate.

Advantages

Real property values are generally stable and the calculation of anticipated revenue is relatively easy.

Taxation of real property would spread the tax burden throughout the state.

Real property taxes could be used to offset the rising cost of education, especially in the K-12 schools.

Disadvantages

Payment of real property taxes must be made by individuals with cash incomes. In periods of recession, lowered family income make payment of such taxes difficult. For property owners with little or no cash income, real property taxes pose an insurmountable problem.

Collection of real property taxes in many areas would be so difficult that it is likely that statewide real property taxes would be collected primarily in those areas in which real property taxes are already imposed.

Local governments already levying real property taxes use all or a portion of the tax revenues to support education. A statewide tax as an additional tax might weaken the local effort to support education.

The foregoing chart of advantages and disadvantages is not exhaustive, but is set forth to illustrate the types of considerations the Subcommittee gave to the subject and to set forth a basis for its recommendation.

LOCAL
CAP
would
not
apply to
statewide

Recommendation: A statewide real property tax should not be considered as a reasonable new source of revenue because: (1) the cost of collection would be extraordinarily high; (2) collection would require the establishment of a sizable bureaucracy to administer the tax; and (3) local governments rely upon real property taxes as a major source of revenue to fund local government.

Statewide Sales Tax

Sales taxes are a popular form of taxation in other states as well as among Alaska's units of local government. Some local government units, Anchorage for example, have steadfastly resisted the imposition of a sales tax. Fairbanks had a sales tax at one time, but repealed it. Juneau imposes a four percent sales tax. In contract, the State of Washington imposes a sales tax of over 13 percent.

There are two broad arguments for a sales tax. One is that it is easy to collect because the seller, in effect, is the tax collector. The other is that it spreads whatever tax burden there is widely to all purchases of goods and services.

At the present time, the state does not impose a sales tax, but in AS 29.45.650 et seq. authorizes local government units to impose sales and use taxes. Sales taxes are useful in those areas in which real property taxes are unrealistic because it enables local government units to generate revenues based on the community's ability to pay.

There is one broad argument against sales and use taxes and this is that the tax is regressive. A regressive tax is a tax that creates the largest burden for those who have the least ability to pay. In recognition of this, many jurisdictions exempt food and other categories of essential goods and services. The federal government requires, and the state has adopted such legislation, that items purchased by food stamps be tax exempt.

Commissioner Wilson L. Condon of the Department of Revenue has supplied the Subcommittee with the department's estimate of revenue from a statewide sales tax. A copy of the report is attached. In summary, the department has estimated that for every one percent of sales tax imposed, the state would receive approximately \$40 million in revenue. This estimate is based on the proposition that the tax would be imposed on all sales and uses, with no exemptions. If exemptions are created, revenues per one percent of tax would, of course, be less.

Advantages

Revenues are easily calculated.

Collection is easy and relatively inexpensive.

Sales taxes spread the burden widely.

Sales taxes would create new revenue from the tourists and other non-permanent residents of the state.

Disadvantages

Revenues are dependent on the general economic health of the state and should, therefore, be considered volatile.

Auditing sales tax returns from sellers would be expensive, requiring hiring of a number of personnel to conduct audits and requiring large amounts of travel.

Sales taxes would impose an additional burden on purchasers and might reduce other local government revenues.

Sales taxes might create a greater tax rivalry between communities than already exists.

Advantages

The percentage of additional cost that a sales tax would represent is not a burden.

Disadvantages

Sales taxes of any amount create burdens for the economically disadvantaged, especially for those whose cash incomes are limited.

The Subcommittee considered the role sales taxes play at the present time and probably in the future in funding local government. The Subcommittee considered the impact on buyers of goods and services in those communities in which sales taxes are imposed and also considered that the ability to impose sales taxes may offer a powerful incentive to areas in the unorganized borough to organize into units of local government. As a consequence, the Subcommittee makes the following:

Recommendation: Sales and use taxes should remain exclusively within the taxing jurisdictions of units of local government and should not be considered as a means to fill the fiscal gap.

Individual Income Tax

From 1949 to 1979 Alaska imposed an individual income tax that, until the advent of oil and gas revenues, was the single largest source of revenue to the Territory and then to the State. The citizens of the Territory of Alaska were originally persuaded that an income tax was necessary because of the increasing costs of territorial government and the fact that employment in Alaska, other than government, was seasonal and an income tax was a method of capturing a portion of individual income earned in Alaska before it was exported to other states. When it became clear that oil and gas revenues were going to be greater than the state's requirements, the individual income tax was repealed.

The Subcommittee requested and received assistance from the Department of Revenue in estimating the potential of an individual income tax to generate enough revenue to close the fiscal gap in the present as well as in the future, at least until 2005. The department estimates that if an individual income tax were imposed using the same formula that was in effect in 1978, the amount of revenue that would be generated would be approximately \$450 million per year.

The Subcommittee also had available to it the studies performed by the Institute of Social and Economic Research (ISER) covering a number of subjects, but principally ISER's studies of the fiscal gap and sources of revenue to close the gap. A number of ISER studies compare the tax burdens borne by Alaskans with those borne by citizens of other states. Those studies make it clear that on an individual or per capita basis, the tax burden borne by Alaskans is very light, less than one-half of the U. S. average.

The Subcommittee, therefore, considers that the individual income tax represents a significant and, probably, essential new source of revenue to close the fiscal gap. However, it

believes that imposition of an individual income tax cannot be undertaken without reference to other major sources of both state and individual income. However, an individual income tax reaches all income earned in Alaska and, therefore, imposes the burden of funding state government on all of those who take advantage of work and investment opportunities here who have not contributed to the cost of government over the past nearly 20 years.

The Subcommittee has heard representations that an individual income tax should not be imposed as long as the state pays to each citizen who applies a dividend from the Permanent Fund earnings. The Subcommittee does not consider an individual income tax to be an alternative to the annual dividend, but recognizes that in the minds of most Alaskans, it is. Notwithstanding the political linkage, the Subcommittee considers that imposition of an individual income tax is probably necessary if expenditure cuts and other revenues cannot close the fiscal gap.

The Subcommittee considers the method of calculation of the income tax that was in effect in 1978 may now not be appropriate. The Subcommittee believes that the Department of Revenue should be requested and funded to develop models of an individual income tax system that would be fair, efficient and reasonably simple for people to calculate.

NEW REVENUE SOURCES - NON-TAX

Alaska Permanent Fund

The Alaska Permanent Fund was established in 1977 by a constitutional amendment adopted in 1976. It is designed to act as a savings account to capture a portion of the revenue received by the state from state and federal mineral rents, royalties and bonuses. At the beginning of FY 1996 (July 1, 1995), it is estimated to have a principal value of approximately \$13.5 billion.

The constitution requires that the principal of the Fund be "used only for...income-producing investments...designated by law..." and that the income be deposited in the General Fund unless otherwise provided by law. At the present time, instead of depositing the income into the General Fund, AS 37.13 requires that the income be used to inflation proof the fund and to pay to each citizen applying for it a dividend. Any surplus that exists after these purposes have been satisfied is retained in an account designated as the "earnings reserve account." As of the end of FY 1995 (June 30, 1995), the earnings reserve account holds \$1.138 billion.

Since 1980, the Permanent Fund Dividend has become imbedded in the culture and economy of the state. The amount of the annual dividend has risen from approximately \$300 per applicant to approximately \$950 per applicant. Surveys conducted by the Alaska Permanent Fund Corporation, the state entity that manages the Fund, indicate that recipients of dividends use the money for a variety of purposes including payment of bills, education, travel and investment. Since issuance of the dividend commenced, approximately \$5 billion in dividends has entered the Alaska economy.

GUEST FACSIMILE

To:
KAREN HAMMERFacsimile Number:
(907) 786-6123Phone Number:
(907) 786-1437Date: 7/24/95THE
CHARLES
HOTEL

COVER PAGE

From:
LEE GORSUCHHotel Facsimile Number
(617) 864-5715Guest Room:
539Page 1 of 1

REGARDING:

Karen,

Please call Melissa Fouse @ Leg. Info. Ofc. & ask her to request Jim Kelly of the Ak Perm. Fund to prepare a spreadsheet which assumes: 1) a real rate of return of 6 percent; 2) dividends capped at \$500m and declining @ 1.5% per year 3) all but \$1b of "transition" funds deposited into the Ak Perm Fund; 4) \$80m of real earnings of the Permanent Fund go to G.F., compounding by \$80m each year for 5 years i.e. total of a \$400m payout to G.F.; 5) reduce inflation proofing by the % of the Fund's portfolio that is in equities; and 6) move % of Fund portfolio in equities to 70 percent over 5 years. (Ask Jim to make certain not to double count either inflation proofing if it is already reflected in the unrealized capital gains or calculations of real rates of return if they already account for adjustments to unrealized capital gains.

Also, please give my best wishes to Jonett Tr. Hatch and send me telephone #'s for Jim Kelly and Brad Pierce (@OMB).

For Questions Regarding the Transmission of this Facsimile, Please Call the Concierge
at The Charles Hotel in Harvard Square.
(617) 864-1200 ext. 4

Mark
Lee

Guest: Please refer to price information on reverse.

TO: Jim Kelly

FM: Melissa Fouse