

SCOMM

134:10

SPONSOR STATEMENT / SECTIONAL ANALYSIS

Rp. Carl E. Moses, 465-4451 / Staff: Tim Benintendi, 465-6591

HB 470 – Reinstatement of Personal Income Tax

HB 470 would reimpose a state income tax on individuals and fiduciaries (estates and trusts). A state income tax was last on the books in Alaska in 1980, and the sponsor feels it is time to revive it. This bill would essentially bring back the format of the tax as it used to be, but phases it back in over the first three years. This measure could be considered a valid component of a long-range fiscal plan, and produce income of about \$100 million annually. Its cost of administration has been estimated at about \$7 million. The bipartisan 1995 Long Range Financial Planning Commission recommended an income tax by 2002. Other legislative and private entities have recommended the revival of a personal income tax as well.

There are no issues of constitutionality in bringing back the state income tax. This measure responds to the need for additional state revenue, given that we continue deficit spending. It also has appeal to those who believe non-resident workers should pay a fair share of their burden here. It would not extend to any Native Corporation which is not currently paying a corporate state income tax.

The core of the bill reinstitutes the individual income tax in Tax Year 2005, makes it a percentage of a taxpayer's federal income tax liability (form 1040, line 60), sets up a graduating scale of taxation in the first three years, provides requirements for completing filing and employer responsibilities, makes provisions for amended filings, and identifies those credits made available to the taxpayer.

The major tax credit of interest to Alaskans would be the tax credit authorized for real and personal property taxes paid to a municipality in this state. This credit impacts the greater potential for revenue under this measure, but is designed to soften the effect of the income tax on working families.

Bill Section 1: Adds to AS 43.20.011, a provision for the taxation of income of every resident, non-resident, and part-year resident individual and fiduciary in the state. It apportions the tax liability of a non-resident, part-year resident, or fiduciary, as that percentage of their federal income tax liability that is their taxable income from sources within Alaska only.

In Tax Year 2005 (from December 31, 2004 through December 31, 2005), HB 470 sets a level of federal income tax liability at \$20,000 as the bar below which, state income tax liability would be 5% of that liability, and above which, state income tax liability would be 10%.

In Tax Year 2006 (from December 31, 2005 through December 31, 2006), the bill changes the rates as follows: When federal income tax liability is less than \$20,000, the rate would go up to 10%, and when it is greater than \$20,000, the rate would go up to 15%.

Finally, in Tax Year 2007 and beyond, the state income tax rates become 15% and 20% respectively, for federal income tax liabilities either below or above the \$20,000 level.

This section further requires the use of one's federal filing status as that which would be used in determining the state income tax liability.

Bill Section 2: Directs individuals and fiduciaries to file state income tax returns with the Department of Revenue, the same as corporations and others required to file under 26 U.S.C., the Internal Revenue Code. Provides for allowable credits and payments against the state tax liability.

Bill Section 3: Makes the state income tax liability due and payable at the same time and in the same manner as one's federal income tax liability.

Bill Section 4: Requires the taxpayer to file with the state tax return, a copy of one's federal tax return for the same tax year. It also provides for the filing of an amended return within sixty days following a final determination of the taxpayer's federal tax liability if such should be in question.

Bill Section 5: Adds a new section to AS 43.20 that determines income sources within the state, which would be used in calculating the tax liabilities of non-residents, part-year residents, or fiduciaries. For purposes of calculating taxable income attributable to sources from within the state, this section also provides that deductions and adjustments are allowed only to the extent they are connected with income that arises from sources within the state.

Bill Section 6: Adds salaries or wages, and estate or trust income, to the list of income sources considered as being from within the state.

Bill Section 7: Provides for the Multistate Tax Compact, AS 43.19, as the authority in determining what income is taxable from entities which do business both partly inside and partly outside of the state.

Bill Section 8: Establishes credits against the state income tax liability, beginning with the amount of payroll tax withheld. It further establishes a credit for resident and part-year resident taxpayers for income taxes imposed by other U.S. states or territories, on income that is also subject to tax in Alaska. This credit, though, is limited to the proportion of the tax calculated under Alaska statute that relates to the percentage the taxable income from the other jurisdiction bears to the taxpayer's total taxable income. The credit may not exceed actual taxes paid to the other jurisdiction.

A significant tax credit authorized under this section allows a tax deduction for real and personal property taxes paid to a municipality in this state.

Bill Section 9: Provides for corporate taxpayers to allocate and apportion their net income as provided in the Multistate Tax Compact, on income taxable both inside and outside the state, or on income from other sources both inside and outside Alaska.

Bill Section 10: Establishes tax collection procedures, including deduction and withholding features and instructions to employers regarding tax payments and other information due the state. This section also describes the employer reporting responsibilities to the employee, annually by January 31st, or thirty days after termination, of wages / compensation, and withholding / deductions. Employer penalties are also referenced as those in AS 43.05.220 (d).

This section also establishes the authority for governmental entities to deduct and withhold from employees, as well as return deductions and withholdings to those officers of the entities appropriately designated to perform these functions. The terms "employee," "employer," and "wages," are defined by the Internal Revenue Code under 26 U.S.C.

Bill Section 11: Imposes the same time limitations on the assessment and collection of taxes by the state, and the same exceptions, as is found in the Internal Revenue Code, 26 U.S.C. 6501-6503. When additional tax is due from changes made to a federal income tax return, the period of limitation begins from the date that one files an amended return. If no amended return is filed, the additional tax due may be assessed at any time.

Bill Section 12: Defines the terms "bank," "corporation," "fiduciary," "fiscal year," "individual," "Internal Revenue Code," "resident," "non-resident," "part-year resident," "person," "taxable year," "taxpayer," and "trade or business."

Bill Section 13: Identifies necessary repealers.

HB 470 / Rp. Carl E. Moses (staff: tim benintendi / 6591) 2-23-04

Revenue/Tax Division

To: Dan Dickinson, Tax Division Director

From: Mike Williams, Revenue Auditor

Date: February 26, 2004

RE: Personal Income Tax Rate Comparison

The table below represents various potential tax rates that Alaska could impose on personal income. The purpose of the table is to compare flat rates based on Adjusted Gross Income with the equivalent flat rates on other potential tax bases.

	% of Adjusted Gross Income	% of Federal Taxable Income	% of Net Federal Tax Liability
Revenue (millions)			
\$130.0	1.0	1.38	7.0
\$270.0	2.0	2.74	13.88
\$415.0	3.0	4.15	21.00
\$555.0	4.0	5.50	27.90
\$700.0	5.0	6.91	35.03
\$840.0	6.0	8.27	41.92
\$985.0	7.0	9.68	49.05
*	8.0	n/a	n/a
*	9.0	n/a	n/a
*	10.0	n/a	n/a

* The Department's model currently does not have the ability to generate rates for more than \$1 billion in revenue. Speaking practically, there is insufficient personal income within the State to sustain a \$1 billion personal income tax.

Note that the revenue increasing from one percentage point to the next does not correspond exactly with adding the amount of revenue at one percentage point. This is a result of computing potential credits for taxes paid to other states, on income earned in those states.

For reference:

Adjusted gross income can be found on Form 1040 line 34.

Federal taxable income can be found on Form 1040 line 40.

Net federal income tax liability can be found on Form 1040 line 54.

All references apply to the 2003 Form 1040.

Personal Income Tax

OTHER STATES

Of the 50 states, 43 have a personal income tax. Joining Alaska on the side without a tax are Florida, Nevada, South Dakota, Texas, Washington and Wyoming. Of the 43 with a tax, New Hampshire and Tennessee collect taxes on dividends and interest income only.

Some states have a flat tax — Colorado, Michigan, Massachusetts, Illinois, Indiana and Pennsylvania — ranging from 2.8% of federal taxable income in Pennsylvania to 5.6% of adjusted gross income in Massachusetts.

States with tax brackets range to a high of 10 income brackets. Montana has 10 tax brackets, ranging from 2% to 11% of adjusted gross income, with some deductions allowed.

Most states use federal adjusted gross income as a starting point to calculate the state tax, and most also use federal provisions in calculating allowable itemized deductions.

- 29 states exempt Social Security benefits from taxation.
- 8 states exempt unemployment benefits from taxation.
- 2 states exempt all capital gains from taxation.
- 37 states exempt interest earned on their own state and municipal bonds.
- 5 states exempt military pay from taxation.
- 33 states allow a standard deduction for taxpayers, with 12 using the federal amount.
- 37 states allow check-off contributions for endangered wildlife funds, with 22 states allowing check-off contributions for children and domestic abuse funds.

TAX BASE OPTIONS

There are three options for a tax base for calculating an individual's state tax liability:

- Adjusted gross income.
Total income with few, if any, deductions. Because the tax base would be the highest of the three options, the tax rate would be the lowest.
- Federal taxable income.
This requires the state to accept whatever tax deductions are allowed under federal law, although the state also could include its own deductions, credits or other conditions.
- Federal tax liability.
This also requires the state to accept whatever deductions and credits are allowed under federal law. Because the tax base would be the lowest of the three options, the tax rate would be the highest. Another feature of using federal tax liability as the base is that the state tax would be progressive, even with a flat tax rate. By using federal tax liability as the base, the state would be adopting the progressive nature of the federal tax tables.

ALASKA INCOME

Internal Revenue Service tapes show Alaskans filed 333,061 personal income tax returns for 2001, representing 450,073 taxpayers (117,012 were joint returns). Some facts from those returns:

- Almost 90% of the tax returns showing more than \$100,000 in adjusted gross income were joint returns.
- About 7% of returns showing less than \$20,000 in gross income were joint returns.
- Federal adjusted income reported by Alaskans in 2001 totaled \$14.2 billion.
- Of the 450,073 taxpayers, 70% reported gross income of under \$50,000 and almost 82% reported gross income below \$75,000 a year.
- The 10% of taxpayers reporting more than \$100,000 a year in gross income represent 33% of total income reported by all Alaskans.
- The 18% earning more than \$75,000 represent 51% of total income for Alaskans.

REVENUES TO THE STATE

These are approximate numbers for tax rates and how much revenue would be raised. The following table assumes a flat tax, for sake of simplicity in showing potential revenues. The Tax Division could devise tax tables with several different tax brackets to generate whatever level of revenue is desired.

For its discussions, the Legislative Fiscal Caucus has used a 3% flat tax on federal taxable income as its starting point for consideration of a state personal income tax. Such a tax would raise an estimated \$270 million to \$275 million a year.

Income Tax Rates and Revenue Projections (2001 IRS Data)			
\$ Million Revenue	% Adjusted Gross Income	% Federal Taxable Income	% Federal Tax Liability
\$250	1.85	2.54	12.90
\$300	2.20	3.03	15.36
\$350	2.55	3.51	17.82
\$400	2.90	4.00	20.28

ALASKA'S OLD INCOME TAX

Alaska abolished its personal income tax in 1980. The tax raised \$210.4 million in Fiscal 1977, its highest collections ever.

The tax was assessed as a percentage of federal taxable income, ranging from 3.5% for income up to \$8,000 per year to a high of 14.5% on income in excess of \$300,000. In the middle, taxpayers paid 10% of their federal taxable income over \$52,000.

If the pre-1980 tax rates were in effect today, Alaskans would pay about \$750 million in state personal income taxes. That number would be significantly lower if the tax tables were adjusted for inflation.

OUT-OF-STATE RESIDENTS

An income tax certainly would collect money from non-residents working in Alaska, but there is no way to know exactly how much it would collect.

Available IRS data reports income earned by taxpayers with an Alaska mailing address; it does not report income earned by non-residents working in Alaska.

There are no exact numbers for non-resident wages in Alaska, but estimates range from 3% to 10% and the Department of Revenue believes the true number is probably in the middle. At 6% or 7%, an income tax that raised \$300 million would collect perhaps \$20 million a year from non-residents.

It is important to remember that most of the non-resident workers who come to Alaska are here for low-paying summer tourism and seafood processing jobs and would not pay much in personal income taxes.

FEDERAL DEDUCTION FOR STATE INCOME TAX

A state personal income tax would be deductible from federal income taxes for Alaskans who itemize. IRS statistics indicate about 25% of Alaska taxpayers itemize their deductions, though most higher-income Alaskans itemize on their federal returns. And since it would be the higher-income Alaskans who would provide most of the state's new income tax revenues, a substantial portion of that tax would be deducted from Alaskans' tax payments to the federal government.

The easiest way to "export" a tax — that is, to shift its cost — is through its deduction against federal tax liability. There is no deduction for state or municipal sales taxes; only income taxes are deductible. A deduction means part of the tax revenue remains in the state instead of going to the federal treasury.

We estimate that Alaskans would recover about 15% of the cost of a state income tax by deducting it from their federal tax bills. For example, if a state income tax generated \$300 million a year, \$45 million would come from the deductibility of the state income tax against federal income taxes and \$255 million would come from pockets of Alaskans.

COST OF COLLECTION

The Department of Revenue estimates it could cost \$7 million in one-time expenses to set up a personal income tax, including computers, printing forms and booklets, launching a public education campaign, and establishing a central office and field offices in several Alaska cities.

Ongoing expenses for a personal income tax would be an estimated \$6 million a year.

Assuming \$300 million a year in tax revenues, that would be 2% of collections. This compares to other states, where the cost of collection runs a similar percentage.

EFFECTIVE DATE

Because of the nature of a personal income tax, a new tax in Alaska would need to start Jan. 1. Any other start date would cause immense logistical problems for calculating tax liabilities, and would place a burden on taxpayers, employers and the Tax Division.

And because of the large amount of work required to start an income tax program from scratch, the Department of Revenue would need to devote significant resources to the effort immediately upon passage of enabling legislation. Much of the work, however, would have to be started before a bill passes, in preparation for the new tax and in expectation that the tax would begin within a matter of months after passage.

With payroll deductions and estimated tax payments in the first calendar year of the new tax, the state could expect to collect somewhat less than half of a full year's revenue the first fiscal year of the tax. January through May payroll deductions would be collected in February through June, producing five months of withholding tax income.

WORK REQUIRED TO SET UP A NEW TAX PROGRAM

The Department of Revenue would face several challenges in setting up a tax to start Jan. 1 after legislative passage. In addition to adopting regulations to implement the new tax, the department and its Tax Division would need to:

- Hire and train staff.
- Procure central office space and field offices.
- Design software and a web-based system for taxpayers.
- Set up electronic fund transfers with employers.
- Prepare and print tax books and forms, and distribute to employers.
- Conduct workshops statewide to explain the new law, particularly to employers.

All of this would need to be completed by November in order for employers to distribute withholding forms to their employees and update their payroll software to start collecting the new tax on Jan. 1.

ISSUES

In addition to deciding on the tax base (gross income, taxable income or federal tax liability), and flat tax vs. a variable tax, the state also would have to consider:

- Taxability of federal employee cost-of-living payments.
These are exempt from federal income tax but could be taxed by the state.
- Permanent Fund dividends.
Politically, it would make sense to exempt the dividends from state taxes.
- Expectations for audits, enforcement.
The stronger the enforcement, the more effective the program, especially with out-of-state residents.

Sales Tax vs. Income Tax vs. Budget Cuts vs. Dividends

PROGRESSIVITY vs. REGRESSIVITY

Supporters of a sliding-scale income tax say it is progressive, in that it assigns a higher rate to higher-income households. A flat tax is not progressive, unless it is assessed on federal tax liability, in which case it picks up the progressivity of the federal tax tables.

Supporters of a sales tax say it is fair in that it taxes everyone at the same rate, but opponents of a sales tax say it is regressive because low-income households spend a greater proportion of their income on essentials than higher-income households.

Opponents of reducing the dividend argue it would be regressive, in that all would suffer the same economic loss — regardless of their income. Low-income Alaskans have come to depend on the dividend for a significant portion of their annual household income. Supporters, however, argue everyone should help pay for public services, and that reducing the dividend is one way to ensure all Alaskans contribute to the solution.

WHAT IS LEAST PAINFUL TO THE ECONOMY?

There are no recent studies on precisely what would be least harmful to the state's economy: state budget cuts, new taxes, or reducing the dividend. However, thoughtful consideration produces some generally accepted assumptions:

- More of the Permanent Fund dividend leaves the state faster than state operating expenses or wages earned by Alaska, and therefore reduced dividends would be less harmful to the overall economy.

Because Alaskans save or invest a greater proportion of their dividends than their wages, and because Alaskans spend a greater proportion of their dividends than their wages on big-ticket purchases manufactured out of state and on travel, we believe that reducing dividends would take less money out of the Alaska economy than a personal income tax or sales tax.

- If, for example, the state wanted \$300 million a year, either from a personal income tax or a sales tax, we believe a sales tax would raise more money from out-of-state residents but the income tax, overall, would be less costly to the Alaska economy.

A \$300 million sales tax might collect about \$30 million from out-of-state residents (visitors and workers), while a \$300 million income tax would collect perhaps \$20 million from out-of-state workers and also would reduce Alaskans' federal income tax payments by an estimated \$45 million. The net cost to Alaskans of a sales tax would be \$280 million vs. \$235 million for the income tax.

- Although a sales tax would raise more money overall from non-residents, an income tax would collect more revenue from higher-income non-residents working in Alaska. A non-resident with \$60,000 a year in taxable Alaska wages would pay \$1,800 if the state imposed a flat 3% income tax. That same non-resident worker would have to spend \$60,000 a year after all state and federal taxes — more than his or her entire paycheck — for the state to collect \$1,800 a year in sales taxes at a 3% rate.

ECONOMIC EFFECTS

Economists classify a tax as "efficient" when it has little or no effect on economic behavior. For example, taxes are inefficient when they influence consumer buying decisions or manufacturers' production decisions. Likewise, taxes are more efficient than government spending cuts if they do less damage to the state's economy.

The size of the tax rate may also influence economic behavior. A personal income tax certainly could influence a person's economic decisions by lowering take-home pay, thereby affecting spending and working decisions. The amount of a sales tax also can make a difference in spending decisions. For example, a person who normally buys goods locally may continue to do so at a low sales tax rate. However, a high tax rate may cause the person to purchase the same product on the Internet or by mail order. The Alaska economy would suffer because the expenditure is made out-of-state and the money would not circulate in the local economy.

A recent report in *State Tax Notes* addresses the issue of taxes vs. budget cuts. It was prepared by Peter Orszag, senior fellow in tax and fiscal policy at the Brookings Institution, and Joseph Stiglitz, Columbia University economics professor and winner of the 2001 Nobel Prize in economics.

The report said analysis suggests tax increases may be less harmful to the economy than spending reductions because some of the tax increase would result in reduced saving rather than reduced consumption. And since much of an individual's savings do not move around the state's economy (the multiplier effect) the same as wages or purchases, a reduction in savings would be less harmful than government budget cuts.

For example, if individual taxes increase by \$1, consumption may fall by 90 cents and savings may fall by 10 cents. Some types of government spending reductions, however, would reduce demand in the economy on a dollar-for-dollar basis, and therefore would be more harmful to the economy than a tax increase.

The report continued:

"For states interested in the impact only on their own economy rather than the national economy, the arguments made above are even stronger. In particular, the government spending that would be reduced if direct spending programs are cut is often concentrated among local businesses. ... By contrast, the spending by individuals and businesses that would be affected by tax increases often is less concentrated among local producers — since part of the decline in purchases that would occur if taxes were raised would be a decline in the purchase of goods produced out of state.

"In addition, higher-income families appear to consume relatively more goods and services produced in other regions of the country than lower-income families do. ... A tax increase concentrated on higher-income families thus is likely to have a smaller adverse impact on the state economy than other budget-balancing alternatives."

AK Dept of Revenue / Tax Division

To: Dan Dickinson
Larry Meyers
Chuck Harlamert
Carl Meyer

From: Mike Williams

Date: September 26, 2003

Re: Projected Revenue for potential Tax on Investment Income

The table below summarizes the potential revenue from an Alaska tax on investment income. Investment income under this scenario is taxable interest, dividends, and net capital gains as defined in the Internal Revenue Code.

Exemption amount Per person	Revenue per 1% pt tax rate	Estimated # of Returns
0	8,900,000	333,000
1000	5,500,000	100,000
1250	5,000,000	100,000
1500	4,750,000	55,000
2000	4,250,000	28,000

Tax Base: New Hampshire and Tennessee impose a tax on interest and dividends. Neither taxes capital gains. Tennessee's tax on interest income only applies to interest on bonds. New Hampshire taxes interest to the Constitutional limit, but exempts most interest from instate banks, credit unions, and municipal bonds. In Alaska, interest and dividends combined total about \$540 million per year from 1999 to 2001. Capital gains have fluctuated with the market: from \$665 million in 1999, to \$790 million in 2000, then plunging to \$342 million in 2001. Fluctuations in the market aside, any proposed Alaska tax on investment income would not generate much revenue without the capital gains component.

Exemptions: NH exempts the first \$2,400 (\$4,800 for married filing joint). TN exempts \$1,250 per person (\$2,500 for married filing joint). TN has additional exemptions for 65+ and the blind. Alaska's potential revenue base is limited, given its small population. However, IRS statistics show significant interest income (average per return) for returns with less than \$50,000. This may be attributed to some saving their PFD, as well as a large retirement population. For this reason, an exemption for anything less than \$1,000 per person does not produce a significant decrease in the number of returns the Department might receive; it only reduces revenue. At \$2,000 per person, the revenue base is mostly returns with gross income over \$100,000. Therefore, increasing the exemption beyond \$2,000 will only reduce revenue, without significantly reducing the number of returns filed.

Nexus / Source: NH & TN get around this by taxing resident income only. The Constitutional standard for intangible income is fuzzy at best. The State has a right to tax income derived from sources within Alaska, including distributions from Alaska corporations or interest secured by Alaska property. I have insufficient data to quantify administering and enforcing this right.

Other Issues: Any investment income tax proposal should also consider the following points.

- ANCSA §21 (Alaska Native Claims Settlement Act) prohibits the State from taxing any ANCSA distribution in direct settlement of a claim, i.e., capital gains from the sale of ANCSA property. However, the State may tax any income generated from the investment of ANCSA property.
- Cannot tax obligations of the U.S. government and income from non-resident members of the military.
- Both NH & TN exempt tax on income from regulated investment companies, unit investment trusts, and business trusts. May warrant further research into IRC regarding tax status of these entities.
- Distributions from S-Corporations and LLCs. Should the definition of investment income include distributions from these entities? The table above does not include revenue from this source. Both NH & TN tax S-Corp distributions, and distributions from any other entity with corporate characteristics.
- Estimated payments or withholding. Will we want to require estimated payments for tax above a certain threshold? Without some provision to pay or withhold, the money only comes in once a year (if at all).
- Filing requirements. If investment income is below the exemption amount, then no filing requirement. This holds true in both NH & TN. Otherwise, filing date is same as federal (April 15).

**Department of Revenue
Comparative Analysis HB 470
Alaska State Individual Income Tax Proposals**

	Child under age 14	Teenager with summer job	Single parent earning \$1+ hour	Single taxpayer - renting	Retiree with Soc. Sec. Income	Single income family - renting	Dual income family with \$150k mortgage	Dual income family with \$225k mortgage	Dual income family with \$300k mortgage	Dual income family with \$600k mortgage
Wages	50	2,700	22,880	65,000	32,500	65,000	130,000	260,000	520,000	
Interest Income		150		400		400	2,000	10,000	20,000	
Taxable Pension				5,000	10,000					
Gross Social Security				12,000						
AKPFD	1,100	1,100	1,100	1,100	1,100	2,200	2,200	2,200	2,200	2,200
children file separate to report PFD										
Dependents			1			2	2	2	2	2
Child Care Expenses			3,000			6,000	6,000	6,000	6,000	6,000
Real Estate Tax						3,100	4,650	6,200	12,400	
Mortgage Interest						11,500	17,250	23,000	46,000	
Charitable Contributions						1,000	3,000	10,000	25,000	
Federal Return Values										
Adjusted Gross Income	1,150	3,950	23,980	66,500	22,100	34,700	67,600	134,200	272,200	542,200
Taxable Income	400	1,250	10,880	58,700	13,350	13,000	39,800	97,100	220,800	446,600
Tax Before Credits	40	125	1,088	11,491	1,656	1,303	5,274	17,895	54,310	131,517
Tax After Credits	40	125	(1,721)	11,491	1,656	(697)	2,074	16,695	53,110	130,317
Alaska Income Tax										
If fed tax before fed credits	6	19	163	1,724	248	195	791	2,684	10,862	26,303
Property tax credit	-	-	-	-	-	-	791	2,684	6,200	12,400
AK tax net of AK credit	6	19	163	1,724	248	195	-	-	4,662	13,903
If fed tax after fed credits	6	19	-	1,724	248	-	311	2,504	10,622	26,063
Property tax credit	-	-	-	-	-	-	311	2,504	6,200	12,400
AK tax net of AK credit	6	19	-	1,724	248	-	-	-	4,422	13,663

Assumptions:

- 1) All family examples assume two children. Dual income family examples assume child care expense of \$3,000 per child.
- 2) All results are based on AKPFD and federal tax law and rates in effect for 2003.
- 3) Analysis does not include the effect of a federal itemized deduction for the Alaska tax.
- 4) Analysis does not phase out deductions or exemptions at top end, as amounts were immaterial to presentation.

Income Tax on Individuals and Fiduciaries

HB 470

February 23, 2004

Page of

Year 1

HB 470 INCOME TAX MODEL - INCOME TAX WITH PROPERTY TAX CREDIT

FY 2005 Revenue

\$132,486,849	Revenue before credits. From 2001 IRS data.
(\$790,799)	Less: Non-resident revenues
\$131,696,050	Tax before credits
68.00%	Home ownership % from US Census Bureau
\$89,553,314	Potential Tax on homeowners
(\$412,243,808)	Potential Property Tax Credit
\$0	Tax raised from Alaska homeowners
\$42,142,736	Tax raised from Alaska non-homeowners
(\$5,190,720)	Non-homeowner portion of credit for tax paid to other states
\$36,952,016	Tax raised from residents
\$790,799	Tax raised from nonresidents
\$790,799	Total tax raised from nonresidents.
\$37,742,815	TOTAL TAX RAISED AFTER CREDITS (Calendar year)
\$18,871,408	Assume tax takes effect Jan. 1, 2005 (half year of withholding)

Insufficient data to determine who paid personal property taxes.

Insufficient data to determine who paid taxes to other states. Credit tied to homeowner percentage. Homeowner credit for taxes paid to other states not included since property tax credit offsets any revenue from property owners.

Year 2

HB 470 INCOME TAX MODEL - INCOME TAX WITH PROPERTY TAX CREDIT

FY 2006 Revenue

\$239,507,547	Revenue before credits. From 2001 IRS data.
<u>(\$1,581,597)</u>	Less: Non-resident revenues
\$237,925,950	Tax before credits
68.00%	Home ownership % from US Census Bureau
<u>\$161,789,646</u>	Potential Tax on homeowners
<u>(\$412,243,808)</u>	Potential Property Tax Credit
\$0	Tax raised from Alaska homeowners
\$76,136,304	Tax raised from Alaska non-homeowners
<u>(\$5,190,720)</u>	Non-homeowner portion of credit for tax paid to other states
<u>\$70,945,584</u>	Tax raised from residents

<u>\$1,581,597</u>	Tax raised from nonresidents
<u>\$1,581,597</u>	Total tax raised from nonresidents.

<u>\$72,527,181</u>	TOTAL TAX RAISED AFTER CREDITS (Calendar year)
---------------------	--

<u>\$55,134,999</u>	1/2 year at 5%-10% rate and 1/2 year at 10%-15% rate
---------------------	--

Insufficient data to determine who paid personal property taxes.

Insufficient data to determine who paid taxes to other states. Credit tied to homeowner percentage. Homeowner credit for taxes paid to other states not included since property tax credit offsets any revenue from property owners.

Income Tax on Individuals and Fiduciaries

HB 470

February 23, 2004

Page of

Year 3

HB 470 INCOME TAX MODEL - INCOME TAX WITH PROPERTY TAX CREDIT

FY 2007 Revenue

\$346,528,245	Revenue before credits. From 2001 IRS data.
<u>(\$2,372,395)</u>	Less: Non-resident revenues
\$344,155,850	Tax before credits
68.00%	Home ownership % from US Census Bureau
<u>\$234,025,978</u>	Potential Tax on homeowners
<u>(\$412,243,808)</u>	Potential Property Tax Credit
\$0	Tax raised from Alaska homeowners
\$110,129,872	Tax raised from Alaska non-homeowners
<u>(\$5,190,720)</u>	Non-homeowner portion of credit for tax paid to other states
<u>\$104,939,152</u>	Tax raised from residents
<u>\$2,372,395</u>	Tax raised from nonresidents
<u>\$2,372,395</u>	Total tax raised from nonresidents.
<u>\$107,311,547</u>	TOTAL TAX RAISED AFTER CREDITS (Calendar year)
<u>\$89,919,364</u>	FY 2007 with 1/2 year at 10%-15% and 1/2 year at 15%-20%

Insufficient data to determine who paid personal property taxes.

Insufficient data to determine who paid taxes to other states. Credit tied to homeowner percentage. Homeowner credit for taxes paid to other states not included since property tax credit offsets any revenue from property owners.

IRS SOI Data (2001 Tax Yr)

% of Adjusted Gross Income

DRAFT

Target Revenue

Nonresident Business Inc. Tax Est.

Model Target Revenue

Rate on AGI below bracket amount

Bracket amount

AK Credit (Y or N)

Credit on Rts or Person.

\$	350,000,000
\$	-
\$	350,000,000
	none
\$	-
	n
	t

<<<Enter the revenue you expect from Non-resident business income

<<< none = flat

>>>> If 'Y' enter >>>>>

Individual AK credit \$ -

>>>> T for Person Based Credit

AGI range (000)	< \$20	\$20 < \$30	\$30 < 50	\$50 < 75	\$75 < 100	>= \$100	Total
Federal Tax Returns	134,676	39,926	57,399	46,166	26,653	28,241	333,061
Joint Returns Above	9,466	9,523	21,619	29,539	22,041	24,824	117,012
Taxpayers	144,142	49,449	79,018	75,705	48,694	53,065	450,073
# of Credits	144,142	49,449	79,018	75,705	48,694	53,065	450,073
Federal Adjusted Gross Income	913,599,000	991,767,000	2,254,111,000	2,840,734,000	2,298,259,000	4,865,891,000	14,164,361,000
Recon to AKDOL gross wages	5,854,284		21,995,015	1,463,420	12,487,449		41,800,168
Alaska Tax Base	919,453,284	991,767,000	2,276,106,015	2,842,197,420	2,310,746,449	4,865,891,000	14,206,161,168
Amount over Bracket		0	0	0	0	0	
Tax Generated (Base x Rate)	23,441,586	25,285,234	58,029,631	72,462,208	58,912,793	124,056,549	362,188,000
Credits	0	0	0	0	0	0	0
Credit: taxes pd to other states	(266,000)	(338,000)	(1,191,000)	(2,232,000)	(2,232,000)	(5,929,000)	(12,188,000)
Revenue (Tax - Credits)	23,175,586	24,947,234	56,838,631	70,230,208	56,680,793	118,127,549	350,000,000
Flat Rate	2.55%	2.55%	2.55%	2.55%	2.55%	2.55%	
Flat Rate		2.55%	2.55%	2.55%	2.55%	2.55%	
Average Effective AK Tax Rate	2.52%	2.52%	2.50%	2.47%	2.45%	2.43%	
% of revenue from group	6.62%	7.13%	16.24%	20.07%	16.19%	33.75%	

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

February 24, 2004

SUBJECT: S-Corporations, LLCs, and the Individual Income Tax (HB 470)

TO: Representative Carl Moses
Attn: Tim Benintendi

FROM: Kathryn Kurtz 
Legislative Counsel

You asked about the treatment of S corporations and limited liability companies (LLCs) under HB 470.

Corporate Income Taxes

An S corporation is a corporation that has elected to file federal returns under 26 U.S.C. 1361 - 1379 (Internal Revenue Code, Subtitle A, Chapter 1, Subchapter S). S corporations and some LLCs are required to file Alaska state corporate income tax returns.

According to the Department of Revenue's corporate income tax return instructions,

An S Corporation doing business in Alaska is required to file an Alaska return. . . . Alaska does not impose a tax on the S Corporation for pass-through items of income or loss. . . . Alaska imposes both the federal excess net passive income tax and the corporate level tax on built-in gains.

And:

An LLC doing business in the state must file an Alaska return consistent with its federal tax status. If the LLC is characterized as a corporation for federal income tax purposes, the LLC must file a return in accordance with the instructions applicable to corporations. An LLC with corporate member(s), that is characterized as a partnership for federal income tax purposes, must follow the instructions applicable to partnerships with corporate partners. An LLC taxable as a partnership, but which has no corporate members, is not required to file a return or report.

Form 04-611 Alaska Corporation Net Income Tax Return Instructions.

Representative Carl Moses
February 24, 2004
Page 2

So, some income received by S corporations may be subject to the corporate income tax, but much of it is simply passed through to shareholders. Similarly, income received by an LLC may be subject to the corporate income tax, depending on the federal tax status elected by the LLC. If the LLC elects to be taxed as a partnership, the income is simply passed through to the members.

Individual Income Taxes

HB 470 would impose an income tax based on a percentage of federal income tax liability. The income taxed would include income individuals and fiduciaries receive from subchapter S corporations and LLCs, including income that was not subject to the corporate income tax.

KLK:med
04-226.med

STATE INDIVIDUAL INCOME TAXES

(Tax rates for tax year 2003 - as of January 1, 2003)

State	---Tax Rates---		# of Brackets	--Income Brackets--		---Personal Exemption---			Federal Tax Ded.
	Low	High		Low	High	Single	Married	Child.	
ALABAMA	2.0	- 5.0	3	500	(b) - 3,000 (b)	1,500	3,000	300	*
ALASKA	No State Income Tax								
ARIZONA	2.87	- 5.04	5	10,000	(b) - 150,000 (b)	2,100	4,200	2,300	
ARKANSAS (a)	1.0	- 6.5 (e)	6	2,999	- 25,000	20	(c) 40	(c) 20 (c)	
CALIFORNIA (a)	1.0	- 9.3	6	5,834	(b) - 38,291 (b)	80	(c) 160	(c) 251 (c)	
COLORADO	4.63		1	-----Flat rate-----		-----None-----			
CONNECTICUT	3.0	- 4.5	2	10,000	(b) - 10,000 (b)	12,500	(f) 24,000 (f)	0	
DELAWARE	2.2	- 5.95	7	5,000	- 60,000	110	(c) 220	(c) 110 (c)	
FLORIDA	No State Income Tax								
GEORGIA	1.0	- 6.0	6	750	(g) - 7,000 (g)	2,700	5,400	2,700	
HAWAII	1.4	- 8.25	8	2,000	(b) - 40,000 (b)	1,040	2,080	1,040	
IDAHO	1.6	- 7.8	8	1,087	(h) - 21,730 (h)	3,000	(d) 6,000	(d) 3,000 (d)	
ILLINOIS	3.0		1	-----Flat rate-----		2,000	4,000	2,000	
INDIANA	3.4		1	-----Flat rate-----		1,000	2,000	1,000	
IOWA (a)	0.36	- 8.98	9	1,211	- 54,495	40	(c) 80	(c) 40 (c)	*
KANSAS	3.5	- 6.45	3	15,000	(b) - 30,000 (b)	2,250	4,500	2,250	
KENTUCKY	2.0	- 6.0	5	3,000	- 8,000	20	(c) 40	(c) 20 (c)	
LOUISIANA	2.0	- 6.0	3	10,000	(b) - 50,000 (b)	4,500	(i) 9,000	(i) 1,000 (i)	*
MAINE (a)	2.0	- 8.5	4	4,200	(b) - 16,700 (b)	4,700	7,850	1,000	
MARYLAND	2.0	- 4.75	4	1,000	- 3,000	2,400	4,800	2,400	
MASSACHUSETTS	5.3		1	-----Flat rate-----		3,300	6,600	1,000	
MICHIGAN (a)	4.0	(j)	1	-----Flat rate-----		3,000	6,000	3,000	
MINNESOTA (a)	5.35	- 7.85	3	18,710	(k) - 61,461 (k)	3,000	(d) 6,000	(d) 3,000 (d)	
MISSISSIPPI	3.0	- 5.0	3	5,000	- 10,000	6,000	12,000	1,500	
MISSOURI	1.5	- 6.0	10	1,000	- 9,000	2,100	4,200	2,100	* (s)
MONTANA (a)	2.0	- 11.0	10	2,200	- 75,400	1,720	3,440	1,720	*
NEBRASKA (a)	2.56	- 6.84	4	7,400	(l) - 26,500 (l)	94	(c) 188	(c) 94 (c)	
NEVADA	No State Income Tax								
NEW HAMPSHIRE	State Income Tax is Limited to Dividends and Interest Income Only.								
NEW JERSEY	1.4	- 6.37	6	20,000	(m) - 75,000 (m)	1,000	2,000	1,500	
NEW MEXICO	1.7	- 8.2	7	5,500	(n) - 65,000 (n)	3,000	(d) 6,000	(d) 3,000 (d)	
NEW YORK	4.0	- 6.85	5	8,000	(b) - 20,000 (b)	0	0	1,000	
NORTH CAROLINA									
(o)	6.0	- 8.25	4	12,750	(o) - 120,000 (o)	3,000	(d) 6,000	(d) 3,000 (d)	
NORTH DAKOTA	2.1	- 5.54 (p)	5	27,050	(p) - 297,350 (p)	3,000	(d) 6,000	(d) 3,000 (d) (p)	
OHIO (a)	0.743	- 7.5 (q)	9	5,000	- 200,000	1,200	(q) 2,400	(q) 1,200 (q)	
OKLAHOMA	0.5	- 7.0 (r)	8	1,000	- 10,000	1,000	2,000	1,000	* (r)
OREGON (a)	5.0	- 9.0	3	2,500	(b) - 6,250 (b)	145	(c) 290	(c) 145 (c)	* (s)
PENNSYLVANIA	2.8		1	-----Flat rate-----		-----None-----			
RHODE ISLAND	25.0% Federal tax liability (t)								
SOUTH CAROLINA									
(a)	2.5	- 7.0	6	2,400	- 12,000	3,000	(d) 6,000	(d) 3,000 (d)	
SOUTH DAKOTA	No State Income Tax								
TENNESSEE	State Income Tax is Limited to Dividends and Interest Income Only.								
TEXAS	No State Income Tax								
UTAH (a)	2.30	- 7.0	6	863	(b) - 4,313 (b)	2,250	(d) 4,500	(d) 2,250 (d)	* (u)
VERMONT	3.6	- 9.5	5	27,950	(v) - 307,050 (v)	3,000	(d) 6,000	(d) 3,000 (d)	
VIRGINIA	2.0	- 5.75	4	3,000	- 17,000	800	1,600	800	
WASHINGTON	No State Income Tax								
WEST VIRGINIA	3.0	- 6.5	5	10,000	- 60,000	2,000	4,000	2,000	
WISCONSIN	4.6	- 6.75 (w)	4	8,280	- 124,200	700	1,400	400	
WYOMING	No State Income Tax								
DIST. OF COLUMBIA	4.5	- 8.7 (x)	3	10,000	- 40,000	1,370	2,740	1,370	

Source: The Federation of Tax Administrators from various sources.

- (a) Eight states have statutory provision for automatic adjustment of tax brackets, personal exemption or standard deductions to the rate of inflation. Arkansas, Michigan, Nebraska and Ohio indexes the personal exemption amounts only.
- (b) For joint returns, the taxes are twice the tax imposed on half the income.
- (c) tax credits.
- (d) These states allow personal exemption or standard deductions as provided in the IRC. Utah allows a personal exemption equal to three-fourths the federal exemptions.
- (e) A special tax table is available for low income taxpayers reducing their tax payments.
- (f) Combined personal exemptions and standard deduction. An additional tax credit is allowed ranging from 75% to 0% based on state adjusted gross income. Exemption amounts are phased out for higher income taxpayers until they are eliminated for households earning over \$54,500.
- (g) The tax brackets reported are for single individuals. For married households filing separately, the same rates apply to income brackets ranging from \$500 to \$5,000; and the income brackets range from \$1,000 to \$10,000 for joint filers.
- (h) For joint returns, the tax is twice the tax imposed on half the income. A \$10 filing tax is charge for each return and a \$15 credit is allowed for each exemption.
- (i) Combined personal exemption and standard deduction.
- (j) Tax rate scheduled to decrease to 3.9% for tax years after 2003.
- (k) The tax brackets reported are for single individual. For married couples filing jointly, the same rates apply for income under \$27,350 to over \$108,661.
- (l) The tax brackets reported are for single individual. For married couples filing jointly, the same rates apply for income under \$4,000 to over \$46,750.
- (m) The tax brackets reported are for single individuals. For married couples filing jointly, the same rates apply for income under \$20,000 to over \$150,000.
- (n) The tax brackets reported are for single individuals. For married couples filing jointly, the same rates apply for income under \$8,000 to over \$100,000. Married households filing separately pay the tax imposed on half the income.
- (o) The tax brackets reported are for single individuals. For married taxpayers, the same rates apply to income brackets ranging from \$21,250 to \$200,000. Lower exemption amounts allowed for high income taxpayers. Tax rate scheduled to decrease after tax year 2003.
- (p) Rates reported are for short form filers. Long form filers rates range from 2.67% for income under \$3,000 to 12% over \$50,000. Long form filers only can deduct federal income taxes. An additional \$300 personal exemption is allowed for joint returns or unmarried head of households.
- (q) Plus an additional \$20 per exemption tax credit. Rate reported are for tax year 2002, the 2003 rates will not be determined until July, 2003.
- (r) The rate range reported is for single persons not deducting federal income tax. For married persons filing jointly, the same rates apply to income brackets ranging from \$2,000 to \$21,000. Separate schedules, with rates ranging from 0.5% to 10%, apply to taxpayers deducting federal income taxes.
- (s) Deduction is limited to \$10,000 for joint returns and \$5,000 for individuals in Missouri and to \$5,000 in Oregon.
- (t) Federal Tax Liability prior to the enactment of Economic Growth and Tax Relief Act of 2001.
- (u) One half of the federal income taxes are deductible.
- (v) The tax brackets reported are for single individuals. For married couples filing jointly, the same rates apply for income under \$46,700 to over \$307,050.
- (w) The tax brackets reported are for single individuals. For married taxpayers, the same rates apply to income brackets ranging from \$11,040 to \$165,600. An additional \$250 exemption is provided for each taxpayer or spouse age 65 or over.
- (x) Tax rate decreases are scheduled for tax years 2004.

From: "Patti Blattmachr" <djblatt@alaskatrust.com>
To: <paulr@alaska.net>
Sent: Wednesday, February 25, 2004 7:45 AM
Attach: header.htm
Subject: Taxation Memo.doc



MEMORANDUM

TO: To Whom it May Concern
FROM: Douglas Blattmachr
DATE: February 25, 2004
RE: Taxation of Trusts & Estates

It is imperative that if Alaska does implement a state income tax, that it exclude trusts and estates set-up by non-residents from an income tax. Alaska has, over the past six years, modified its trust laws to encourage individuals outside of Alaska to set up trusts in Alaska. Alaska Trust Company alone has set up approximately 1000 trusts from individuals outside Alaska. One of the important reasons non-residents are using Alaska is that Alaska does not impose an income tax on trust income. If Alaska were to impose an income tax on trust income, Alaska would lose all of the trusts that have been set up by non-residents. It must be understood other states such as Delaware, Utah and Nevada have similar laws as Alaska and do not impose an income tax on foreign trusts and therefore Alaska would lose these trusts.

This would have a significant economic impact to Alaska and would cause revenue loss more than any income tax would provide. Alaska Trust Company has nine full-time positions and will be expanding in the near future. It is making a profit, and therefore will be paying state corporate income tax. Alaska Trust Company currently has an excess of \$25,000,000 on deposit with local banking institutions. It has banking transactions in the \$100s of millions with local banks. We have had an excess of \$50,000,000 in deposits. In addition, because of Alaska's favorable trust laws, additional life insurance has been issued in Alaska, which has generated significant premium tax for the state of Alaska. Our estimates are that life insurance trusts and partnerships using Alaska Trust Company have generated, over \$2,000,000 of premium tax for the state of Alaska. Again, implementing an income tax on these entities would eliminate this additional revenue to the state of Alaska.

Non-resident clients and their advisors are using Alaska for a variety of different reasons. This has caused an increase in business for attorneys, CPAs, life insurance agents, and stockbrokers, etc. Obviously, expanding Alaska's financial service industry is a great diversification for Alaska's

2/25/04

economy. The imposition of an income tax on foreign trusts, etc. would eliminate, and I mean eliminate, receiving business from non-residents. This is such an important issue that New York state is in the process of eliminating its income tax on trusts because it is losing significant business to states that don't impose an income tax. It is important to realize that Alaska would not gain any tax revenue on taxing Foreign Trust & Estates because the Trust & Estates would transfer to another state such as Delaware, Utah, South Dakota, Nevada, etc., which do not tax non-resident Trust & Estates. The transfer of trusts to a different state is very easy.

Alaska has become the premium trust jurisdiction in the U.S. Let's keep it that way.



***Tax Reform in Alaska:
An AARP Survey of Residents Age 18+***

Highlights

- At least eight in ten people in Alaska believe that it is important the state maintain current levels of funding for education and human services and programs.
- A majority of Alaskans support the state finding ways to generate revenue for services, with those age 35 years and older more likely to strongly support these efforts.
- Half of all Alaskans think that the cost of human services and programs should be shared between the individual and the state government.
- Alaskans of all ages and income levels are equally likely to strongly oppose a state-wide sales tax, as well as strongly oppose this initiative because of the burden it may place on lower-income families.
- Half of all Alaskans support a state-wide income tax.
- A majority of Alaskans oppose ending the Alaska Permanent Fund Dividend checks even if it means increasing sales taxes or imposing a new state income tax. However, about one-third of all Alaskans may be very willing, and another quarter are somewhat willing, to accept a \$100 reduction in their checks as option to help maintain human services and balance the state budget.
- Half of all Alaskans strongly support increasing the cigarette tax and the beer and alcohol tax in order to avoid cuts in funding for education and human services.



February 17, 2004

To: The Honorable Frank Murkowski, Governor of Alaska
The Honorable Loren Leman, Lieutenant Governor of Alaska
Members of the Alaska Senate
Members of the Alaska House of Representatives

Elizabeth Lucas

From: Elizabeth Lucas, President
AARP Alaska
2880 Fritz Cove Road
Juneau, Alaska 99801
(907) 789-9655
cellpd@gci.net

Marguerite Stetson

Marguerite Stetson
AARP State Coordinator for Advocacy
3009 Northwood Street
Anchorage, Alaska 99517
(907) 245-5259
ffmas@aurora.uaf.edu

Subject: AARP Commissioned Survey on Tax Options

We are enclosing a copy of the results of a survey of Alaskans over age 18 to solicit their recommendations on how to resolve our fiscal gap and generate additional revenue for our State.

We recognize that you are receiving input from a variety of organizations and individuals. This survey is not representative of AARP members but we feel it is a representative sample of Alaskans over age 18, those who are most likely to be paying some form of taxes.

We hope you and your staff will be able to take a few minutes to review the results and add them to your deliberations about how to resolve our fiscal situation. Please be assured that AARP stands ready to assist you as you deal with this issue.

Should you have any questions about our position, please feel free to contact Marie Darlin, Coordinator of the AARP Capital City Task Force (907- 586-3637); Patrick Luby, AARP Legislative Representative (907-762-3314); or one of us.

CC: Marie Darlin
Patrick Luby

Dr. Carl S. Benson, PhD
1551 Farmers Loop
Fairbanks, Alaska 99709
10 December 2000

Senator Gary Wilken
1851 Fox Ave.
Fairbanks, Alaska 99701

Dear Gary,

Thanks for your letter of 28 November 2000, in which you asked for information on a long-range fiscal plan that makes sense. Here are my responses to your three questions:

1. What is your definition of a long-range fiscal plan?

A long-range fiscal plan provides renewable sources of funding for essential services of state government.

2. What is the ultimate goal(s) of a long-range fiscal plan?

The ultimate goal is to provide stability for both operating and capital budgets. It is not in the best interest of the state to have its funding of state functions tied to the price of a single commodity.

(a) Operating Budget:

Alaska's operating budget has been cut to dangerous levels. As I stated in my campaign: "If a foreign power had done to Alaska what our Legislative Leadership has done, we would consider it an act of war."

(b) Capital Budget:

Alaska's work force and contractors depend on stability in the state capital budget from year to year in order to maintain competence and quality. The state has many pressing needs and it has the labor available to deal with them. But when the amount of work to be done in a given year exceeds local capability, we bring in too many workers from outside. On the other hand in a lean year we let projects go unfunded, lay off local workers and, by deferring maintenance, cause costs to increase.

3. What components should be included in a long-range fiscal plan?

An essential component is to reinstate the state income tax. I realize that some Republicans are opposed to this in a "knee-jerk" way but I respectfully request that it be considered as a key ingredient in a long-range fiscal plan.

I have outlined an argument for reinstating the state income tax at a simple percentage of the federal tax, as it was before. Although Republican leaders have said *absolutely no* to reinstating our income tax, it cannot be removed from the table before we analyze the condition of the state's budget. Everything should be considered and the income tax could play an important part of the long-range plan which we obviously need.

The first step is to analyze the pros and cons of an income tax as opposed to a state sales tax.

A state-wide sales tax would be hardest on rural areas and poor people; costs are already higher in rural areas. Decisions on sales taxes should be left to local governments, along with property taxes. Some communities already have sales tax and the mix of sales tax and property tax is best left to local communities. This was essentially decided when the state-wide property tax was voted down. A state-wide sales tax will not be considered further here. At the state level an income tax is more appropriate for several reasons.

Let us consider the problem in more detail:

1. It was stated that it makes no sense for the legislature to send out a dividend and then take it back with the income tax. But this statement makes no sense; the amount of the dividend is far greater than the amount to be raised by a tax. Last year the Dividend was \$1,200 million and the expected tax revenue is estimated at about \$300 million, that is only one quarter of the Dividend. Also, an income tax would not come only from the unearned money of the Dividend alone but from all of the \$10 billion in wages and salaries earned in Alaska by residents and non-residents.

2. People for whom the Dividend means the most would pay the least in income tax, many would pay only a few hundred dollars.

3. People for whom the Dividend means the least would pay the most in income tax, but:

(a) their dividend would pay most or all of it, and

(b) what they pay would be deductible from their Federal income tax; this would keep more Alaskan money in Alaska, which is the state they say they love.

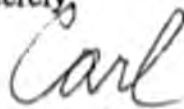
4. About ten percent of Alaska's \$10 billion in total wages and salaries is earned by non-residents (\$930 million in 1999). This money is taken out of Alaska by non-residents who make no contribution to paying for state services. An income tax on this would contribute about 30 million dollars to our state's general fund. Even in a wealthy state like Alaska this is significant.

5. The income tax would give us a base of about \$300 million from which to operate. If we matched it two-for-one with money from the earnings reserve account we would basically eliminate our "budget gap." This money would be from what some refer to the "surplus earnings," i.e., the annual earnings in excess of what is needed for dividends and inflation proofing. By tying it to the amount raised by the income tax we would put a limit on it which some people feel is important.

6. Finally, the income tax could help reinvigorate the concept of citizenship in Alaska. People have no stake in the state government now because they do not contribute to it. Instead, they wait for an annual check from the state and have begun to look on it as an entitlement. We are attracting people to move here because we have no taxes and we give away free money. Although the dividend program is unique in the United States, it can be enhanced by combining it with our income tax so that people can again say: "I am a citizen and a tax payer."

The income tax should be looked at and thought about. It needs more than a knee-jerk reaction. In 1948 Alaska set up the territorial income tax and became a proud Territory with resources available to serve its citizens. Before that, it was essentially at the control of outside interests, primarily fishing and mining run from New York and Seattle. Today another industry dominates Alaska and we need to exercise the same degree of independence now that we did in 1948. I will be glad to discuss this with you further.

Sincerely,



Dr. Carl S. Benson, PhD

THE
FOLLOWING
DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES

**Lake and Peninsula Borough**

P.O. Box 495
King Salmon, Alaska 99613

Telephone: (907) 246-3421

Fax: (907) 246-6602



February 16, 2001

Representative Carl Moses
State Capital Building
Room 500 / Mail Stop 3100
Juneau, AK. 99801-1182

SUBJECT: State Income Tax

Dear Carl:

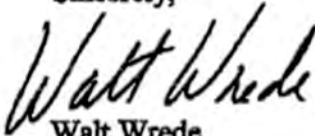
I am writing to let you know that the Lake and Peninsula Borough fully supports your efforts to institute a State Income Tax. The Borough Assembly considered this question at length during its regular meeting on January 16, 2001. At that time, the Assembly voted unanimously to endorse an income tax. It also instructed me to inform the Legislature, the Governor, and the general public of the position it has taken. Although the members expressed reservations about recommending new taxes, they all agreed that this step was necessary to insure long term social and economic stability.

The Assembly voted to support an income tax for a number of reasons which include:

1. It believes that a long range fiscal plan for the State would be prudent and urges the Legislature and the Administration to work together to adopt one. The reality is that revenue enhancement and diversification must be part of this plan. Long term financial stability is necessary if we are going to insure that that our economy continues to grow and that our residents receive the basic public services necessary for the quality of life they deserve. Our Assembly members were born and raised in Alaska and they intend to stay here. They care deeply about how our schools, public facilities, infrastructure, and economy will look 20 years from now.
2. An income tax is preferable to a general sales tax because it is less regressive and it does not impinge upon the traditional taxing authority of municipalities.
3. An income tax is the best vehicle to enable workers that are employed here but reside outside to make a contribution to infrastructure and basic public services in Alaska.
4. An income tax could be structured so that taxes paid can be deducted from one's Federal income tax obligation. This would insure that the new tax has a minimal impact upon Alaskans.

In closing, the Borough appreciates your efforts the past few years to institute a State Income Tax. We recognize that this has been a lonely effort and that the environment in Juneau has not been conducive to reasonable debate and forward thinking. However, we believe you should be commended for the leadership you have shown and for having the courage to "get out in front" on this politically difficult issue. Please let us know if there is anything the Borough can do to assist you in this effort.

Sincerely,



Walt Wrede
Borough Manager

c.

Governor Tony Knowles
House and Senate Finance Committees