

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

3075 SCOMM 14.2: HOUSE SPECIAL COMMITTEE ON WAYS & MEANS 2005-2006

TABLE 1
ESTIMATED STATE TAXES PAID BY INDIVIDUAL ALASKANS: FY 72 - FY 86

TAX CATEGORY	FY 72	FY 76	FY 78	FY 80	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
TAXES PAID BY INDIVIDUALS FILING STATE TAX RETURNS										
Individual Income Tax*										
Total Receipts (000's)	\$39,076.3	\$146,202.1	\$145,749.1	\$100,479.0	\$7,237.9	\$1,493.0	\$0.0	\$0.0	\$0.0	\$0.0
Estimated No. of Taxpayers**	149,150	263,700	240,140	255,590	na	na	0	0	0	0
Average Taxpayer Share	\$262	554	607	393	na	na	0	0	0	0
School Tax*										
Total Receipts (000's)	1,491.5	2,637.0	2,401.4	2,555.9	970.1	1.6	0.0	0.0	0.0	0.0
Estimated No. of Taxpayers	149,150	263,700	240,140	255,590	na	na	0	0	0	0
Average Taxpayer Share	10	10	10	10	na	na	0	0	0	0
Estate Tax***										
Total Receipt (000's)	39.3	158.1	244.1	197.6	453.5	334.7	700.0	700.0	500.0	700.0
Estimated No. of Taxpayers	149,150	263,700	240,140	255,590	na	na	na	na	na	na
Average Taxpayer Share	0	1	1	1	na	na	na	na	na	na
TAXES PAID BY ALL ADULT ALASKANS										
Tax on Alcoholic Beverages										
Total Receipt (000's)	4,837.8	7,841.7	7,572.0	7,365.9	8,326.4	8,977.9	10,400.0	14,042.4	13,808.2	13,161.7
Estimated Adult Population	222,750	289,110	295,660	306,520	317,396	339,917	362,759	380,400	393,558	397,477
Average Adult Share	22	27	26	24	26	26	29	37	35	33
Tax on Motor Fuels										
Total Receipt (000's)	11,401.9	24,403.5	23,293.2	26,174.9	23,224.7	31,273.1	36,700.0	32,300.0	36,000.0	36,100.0
Estimated Adult Population	222,750	289,110	295,660	306,520	317,396	339,917	362,759	380,400	393,558	397,477
Average Adult Share	51	84	79	85	73	89	101	85	91	91
Tax on Cigarettes****										
Total Receipt (000's)	3,224.5	4,617.3	4,627.2	4,282.5	4,539.4	4,908.1	5,300.0	5,400.0	5,200.0	7,700.0
Estimated Adult Population	222,750	289,110	295,660	306,520	317,396	339,917	362,759	380,400	393,558	397,477
Average Adult Share	14	16	16	14	14	14	15	14	13	19
TOTAL AVERAGE TAX BURDEN OF ADULT ALASKAN TAXPAYERS*****										
Nominal Dollars	\$359	\$692	\$739	\$527	\$113+	\$129+	\$145+	\$136+	\$139+	\$143+
Real (1986) Dollars	\$894	\$1,218	\$1,138	\$664	\$132+	\$143+	\$158+	\$143+	\$142+	\$143+

NOTES:

- * The individual income tax and school tax were repealed in 1980--effective for calendar year 1980 taxes. Therefore, income and school tax receipts beginning in FY 81 were sharply lower and represent solely payments of back taxes.
 - ** The number of taxpayers is estimated from the school tax receipts @ \$10 per taxpayer since the actual number of taxpayers is not readily available from the Alaska Department of Revenue.
 - *** Without an estimate of the number of taxpayers, we are unable to estimate the estate taxes paid per taxpayer beginning in FY 81.
 - **** The cigarette tax receipts represent the total tax receipts--which are deposited both into the General Fund and a special fund distributed to school districts.
 - ***** A "+" follows the average tax burden figure beginning in FY 81 to indicate that taxes would be slightly higher if we had been able to allocate estate tax receipts on a per taxpayer basis.
- The adult population is based on the Alaska Department of Labor's estimates of Alaskans 15 years and older.



ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES
RESEARCH AGENCY

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Juneau, Alaska 99811
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MEMORANDUM

September 20, 1980

TO: Representative Terry Gardiner
FROM: Jack Kreinheder and Anne DeVries
Research Staff
RE: *State* Income Tax Data
Research Request No. 166

You have asked that we provide the following information regarding State income taxes: (1) total individual income taxes collected for the past several years; (2) the percentage of Alaska's population who paid income taxes; (3) the distribution of taxes paid; and (4) the percentage of Alaska residents who paid taxes in the past several years who are still residents. Before discussing the information we compiled, we should mention the information that was not available.

The Department of Revenue has accurate income tax data only for the tax years 1977 and 1978. 1979 data will not be available until the end of 1980 and the only pre-1977 information available is an estimate for total tax collections in 1976. All tax collection information for earlier years is on a calendar year basis and is not comparable to the later tax year data. Finally, no State agency has compiled the outmigration data required to answer the fourth question stated above; the only outmigration data available for Alaska is from the 1970 census and is too old to be useful.

Despite this lack of data, we were able to compile information for 1977 and 1978 which should be useful. The following table shows the income taxes paid by residents and non-residents in 1977 and 1978, with a total figure for the two groups for 1976. The non-resident figures include part-year residents.

Individual Income Taxes Paid

By

Residents and Non-Residents, 1976 - 1978

	<u>Residents</u>	<u>% of Total</u>	<u>Non-Residents</u>	<u>% of Total</u>	<u>Total</u>
1976	N.A.		N.A.		\$115,000,000
1977	\$113,673,977	83.9%	\$21,808,647	16.1%	\$135,482,624
1978	\$ 94,988,869	89.0%	\$11,730,657	11.0%	\$106,719,525

The table shows that non-residents paid over 16 percent of all income taxes in 1977, but only 11 percent in 1978. This decrease is probably due in part to the completion of the trans-Alaska pipeline in mid-1977. The total income taxes collected for both residents and non-residents also declined from 1977 to 1978. Much of this decrease was the result of the Individual Income Tax Credit introduced in 1978. The credit accounted for an estimated reduction of over \$20 million in taxes collected in 1978.

The percentage of Alaska's population that paid income taxes in 1977 and 1978 appears to be slightly less than half. In 1978, 215,374 persons filed resident tax returns, out of a total state population of 408,000 people, meaning that about 53 percent of the population filed returns. Not all of the persons filing returns paid taxes, however. Roughly 30,000 people who filed returns owed little or no income tax, so that the percentage of the population who actually paid income taxes in 1978 is about 45 percent. The percentage for 1977 is nearly identical. It should be noted that the figures for both years may be slightly high, because it is not possible to determine the number of married persons filing joint returns who paid no tax. About 70,000 joint returns were filed in each of the two years.

Although no data is available for 1979, it is reasonable to assume that the percentage of the population who paid taxes in 1979 is similar to that of 1977 and 1978.

Representative Terry Gardiner
September 20, 1980
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The attached table shows the percentage distribution of income taxes in 1977 and 1978, thereby illustrating how the benefits of refunding taxes for past years would be spread among taxpayers. For example, by comparing the cumulative percentage of taxpayers in 1978 with the cumulative percentage of taxes paid, one can see that 16.9 percent of the taxpayers paid 49.6 percent of the income taxes collected that year.

In round numbers, over one-half of the 1978 taxes collected were paid by about one-sixth of the state's taxpayers. Continuing down the columns, it can be seen that over two-thirds (69.8%) of the 1978 taxes were paid by less than one-third (30.8%) of the taxpayers. Thus, if all 1978 income taxes were refunded, two-thirds of the refund would go to less than one-third of the taxpayers. Similar comparisons can be made for other tax distributions and for the 1977 figures.

These distributions can also be converted to reflect the percentage of the total population, rather than taxpayers, which would receive a given percentage of the tax refund. The percentages of the population are in parentheses next to the cumulative percentages of taxpayers. In terms of the example stated above, the 30.8 percent of the taxpayers who paid two-thirds of the income taxes collected in 1978 represent about 16 percent of Alaska's population.

If you would like further explanation of this information or if you have other questions, please do not hesitate to contact us.

JK:AHD:bf

PERCENTAGE DISTRIBUTION OF TAXES PAID

1978

Adjusted Gross Income	Number of Taxpayers*	Percentage of Taxpayers	Cumulative Percentage of Taxpayers	Percentage of Population	Cumulative Percentage of Population	Percentage of Taxes Paid	Cumulative Percentage of Taxes Paid
Over \$100,000	911	0.4	0.4	0.2	0.2	5.2	5.2
\$60,001 - \$100,000	6,438	3.0	3.4	1.6	1.8	13.0	18.2
\$50,001 - \$ 60,000	9,190	4.3	7.7	2.3	4.1	12.2	30.4
\$45,001 - \$ 50,000	8,320	3.8	11.5	2.0	6.1	8.9	39.3
(,001 - \$ 45,000	11,479	5.4	16.9	2.8	8.9	10.3	49.6
\$35,001 - \$ 40,000	14,094	6.5	23.4	3.5	12.4	10.5	60.1
\$30,001 - \$ 35,000	16,010	7.4	30.8	3.9	16.3	9.7	69.8
\$25,001 - \$ 30,000	17,219	8.0	38.8	4.2	20.5	8.6	78.4
\$20,001 - \$ 25,000	18,353	8.5	47.3	4.5	25.0	7.3	85.7
\$15,001 - \$ 20,000	20,255	9.4	56.7	4.9	29.9	5.4	91.1
\$10,001 - \$ 15,000	23,924	11.2	67.9	5.9	35.8	3.2	94.3
\$ 5,001 - \$ 10,000	26,375	12.2	80.1	6.5	42.3	0.7	95.0
\$ 1 - \$ 5,000	32,382	15.0	95.1	7.9	50.2	-	95.0
(-0-	<u>10,424</u>	<u>4.9</u>	100.0	<u>2.6</u>	52.8	<u>5.0</u>	100.0
	215,374	100.0		52.8		100.0	

*Adjusted for married couples filing jointly.

Source: Individual Income Tax Paid in 1977 and 1978 by Residents and Non-Residents, April 1980
Individual Income Tax Paid by Residents in 1977 and 1978 by Filing Status, June 1980

Alaska Department of Revenue

HOUSE RESEARCH AGENCY

(9/18/80)

PERCENTAGE DISTRIBUTION OF TAXES PAID

1977

Adjusted Gross Income	Number of Taxpayers*	Percentage of Taxpayers	Cumulative Percentage of Taxpayers	Percentage of Population	Cumulative Percentage of Population	Percentage of Taxes Paid	Cumulative Percentage of Taxes Paid
Over \$100,000	1,148	0.5	0.5	0.3	0.3	5.5	5.5
\$60,001 - \$100,000	6,333	3.0	3.5	1.6	1.9	11.5	17.0
\$50,001 - \$ 60,000	9,104	4.2	7.7	2.2	4.1	11.2	28.2
\$45,001 - \$ 50,000	8,157	3.8	11.5	2.0	6.1	8.1	36.3
\$40,001 - \$ 45,000	11,651	5.4	16.9	2.9	9.0	9.9	46.2
\$35,001 - \$ 40,000	15,058	7.0	23.9	3.8	12.8	11.0	57.2
\$30,001 - \$ 35,000	17,676	8.2	32.1	4.4	17.2	10.6	67.8
\$25,001 - \$ 30,000	19,037	8.9	41.0	4.8	22.0	9.6	77.4
\$20,001 - \$ 25,000	19,808	9.2	50.2	4.8	26.8	8.3	85.7
\$15,001 - \$ 20,000	20,310	9.5	59.7	5.1	31.9	6.4	92.1
\$10,001 - \$ 15,000	23,597	11.0	70.7	5.9	37.8	4.3	96.4
\$ 5,001 - \$ 10,000	26,077	12.2	82.9	6.5	44.3	1.9	98.3
\$ 1 - \$ 5,000	31,641	14.7	97.6	7.9	52.2	0.2	98.5
-0-	<u>5,157</u>	<u>2.4</u>	100.0	<u>1.3</u>	53.5	<u>1.5</u>	100.0
	219,754	100.0		53.5		100.0	

*Adjusted for married couples filing jointly.

Source: Individual Income Tax Paid in 1977 and 1978 by Residents and non-Residents, April 1980
Individual Income Tax Paid by Residents in 1977 and 1978 by Filing Status, June 1980

Alaska Department of Revenue

HOUSE RESEARCH AGENCY

(9/18/80)

FALL 2002

REVENUE SOURCES BOOK

Forecast & Historical Data



Tax Division

Tony Knowles, Governor
Wilson L. Condon, Commissioner
Dan E. Dickinson, Director
Charles Logsdon, Chief Petroleum Economist

Personal Income Tax

Of the 50 states, 43 have a personal income tax. Joining Alaska on the list 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.

There are three options for the tax base for calculating a personal income tax:

- **Adjusted gross income.** Because the tax base would be the highest of the three options, the tax rate would be the lowest. Adjusted gross income is Line 33 on the federal personal income tax Form 1040, which is an individual's gross income from all sources minus: IRA contributions, student loan interest, Medical Savings Account contributions, moving expenses, one-half of the self-employment tax paid by self-employed individuals, the self-employed health insurance deduction and alimony.
- **Federal taxable income.** This is Line 39 on Form 1040, which is adjusted gross income minus either the standard deduction or all of the itemized deductions allowed under federal law, plus the per-person exemptions allowed under the federal tax code. 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 is what an individual pays the IRS. Because the tax base would be the lowest of the three options, the actual tax rate would be higher than if the rate were applied to gross income or taxable income. For example, a 1.87% tax on gross income, a 2.54% tax on taxable income, or a 12.66% tax on federal tax liability would all raise the same amount for the state — about \$250 million a year. Using Federal Tax Liability as the base would require the state to accept whatever deductions and credits are allowed under federal law. Federal tax liability is Line 40 on Form 1040 (before several credits under the IRS code), or Line 52 (after Education Tax Credits and Elderly and Disabled Care Credits and others), or Line 52 plus the Earned Income Credit and Additional Child Tax Credit.

These are approximate numbers for tax rates and how much revenue would be raised by a state personal income tax in Alaska. The table assumes a flat tax for the sake of simplicity in showing potential revenues.

Table 13. Income Tax Rates and Income Tax Projections (2000 IRS Data)

\$ Million Revenue	% Adjusted Gross Income	% Federal Taxable Income	% Net Federal Tax Liability
\$250	1.87	2.54	12.66
\$300	2.22	3.03	15.08
\$350	2.58	3.51	17.49
\$400	2.93	4.00	19.91

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. If the tax brackets were adjusted for inflation, that number would be \$660 million.

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. The IRS 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 \$350 million would collect perhaps \$21 million to \$22 million a year from non-residents.

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.

Statewide Sales Tax

The only states in the nation without a statewide sales tax are Alaska, Delaware, Montana, New Hampshire and Oregon. The others collect taxes that range from a low of 2.9% in Colorado to 7% in Mississippi and Rhode Island. In most states, the cities, counties, transit districts and other taxing authorities add their sales tax onto the state tax rate, with the states handling collection and enforcement, then disbursing the funds to the municipal agencies. Because of the cumulative effect of adding local sales taxes to the state tax, many states set a maximum overall rate. The highest total rates approach 10%.

Most states exempt all or some food purchases from sales taxes, with a few states charging a lower tax rate on foods. All states exempt prescription medicines from sales tax. Of those states with a general statewide sales tax, the tax provides an average 32.3% of overall state general fund revenues.

Although there is no statewide sales tax in Alaska, about one-third of Alaskans live in a community — a city or a borough — with a municipal sales tax. The rates for those 200,000-plus Alaskans range from:

- A low of 1% in Tenakee and White Mountain.
- To a high of 7% in Wrangell and 6% in Petersburg, Cordova, Kodiak and Kotzebue.

The 100 cities and boroughs with a sales tax collected about \$125 million in Fiscal Year 2001, for an average of more than \$600 per capita. Each municipality has its own list of tax exemptions, limits and rules, such as a cap on the maximum amount of a single purchase subject to a sales tax (to ease the burden on purchasers of big-ticket items such as cars). There is no uniformity across the state.

If Alaska had a statewide sales tax, the Department of Revenue estimates the state would collect approximately:

- \$110 million a year for every 1% in a statewide sales tax on retail goods and services sold in Alaska, assuming no exemptions.
- \$75 million a year if foods and medical goods and services were exempted.

The New York Times

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March 4, 2005

Fed's Chief Gives Consumption Tax Cautious Backing

By EDMUND L. ANDREWS

WASHINGTON, March 3 - Alan Greenspan, the Federal Reserve chairman, cautiously endorsed a shift in the nation's tax system on Thursday from one that primarily taxes what people earn to one that taxes what they spend.

Testifying before a presidential advisory panel on overhauling the tax code, Mr. Greenspan steered away from sweeping plans to replace the income tax with a national sales tax.

But he supported what many of President Bush's advisers see as a backdoor version of a consumption tax: expanding the role of tax-free savings accounts so that people could shield their income from taxes until they actually spend it.

"Many economists believe that a consumption tax would be best from the perspective of promoting economic growth - particularly if one were designing a system from scratch - because a consumption tax is likely to favor saving and capital formation," Mr. Greenspan said.

But the Fed chairman warned that shifting to a new system would raise difficult "transition issues," and he cautioned against "going for purity" in any kind of tax overhaul.

President Bush, struggling to sell a reluctant Congress on his ideas for partly privatizing Social Security, said he would wait to see what the panel proposes at the end of July.

"I've told the American people I want to work to simplify the tax code to make it easier to understand so that people are spending less time filing paper," Mr. Bush said Thursday afternoon. "I'm looking forward to what the commission has to say."

But many lawmakers in his own party would like to combine Mr. Bush's goals for Social Security with his goal of transforming the tax code. Republican analysts say the two efforts could dovetail in Congress around the idea of private retirement accounts.

The centerpiece of Mr. Bush's Social Security plan is to let people divert part of their payroll taxes to individual investment accounts. Similarly, the kind of "consumed income tax" implied by Mr. Greenspan would be based on a major expansion of tax-free savings accounts like Individual Retirement Accounts. People could put in as much money as they wanted, withdraw it any time and not pay any tax on the investment.

Supporters say that kind of a system might resemble a traditional income tax. But by letting people shield savings and investment income, supporters say, the system could in practice leave only a tax on consumption.

The president's advisory panel, which is bipartisan, is to develop at least one recommendation that alters the basic structure of today's income tax, though the expectation is it will produce more than one proposal. Its recommendations are to be submitted by July 31 to the Treasury Department, which will then devise its own recommendation and present it to Mr. Bush.

Mr. Bush has refused to endorse a particular approach to tax overhaul, but White House officials have made it clear they favor some sort of consumption tax.

The Economic Report of the President, published last month, argued that consumption taxes could increase personal savings by as much as 43 percent in the first year and ultimately lead to higher output and higher wages.

"By removing the tax on the return to savings and investment, a consumption tax would increase savings and investment," the report contended. "With a larger stock of capital, workers would be more productive and output and wages would rise."

Representative Bill Thomas, the California Republican who is chairman of the Ways and Means Committee, has argued since early January that tax overhaul and Social Security should be part of the same agenda. John B. Breaux, the former Democratic senator from Louisiana who is co-chairman of the advisory panel, said recently that he saw merit in combining the issues as well.

"I just think they want to deal with these simultaneously," said Bruce Bartlett, a senior fellow at the National Center for Policy Analysis, a conservative research group. "It opens up a lot of options for them to put together a package. That's what I've been hearing for weeks. The problem is the president - he doesn't want to do it."

In contrast to the partisan divide over Social Security, where Congressional Democrats are almost uniformly opposed to Mr. Bush's plans, the issue of tax overhaul has attracted some Democrats.

Representative Steny H. Hoyer of Maryland, the House Democratic whip, vowed on Thursday to "make progress" on tax overhaul this year and echoed Mr. Bush's rhetoric about the need to make the system "simpler" and "fairer."

But Mr. Hoyer and many other Democrats say they oppose any form of a consumption tax, contending that it would primarily benefit the wealthy, who would escape taxes on investment income.

Some Democrats are also furious with Mr. Greenspan, who they say contributed to the record budget deficits incurred under President Bush by condoning the tax cuts he pushed.

"I'm not a big Greenspan fan," said Senator Harry Reid of Nevada, the Senate Democratic leader, in an interview with CNN on Thursday. "I think he's one of the biggest political hacks we have in Washington."

Mr. Greenspan tried to avoid specific recommendations about taxes, but told the panel that a consumption tax could raise savings and still place more of the tax burden on higher-income households.

A report by the Treasury Department in 2002, though, concluded that almost any form of consumption tax or flat tax would shift some taxes from upper-income to middle-income households.

Mr. Bush also faces a potential contradiction between his own goals. In initiating the advisory panel, Mr. Bush insisted that any new system would have to protect tax breaks for homeowners, the biggest of which is the deduction for mortgage interest.

But William Gale, a senior fellow at the Brookings Institution, a Democratic-leaning research group, said that the mortgage-interest deduction would allow rampant tax avoidance in a system where people did not have to pay taxes on their savings.

"If interest income isn't being taxed and interest payments are deductible, you and I could just lend each other \$1 million," Mr. Gale said. "Neither of us could be taxed on our income, and both of us could deduct the interest payments."

James A. Baker III, who was treasury secretary when President Ronald Reagan pushed through a tax overhaul in 1986, warned the panel of the political minefields.

Mr. Baker noted that the Reagan administration originally proposed a sharp limit on the mortgage-interest deduction to reduce tax rates as much as possible.

But that provoked a storm of protest from the real estate, construction and home-finance industries. Only by capitulating, Mr. Baker said, was it possible to pass a bill that sharply lowered tax rates and eliminated scores of special tax breaks.

"This is a political exercise as much as it is an economic exercise," Mr. Baker noted. "A basic recognition of political reality will help you shape recommendations that can survive the legislative process."

HOUSE BILL NO. 470

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - SECOND SESSION

BY REPRESENTATIVE MOSES

Introduced: 2/16/04

Referred: House Special Committee on Ways and Means, Finance

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the taxation of income."

2 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

3 * Section 1. AS 43.20.011 is amended by adding new subsections to read:

4 (g) For each taxable year or fractional part of a taxable year after
5 December 31, 2004, there is imposed a tax upon the taxable income of every resident,
6 nonresident, and part-year resident individual and fiduciary of the state. The tax
7 imposed by this subsection is determined as a percentage of the taxpayer's entire
8 federal income tax liability, except that the tax on a nonresident or part-year resident
9 individual or fiduciary is the tax determined as a percentage of the taxpayer's entire
10 federal income tax liability multiplied by a fraction the numerator of which is the
11 taxpayer's taxable income from sources in the state and the denominator of which is
12 the taxpayer's taxable income from all sources. The tax is determined as follows:

13 (1) for the taxable year after December 31, 2004, and through
14 December 31, 2005,
15 if the taxpayer's entire federal then the tax, as a percentage

income tax liability is: of the taxpayer's entire federal
income tax liability, is:

not more than \$20,000	5 percent
over \$20,000	10 percent;

(2) for the taxable year after December 31, 2005, and through
December 31, 2006,

if the taxpayer's entire federal	then the tax, as a percentage
income tax liability is:	of the taxpayer's entire federal
	income tax liability, is:
not more than \$20,000	10 percent
over \$20,000	15 percent; and

(3) for each taxable year beginning after December 31, 2006,

if the taxpayer's entire federal	then the tax, as a percentage
income tax liability is:	of the taxpayer's entire federal
	income tax liability, is:
not more than \$20,000	15 percent
over \$20,000	20 percent.

(h) An individual shall determine the tax under (g) of this section using the
same filing status as used on the individual's federal return.

* Sec. 2. AS 43.20.030(a) is amended to read:

(a) An individual, fiduciary, [IF A] corporation, or [A] partnership that has a
corporation as a partner, that is subject to the tax imposed in AS 43.20.011 and is
required to make a return under the provisions of 26 U.S.C. ([THE] Internal Revenue
Code), [IT] shall file with the department [, WITHIN 30 DAYS AFTER THE
FEDERAL RETURN IS REQUIRED TO BE FILED,] a return setting out

(1) the amount of tax due under this chapter, less allowable credits
and payments claimed against the tax; and

(2) other information for the purpose of carrying out the provisions of
this chapter that the department requires.

* Sec. 3. AS 43.20.030(c) is amended to read:

(c) The [NOTWITHSTANDING (a) OF THIS SECTION, THE] total amount

1 of tax imposed by this chapter is due and payable to the department at the same time
 2 and in the same manner as the tax payable to the United States Internal Revenue
 3 Service.

4 * Sec. 4. AS 43.20.030(d) is amended to read:

5 (d) A taxpayer [, UPON REQUEST BY THE DEPARTMENT,] shall file
 6 with the return [FURNISH TO THE DEPARTMENT] a [TRUE AND] correct copy
 7 of the taxpayer's tax return [WHICH THE TAXPAYER HAS] filed with the United
 8 States Internal Revenue Service for the taxable year. Every taxpayer shall file an
 9 amended return with the department and remit any additional tax and interest
 10 due [NOTIFY THE DEPARTMENT IN WRITING OF ANY ALTERATION IN, OR
 11 MODIFICATION OF, THE TAXPAYER'S FEDERAL INCOME TAX RETURN
 12 AND OF A RECOMPUTATION OF TAX OR DETERMINATION OF
 13 DEFICIENCY, WHETHER WITH OR WITHOUT ASSESSMENT. A FULL
 14 STATEMENT OF THE FACTS MUST ACCOMPANY THIS NOTICE. THE
 15 NOTICE SHALL BE FILED] within 60 days after the final determination of the
 16 taxpayer's federal tax liability [MODIFICATION, RECOMPUTATION OR
 17 DEFICIENCY, AND THE TAXPAYER SHALL PAY THE ADDITIONAL TAX OR
 18 PENALTY UNDER THIS CHAPTER]. For purposes of this section, a final
 19 determination means [SHALL MEAN] the time that an amended federal return is
 20 filed or the date a federal [A NOTICE OF DEFICIENCY OR AN] assessment is
 21 made [MAILED TO THE TAXPAYER BY THE INTERNAL REVENUE
 22 SERVICE, EXCEPT THAT IN NO EVENT WILL THERE BE A FINAL
 23 DETERMINATION FOR PURPOSES OF THIS SECTION UNTIL THE
 24 TAXPAYER HAS EXHAUSTED RIGHTS OF APPEAL UNDER FEDERAL
 25 LAW].

26 * Sec. 5. AS 43.20 is amended by adding a new section to read:

27 **Sec. 43.20.032. Tax calculation for nonresidents and part-year residents**
 28 **and fiduciaries.** (a) In computing the tax under AS 43.20.011(g) of a nonresident or
 29 a part-year resident individual, or a fiduciary, the part of the taxpayer's taxable income
 30 attributable to sources in the state is determined under AS 43.20.040.

31 (b) In computing the taxpayer's taxable income attributable to sources in the

1 state for a nonresident or a part-year resident individual, or a fiduciary, deductions and
 2 adjustments are allowed only to the extent that they are connected with income that
 3 arises from sources in the state or property having a situs for taxation in the state.

4 * Sec. 6. AS 43.20.040(b) is amended to read:

5 (b) In this section, income is from a source having a taxable or business situs
 6 in the state if it is derived from

7 (1) owning or operating business facilities or property in the state;

8 (2) conducting business, farming, or fishing operations in the state;

9 (3) [REPEALED]

10 (4)] a partnership that [WHICH] transacts business in the state;

11 (4) [(5)] a corporation that [WHICH] transacts business in the state

12 and that [WHICH] has elected to file federal returns under 26 U.S.C. 1361 - 1379

13 (Subtitle A, Ch. 1S, Internal Revenue Code) [SUBCHAPTER S OF THE

14 INTERNAL REVENUE CODE];

15 (5) [(6) REPEALED

16 (7)] engaging in any other activity from which income is received,
 17 realized, or derived in the state;

18 (6) working for salary or wages in the state;

19 (7) an estate or trust deriving income from sources in the state.

20 * Sec. 7. AS 43.20.040 is amended by adding a new subsection to read:

21 (d) With regard to the tax under AS 43.20.011(g), if a business, trade, or
 22 profession, other than the rendering of purely personal services, is carried on partly
 23 inside and partly outside the state, the income from sources in the state is determined
 24 under AS 43.19 (Multistate Tax Compact).

25 * Sec. 8. AS 43.20 is amended by adding a new section to read:

26 **Sec. 43.20.062. Credits against tax.** (a) The amounts deducted and withheld
 27 as taxes under this chapter during a calendar year are allowed as credits to the taxpayer
 28 against the tax imposed by this chapter.

29 (b) A resident or part-year resident is allowed as a credit against the tax
 30 otherwise due under this chapter the amount of income tax imposed on the taxpayer
 31 for the taxable year by another state or territory of the United States on income derived

1 from sources in the other state or territory that is also subject to tax under this chapter.
 2 However, the credit allowed in this subsection is limited to that proportion of the tax
 3 computed under this chapter that the taxable income from the other state or territory
 4 bears to total taxable income, and the credit may not exceed the actual tax paid to the
 5 other state or territory.

6 (c) An individual or fiduciary is allowed as a credit against the tax otherwise
 7 due under this chapter the amount of any real and personal property taxes paid by the
 8 individual or the fiduciary to a municipality in this state under AS 29.45.

9 * Sec. 9. AS 43.20.065 is amended to read:

10 **Sec. 43.20.065. Allocation and apportionment.** A corporate taxpayer who
 11 has income from business activity that is taxable both inside and outside the state or
 12 income from other sources both inside and outside the state shall allocate and
 13 apportion net income as provided in AS 43.19 (Multistate Tax Compact), or as
 14 provided by this chapter.

15 * Sec. 10. AS 43.20 is amended by adding a new section to read:

16 **Sec. 43.20.171. Collection of income at source.** (a) Every employer making
 17 payment of wages or salaries after December 31, 2004, shall deduct and withhold an
 18 amount of tax computed in a manner to approximate the amount of tax due on those
 19 wages under this chapter for that year. The employer shall remit withheld taxes to the
 20 department, together with a return or report prescribed by the department, at the time
 21 or times required by the department by regulation. The department shall publish the
 22 rate of withholding required by this section. Every employer making a deduction and
 23 a withholding shall furnish to the employee not later than January 31 of the succeeding
 24 year, or within 30 days after termination of employment, whichever is earlier, a
 25 written statement on a form prescribed by the department showing

- 26 (1) the name and taxpayer identification number of the employer;
- 27 (2) the name and social security number of the employee;
- 28 (3) the total amount of wages and other compensation; and
- 29 (4) the total amount deducted and withheld as tax.

30 (b) Every employer making payments of wages or salaries earned in the state,
 31 regardless of the place where the payment is made,

(1) is liable for the payment of the tax required to be deducted and withheld under this section and is not liable to an individual for the amount of the payment; and

(2) shall make return of and pay to the department the amount of tax levied that the employer is required to deduct and withhold under this chapter.

(c) An employer who fails to comply with this section is subject to the penalties set out in AS 43.05.220(d).

(d) If the employer is the United States or the state or a political subdivision of the state, or an agency or instrumentality of one or more of those entities, the return of the amount deducted and withheld on wages or salaries may be made by an officer of the employer having control of the payment of the wages or salaries or who is appropriately designated for that purpose.

(e) In this section, "employee," "employer," and "wages" have the meanings given to them under 26 U.S.C. (Internal Revenue Code).

* Sec. 11. AS 43.20.200(b) is amended to read:

(b) The same period of limitation upon the assessment and collection of taxes imposed under this chapter and the same exceptions to it shall apply as provided in 26 U.S.C. 6501 - 6503 (Internal Revenue Code). In the case of additional tax due by reason of a modification, recomputation, or determination of deficiency in a taxpayer's federal income tax return, the period of limitation on assessment commences from the date that the amended return [NOTICE] required in AS 43.20.030(d) is filed, and, if no amended return [NOTICE] is filed, the tax may be assessed at any time.

* Sec. 12. AS 43.20.340 is amended to read:

Sec. 43.20.340. Definitions. In this chapter,

(1) "bank" means a financial institution, including a national banking association;

(2) "corporation" includes an association, joint-stock company, and an insurance company;

(3) [REPEALED]

(4)] "fiscal year" means an accounting period of 12 months ending on the last day of a month other than December;

1 (4) [(5) "INCLUDES" AND "INCLUDING" WHEN USED IN A
2 DEFINITION DO NOT EXCLUDE OTHER THINGS OTHERWISE WITHIN THE
3 MEANING OF THE WORD DEFINED;

4 (6)] "Internal Revenue Code" means the Internal Revenue Code of the
5 United States (26 U.S.C.) as the code exists now or as hereafter amended, as the code
6 and amendments apply to the normal taxes and surtax on net incomes, which
7 amendments are operative for the purposes of this chapter as of the time they became
8 operative or will become operative under federal law;

9 (5) [(7)] "part-year resident" means an individual who becomes a
10 resident or loses the status of a resident [ENTERS OR LEAVES THE STATE]
11 during the taxable year [AND WHO HAS RESIDED OR WAS DOMICILED IN THE
12 STATE FOR A PERIOD OF LESS THAN 12 MONTHS DURING THE TAXABLE
13 YEAR];

14 (6) [(8)] "person" means an individual, a trust, an [OR] estate, a [OR]
15 partnership, or a corporation;

16 (7) [(9)] "taxable year" means the calendar year or the fiscal year
17 ending during the calendar year upon the basis of which the net income is computed
18 under this chapter; "taxable year" includes, in the case of a return made for a fractional
19 part of a year under this chapter, the period for which the return is made;

20 (8) [(10)] "taxpayer" means a person subject to a tax imposed by this
21 chapter;

22 (9) [(11)] "trade or business" includes the engaging in or carrying on of
23 a trade, business, profession, vocation, employment, and rendition of services or
24 commercial activity and includes the performance of the function of a public office.

25 * Sec. 13. AS 43.20.340 is amended by adding new paragraphs to read:

26 (10) "fiduciary" means an estate, trust, guardian, trustee, executor,
27 administrator, receiver, conservator, or a person acting in a fiduciary capacity for
28 another or for the estate of a deceased person;

29 (11) "individual" means a natural person, married or unmarried, adult
30 or minor, who is subject to the obligation to pay an income tax under 26 U.S.C.
31 (Internal Revenue Code);

1 (12) "nonresident" means an individual who is not a resident or part-
2 year resident;

3 (13) "resident" has the meaning given to the term "state resident" in
4 AS 43.23.095.

5 * Sec. 14. AS 43.05.085; AS 43.20.012, 43.20.013; and AS 47.45.120(a) are repealed.

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

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: HB 470
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Income Tax on Individuals RDU Revenue Programs & Services
and Fiduciaries Component Tax Division
 Sponsor Representative Moses
 Requester House Ways & Means Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	*	*	*	*	*	*
CAPITAL EXPENDITURES	*	*	*	*	*	*
CHANGE IN REVENUES ()	*	*	*	*	*	*

FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY2004) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal: ☐

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

See page 2 for analysis.

Prepared by: Mike Williams & Chuck Harlamert Phone 465-2320
 Division: Tax Division Date/Time 2/25/04 10:48 PM
 Approved by: Steve Porter, Deputy Commissioner Date 2/25/2004
 Agency: Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

BILL NO. HB 470

ANALYSIS CONTINUATION

Revenue Analysis

The proposed bill would create an income tax on individuals and fiduciaries, based on a percentage of the individual's entire federal income tax liability. The proposed tax increases in rate over a three-year period, as follows:

- First year (2005): State tax is 5% of federal income tax liability up to \$20,000 and 10% for federal liabilities over \$20,000.
- Second year (2006): State tax is 10% of federal income tax liability up to \$20,000 and 15% for federal liabilities over \$20,000.
- Third year and beyond (2007 +): State tax is 15% of federal income tax liability up to \$20,000 and 20% for federal liabilities over \$20,000.

The graduated tax rates are not marginal rates, the applicable rate applies to the taxpayers entire tax base. An additional \$1,000 of state income tax on the taxpayers first \$20,000 of federal tax liability is assessed at the point their federal tax exceeds \$20,000.

The proposed bill would allow property tax paid to a municipality as a credit against the income tax, as well as taxes paid to other states on income earned in those states.

The proposed bill provides for withholding on income at the source, and creates a duty of the employer to remit taxes to the state.

Estimating revenue is particularly difficult with this bill because on a per-individual basis there is no method currently available to match property tax and personal income tax liabilities. Consequently, we used data from the Internal Revenue Service to estimate property tax credits by income group. The Department of Revenue estimates the proposed bill would generate revenue as follows (net of credits):

- FY 2005: \$ 18.9 million
- FY 2006: \$ 55.1 million
- FY 2007: \$ 89.9 million
- FY 2008: \$107.3 million
- FY 2009: \$107.3 million
- FY 2010: \$107.3 million

Cost Analysis

We have not conducted an exhaustive cost analysis of this bill. Our initial estimate of ongoing operational costs is \$8.65 million annually. The operational costs estimate was derived from prior estimates of comparable legislation (2002 Legislative Session HB 10) updated for current personnel costs. No other cost estimates from that fiscal note were adjusted. Initial operating costs will be less than \$8.65 million. Based on ongoing costs of \$8.65 million as of FY07, we estimate costs during FY05 and FY06 at \$4.8 and \$8.0 million respectively.

Capital costs over the first three years of the program are estimated at \$6.1 million based on prior estimates without adjustment. Our projected distribution of this capital outlay during FY05, FY06, and FY07 is \$4.3, \$1.3, and \$5.5 million respectively.

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.

	(LINE 34)	(LINE 40)	^{H8470} (LINE 54)
	% 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.

Income Tax on Individuals and Fiduciaries
 HB 470
 February 23, 2004
 Page of

(YEAR ONE)

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.

Income Tax on Individuals and Fiduciaries
 HD 470
 February 23, 2004
 Page of

(YEAR TWO)

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
\$161,789,646	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
\$1,581,597	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
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February 23, 2004
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(YEAR THREE)

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
\$234,025,978	Potential Tax on homeowners
<u>(\$412,243,808)</u>	Potential Property Tax Credit
\$0	Tax raised from Alaska homeowners
\$110,129,072	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.

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

	Child under age 14	Teenager with summer job	Single parent earning \$11/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 \$800K mortgage
Wages		2,700	22,880	65,000		32,500	65,000	130,000	260,000	520,000
Interest Income	50	150		400			400	2,000	10,000	20,000
Taxable Pension					5,000					
Gross Social Security					10,000					
AKPFD					12,000					
children file separate to report PFD	1,100	1,100	1,100	1,100	1,100	2,200	2,200	2,200	2,200	2,200
Dependents			1			2	2	2	2	2
Child Care Expenses			3,000				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	446,800
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	(897)	2,074	16,895	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	8,200	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	8,200	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.

IRS SOI Data (2001 Tax Yr)

% of Federal Tax Liability after federal credits
(net federal tax)

DRAFT

Target Revenue \$ 300,000,000
 Nonresident Business Inc. Tax Est. \$ - <<< Enter the revenue you expect from Non-resident business income
 Model Target Revenue \$ 300,000,000
 Rate on AGI below bracket amount none <<< none = flat
 Bracket amount \$ -
 AK Credit (Y or N) n >>>> If 'Y' enter >>>> Individual AK credit \$ -
 Credit on Rts or Person. t >>>> 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	26,853	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	48,894	53,065	450,073
Federal Adjusted Gross Income	913,599,000	991,787,000	2,254,111,000	2,840,734,000	2,298,259,000	4,865,891,000	14,164,361,000
Federal Tax after credits	42,203,000	66,332,000	208,804,000	326,186,000	322,767,000	1,059,999,000	2,026,291,000
Est tax on DOL wage differential	760,788	0	2,861,748	283,153	2,738,317	0	6,644,007
Alaska Tax Base	42,983,788	66,332,000	211,665,748	326,469,153	325,505,317	1,059,999,000	2,032,935,007
Amount over Bracket		0	0	0	0	0	
Tax Generated (Base x Rate)	6,597,741	10,186,285	32,504,486	50,134,289	49,986,278	162,776,921	312,188,000
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)	6,331,741	9,848,285	31,313,486	47,902,289	47,754,278	156,848,921	300,000,000
Flat Rate	15.36%	15.36%	15.36%	15.36%	15.36%	15.36%	
Flat Rate		15.36%	15.36%	15.36%	15.36%	15.36%	
Average Effective AK Tax Rate	0.69%	0.99%	1.39%	1.69%	2.08%	3.22%	
% of revenue from group	2.11%	3.28%	10.44%	15.97%	15.92%	52.28%	

IRS SOI Data (2001 Tax Yr)

% of Federal Tax Liability before federal credits

DRAFT

Target Revenue

\$ 300,000,000

Nonresident Business Inc. Tax Est.

\$ -

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

Model Target Revenue

\$ 300,000,000

Rate on AGI below bracket amount

none

<<< none = flat

Bracket amount

\$ -

AK Credit (Y or N)

n

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

Individual AK credit \$

-

Credit on Rts or Person.

t

>>>> 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	46,186	26,653	28,241	333,081
Joint Returns Above	9,486	9,523	21,619	29,539	22,041	24,824	117,012
Taxpayers	144,142	49,449	79,018	76,705	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
Federal Tax before credits	50,650,000	80,126,000	236,047,000	353,360,000	338,359,000	1,066,058,000	2,124,508,000
Est tax on DOL wage differential	760,788	0	2,861,748	283,153	2,738,317	0	6,644,007
Alaska Tax Base	51,410,788	80,126,000	238,908,748	353,843,153	341,087,317	1,066,056,000	2,131,242,007
Amount over Bracket		0	0	0	0	0	
Tax Generated (Base x Rate)	7,530,741	11,736,994	34,995,765	51,802,258	49,964,522	156,157,719	312,188,000
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)	7,264,741	11,398,994	33,804,765	49,570,258	47,732,522	150,228,719	300,000,000
Flat Rate	14.65%	14.65%	14.85%	14.65%	14.65%	14.65%	
Flat Rate		14.65%	14.85%	14.65%	14.65%	14.65%	
Average Effective AK Tax Rate	0.80%	1.15%	1.50%	1.74%	2.08%	3.09%	
% of revenue from group	2.42%	3.80%	11.27%	18.52%	15.91%	50.08%	

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.

- 25 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.

\$ 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.

STATE OF ALASKA
DEPARTMENT OF REVENUE
TAX DIVISION
550 West 7th Avenue, Suite 500
Anchorage, Alaska 99501
(907) 269-6632
Fax (907) 269-6644

Fax

To: Tim Benintendi	From: Mike Williams
Fax: 907-465-3445	Pages: 11
Phone: (907) 465-4451	Date: February 25, 2004
Re: HB 470 Schedules, etc.	CC:

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•Comments:

The members of the Ways & Means committee may find some of this info useful.
mw

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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



***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
eellpd@gci.net

Marguerite Stetson

Marguerite Stetson
AARP State Coordinator for Advocacy
3009 Northwood Street
Anchorage, Alaska 99517
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ffimas@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

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 321
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY REPRESENTATIVE WILSON

Introduced: 5/20/03

Referred: House Special Committee on Ways and Means, State Affairs, Finance

A BILL
FOR AN ACT ENTITLED

1 "An Act relating to taxation, including taxation of income of individuals, estates, and
2 trusts, to application of an individual's permanent fund dividend toward the individual's
3 income tax liability, and to a warning about taxation on commercial fishing license
4 applications; and providing for an effective date."

5 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

6 * **Section 1.** AS 16.05.480 is amended by adding a new subsection to read:

7 (j) The application for a commercial fishing license must contain the
8 following warning in boldface type: "WARNING: You are obligated to pay Alaska
9 state income tax and federal income tax on your earnings from fishing, to the extent
10 required by law."

11 * **Sec. 2.** AS 43.20 is amended by adding a new section to read:

12 **Sec. 43.20.009. Tax on individuals, estates, and trusts.** (a) There is
13 imposed for each taxable year an income tax, computed as provided in this section, on
14 every

1 (1) resident individual; and

2 (2) estate, trust, and nonresident and part-year resident individual with
3 income from sources in the state.

4 (b) For a resident individual, the tax under this section is three percent of the
5 individual's taxable income, or \$100, whichever is greater.

6 (c) For an estate or a trust, or for a nonresident or part-year resident individual,
7 the tax under this section is three percent of that portion of the taxpayer's taxable
8 income that is attributable to sources in the state. To identify that portion of the
9 taxpayer's taxable income, the taxpayer shall identify the percentage of the taxpayer's
10 adjusted gross income that comes from sources in the state and apply that percentage
11 to the taxpayer's taxable income.

12 (d) In this section, "taxable income" means "taxable income" as defined in 26
13 U.S.C. 63

14 (1) less any income that is exempt under other provisions of state or
15 federal law, including longevity bonus payments under AS 47.45;

16 (2) plus

17 (A) the cost-of-living allowance that is exempt under 26 U.S.C.
18 912(2); and

19 (B) interest on bonds issued by other states and political
20 subdivisions of other states that is exempt under 26 U.S.C.

21 * Sec. 3. AS 43.20.031(c) is amended to read:

22 (c) In computing the tax under this chapter, a corporation [THE
23 TAXPAYER] is not entitled to deduct any taxes based on or measured by net income.

24 * Sec. 4. AS 43.20 is amended by adding a new section to read:

25 **Sec. 43.20.032. Individual income tax returns and payment; tax cap.** (a)

26 Except as provided in (f) of this section, every individual, trust, estate, and partnership
27 subject to tax under this chapter required to make a return of income under 26 U.S.C.
28 (Internal Revenue Code) shall file with the department, not later than the date the
29 federal return is required to be filed, a return setting out

30 (1) the amount of tax due under this chapter, less allowable credits and
31 payment claimed against the tax; and

(2) other information that the department requires for the purpose of carrying out the provisions of this chapter.

(b) The total amount of tax imposed under AS 43.20.009 is due and payable to the department at the same time and in the same manner as the tax is payable under 26 U.S.C.

(c) A person required to file a return under this section shall file the return using the same filing status as the person uses on the person's return of income under the provisions of the Internal Revenue Code for the year.

(d) The maximum tax liability of a person filing as a single individual under AS 43.20.009 is \$20,000. The maximum tax liability of a couple filing jointly under AS 43.20.009 is \$30,000.

(e) The provisions of AS 43.20.030(b), 43.20.030(d), and 43.20.030(e) apply to individual income tax returns and payments under this section.

(f) An individual subject to tax under this chapter need not file a return and remit the tax if:

(1) the individual is under 19 years of age, and the individual's tax liability is zero;

(2) the individual's only income from sources in the state is from a partnership or corporation that has filed a return on that income under AS 43.20.175; or

(3) the individual's tax liability is \$100 and the individual has elected, on the form provided for under AS 43.23.015(b), to have \$100 of the individual's permanent fund dividend applied to the individual's income tax liability.

(g) The commissioner may by regulation provide for an incentive for accurate and timely filing of tax returns by individuals, trusts, estates, and partnerships, and for electronic filing and payment by individuals, trusts, estates, and partnerships. An incentive under this section may not exceed \$25 a taxpayer.

* Sec. 5. AS 43.20.040 is repealed and reenacted to read:

Sec. 43.20.040. Income from sources in the state. (a) In this chapter, income from sources in the state includes

(1) compensation for personal services rendered in the state;

- 1 (2) working in the state for salary or wages;
- 2 (3) income from real or tangible personal property located in the state;
- 3 (4) income from stocks, bonds, notes, bank deposits, and other
- 4 intangible personal property having a taxable or business situs in the state; however,
- 5 the receipt of interest income from intangible property in the state does not alone
- 6 establish a taxable or business situs in the state;
- 7 (5) rentals and royalties for the use of or for the privilege of using, in
- 8 the state, patents, copyrights, secret processes and formulas, good will, marks, trade
- 9 brands, franchises, and other property having a taxable or business situs in the state;
- 10 (6) income distributed from a trust established under or governed by
- 11 the laws of the state, except that income of a trust established under or governed by the
- 12 laws of the state that is income of a nonresident is not included if the nonresident is a
- 13 resident of a state that does not impose an income tax on income to residents of this
- 14 state from trusts established or governed by the laws of the nonresident's state of
- 15 residence;
- 16 (7) income of a trust established under or governed by the laws of the
- 17 state and income of the estate of a decedent who on the date of death was domiciled in
- 18 the state;
- 19 (8) income, from a source with a taxable or business situs in the state,
- 20 of
- 21 (A) a trust not established under or governed by the laws of the
- 22 state; or
- 23 (B) the estate of a decedent who on the date of death was not
- 24 domiciled in the state;
- 25 (9) income of whatever nature from a source with a taxable or business
- 26 situs in the state.
- 27 (b) Except as provided in (a)(4) of this section, in this section, income is from
- 28 a source with a taxable or business situs in the state if it is attributed to or derived from
- 29 (1) business facilities or property in the state;
- 30 (2) business, farming, or fishing activities in the state;
- 31 (3) conducting in the state the management or investment function for

1 intangible property;

2 (4) a partnership, limited liability company, estate, or trust conducting
3 business activities in the state;

4 (5) a corporation transacting business activities in the state that has
5 elected to file federal returns under subchapter S of the Internal Revenue Code;

6 (6) any other activity from which income is received, realized, or
7 derived in the state.

8 (c) If a business, trade, or profession is carried on partly inside and partly
9 outside the state, other than the rendering of purely personal services by an individual,
10 the income from sources in the state shall be determined as provided in AS 43.19.

11 * **Sec. 6.** AS 43.20 is amended by adding a new section to article 1 to read:

12 **Sec. 43.20.046. Individual, trust, and estate tax credits.** (a) For a resident,
13 a trust established under or governed by the laws of this state, or the estate of a
14 decedent who on the date of death was domiciled in this state, the income tax imposed
15 on that resident, trust, or estate by another state or territory of the United States for the
16 taxable year, on income derived from sources in that state or territory, is allowed as a
17 credit against the tax under this chapter.

18 (b) The credit under (a) of this section is determined by multiplying the tax
19 computed under this chapter by a fraction, the numerator of which is the income
20 derived from sources in the other state or territory and the denominator of which is
21 income derived from all sources. However, the credit under (a) of this section may not
22 exceed the actual tax paid to the other state or territory.

23 (c) An individual under 19 years of age with a tax liability of \$100 under
24 AS 43.20.009 is entitled to a credit of \$100.

25 (d) An individual, estate, or trust is allowed only the state credits provided in
26 this section. The total state credit allowed under this section may not exceed the tax
27 liability for the taxable year for the individual, estate, or trust. A credit may not be
28 carried, in whole or in part, to a different taxable year.

29 * **Sec. 7.** AS 43.20 is amended by adding a new section to read:

30 **Sec. 43.20.171. Tax withholding on wages of individuals.** (a) Every
31 employer making payment of wages or salaries after December 31, 2003,

1 (1) shall deduct and withhold an amount of tax computed in a manner
 2 to approximate the amount of tax due on those wages or salaries under this chapter for
 3 that taxable year;

4 (2) shall remit the tax withheld to the department accompanied by a
 5 return on a form prescribed by the department at the times required by the department
 6 by regulation;

7 (3) is liable for the payment of the tax required to be deducted and
 8 withheld under this section but is not liable to any individual for the amount of the
 9 payment; and

10 (4) shall furnish to the employee at the time required by the department
 11 a written statement on a form prescribed by the department showing

12 (A) the name and taxpayer identification number of the
 13 employer;

14 (B) the name and social security number of the employee;

15 (C) the total amount of wages or salary for the taxable year;

16 and

17 (D) the total amount deducted and withheld as tax for the
 18 taxable year.

19 (b) The department shall publish the rates of withholding required by this
 20 section.

21 * **Sec. 8.** AS 43.20 is amended by adding a new section to read:

22 **Sec. 43.20.175. Tax withholding by pass-through entities.** (a) A
 23 partnership that pays or credits amounts to a nonresident on account of the partner's
 24 distributive share of income from sources in the state shall withhold the tax owed by
 25 the individual under AS 43.20.009.

26 (b) A corporation for which an election under 26 U.S.C. 1362(a) (Internal
 27 Revenue Code) is in effect for the tax year that pays or credits income from sources in
 28 the state to a nonresident shall withhold the tax owed by the nonresident under
 29 AS 43.20.009.

30 (c) A partnership or corporation required to withhold tax under (a) or (b) of
 31 this section is liable to the department for payment of that tax.

1 (d) A partnership or corporation required to withhold tax under (a) or (b) of
 2 this section shall file a return of the income on a form prescribed by the department
 3 and pay the tax to the department.

4 (e) For purposes of this section, "partnership" means a person that is taxable as
 5 a partnership for purposes of 26 U.S.C. (Internal Revenue Code).

6 * Sec. 9. AS 43.20.340 is amended by adding new paragraphs to read:

7 (12) "individual" means a natural person, married or unmarried, adult
 8 or minor, subject to payment of income tax under 26 U.S.C. (Internal Revenue Code);

9 (13) "nonresident" means an individual who is not a resident or part-
 10 year resident;

11 (14) "resident" means an individual who, for the entire taxable year,
 12 was domiciled in the state or resided in the state.

13 * Sec. 10. AS 43.23.015(b) is amended to read:

14 (b) The department shall prescribe and furnish an application form for
 15 claiming a permanent fund dividend. The application must include notice of the
 16 penalties provided for under AS 43.23.035 and contain a statement of eligibility and a
 17 certification of residency. **The application must allow an applicant to elect to have**
 18 **\$100 of the dividend retained by the department and applied to the individual's**
 19 **state income tax liability.**

20 * Sec. 11. AS 43.05.085; AS 43.20.012, and 43.20.013 are repealed.

21 * Sec. 12. The uncodified law of the State of Alaska is amended by adding a new section to
 22 read:

23 TRANSITIONAL PROVISIONS: REGULATIONS. The commissioner of the
 24 Department of Revenue shall adopt regulations to implement the provisions of this Act.

25 * Sec. 13. Section 12 of this Act takes effect immediately under AS 01.10.070(c).

26 * Sec. 14. Except as provided in sec. 13 of this Act, this Act takes effect January 1, 2004.

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

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

MEMORANDUM

May 18, 2003

SUBJECT: Income Tax CSHB 321()
TO: Representative Peggy Wilson
FROM: Kathryn L. Kurtz

You have requested a sectional summary of the above-described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents. If you would like an interpretation of the bill as it may apply to a particular set of circumstances, please advise.

Section 1. Requires that a notice be printed on commercial fishing license applications, warning that income from commercial fishing is taxable.

Section 2. Imposes an income tax of three percent of federal taxable income or \$100, whichever is greater.

Section 3. Conforming amendment to corporate income tax.

Section 4. Requires tax payers to file return and remit tax on the same day federal return is due. Exempts

- . those that owe \$100 and have the tax deducted from their permanent fund dividend;
 - . those under 19 with tax liability of \$1 00 or less;
 - . nonresidents whose only income in the state is from a trust or corporation that withholds taxes and files returns.
- Caps tax liability at \$20,000 for individuals and \$30,000 for joint filers.

Section 5. Defines income from sources in the state.

Section 6. Provides credits for taxes paid to another state, and a \$100 credit for individuals under 19 years of age with a tax liability of \$1 00 or less.

Section 7. Provides for employer withholding of taxes

Section 8. Provides for withholding by partnerships and certain corporations of taxes from the distributive share of nonresidents.

Section 9. Adds definitions pertinent to the individual income tax to the definitions section for the individual and corporate income taxes.

Section 10. Provides for a box on the pennant fund dividend for a taxpayer to elect to have \$100 withheld from the taxpayer's dividend and applied to the taxpayer's income tax liability.

Section 11. Repeals credit provisions relating to Alaska's former individual income tax.

Section 12. Gives the Department of Revenue authority to adopt regulations to implement the individual income tax.

Section 13. Provides an immediate effective date for the section authorizing regulations. **Section 14.** Provides an effective date of January 1, 2004 for the remainder of the bill.

KLK:med

03-562.med

Alaska State Legislature

Representative Peggy Wilson
House District 2

SPONSOR STATEMENT SSHB 321 State Income Tax

It is time for the Legislature to get down to the business of assuring a dependable revenue stream for the State NOW before it is too late.

Any broad based tax that the legislature puts in place will take two years to fully implement. We can't continue on the road before us without knowing from one year to the next how we are going to fund the Budget much less where the funds are going to come from. A decision needs to be made this year in order for it to be fully in place by 2006. We must plan for the future now and not wait until our economy hits the wall or drops off the cliff. We don't want a repeat of the mid 80's.

I am proposing SSHB 321- as a starting point for discussion and consideration of an income tax. SSHB 321 would impose a 3% flat tax on federal taxable income as reported on Federal tax 1040 form.

An income tax is the right choice for a broad base tax because:

- It is the fairest to all concerned
 - It is the easiest to administer
 - It is the cheapest to administer
 - It is the least harmful to the State as a whole
 - It is the best broad based tax for municipalities
 - It is the right thing to do.
- State income taxes can be deducted from your federal income tax thus part of it would be paid by the federal government.
 - An income tax would require those out of state workers who work in Alaska but live in another state to pay their fair share.

The majority of the people in the state agree that K-12 education badly needs more money in order to provide the quality education that we all want for our children and grand children. In addition we have spent so much from our savings account, the Constitutional Budget Reserve that it is in danger of running dry. We need to keep \$1 billion in the CBR for a disaster fund to insulate against wild fluctuations in the price of oil and any possible natural or man made disaster to our State. It is time for the people of Alaska to step up to the plate and pay something at the State level for the required services plus those we all think we need and want. I believe that the fairest tax overall is a flat rate income tax.

Alaska State Income Tax

Enter Taxable Income from Federal Income Tax Return

1. _____

Multiply line 1. by .03%

2. _____

Enter Number of Persons over 19 covered by this return

3. _____

Multiply line 3 by \$100.

4. _____

Enter the greater of line 2 or line 4

5. _____

Enter \$20,000 if filing singly or \$30,000 if filing jointly

6. _____

Enter the lesser of line 5 or line 6

7. _____

Line 7 is amount owed for Alaska State Income Tax

SCOMM

142.4

RESOURCE REVIEW



A PERIODIC PUBLICATION OF THE RESOURCE DEVELOPMENT COUNCIL FOR ALASKA, INC.

www.akrdc.org

ELF TAX DECISION GENERATES CONCERN THROUGHOUT PRIVATE SECTOR, SHAKES INVESTOR CONFIDENCE IN ALASKA

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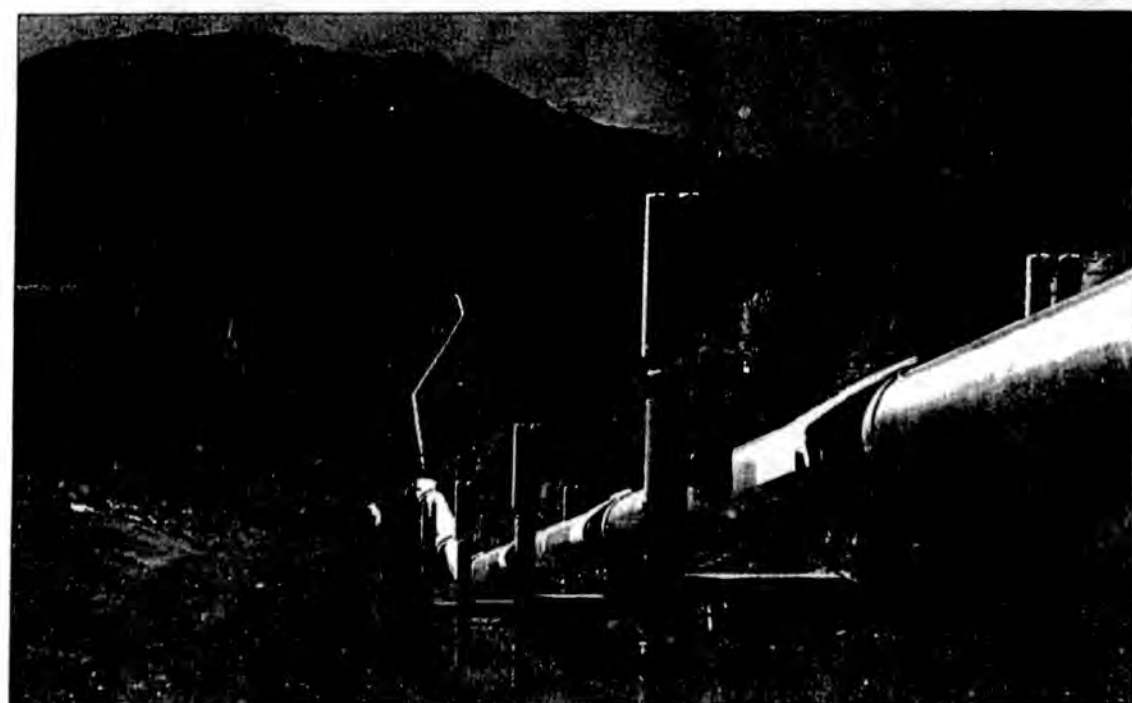
Tesoro Alaska Petroleum
Company

The January decision by Governor Frank Murkowski to significantly increase production taxes on six North Slope satellite oil fields has sent shock waves through the oil industry and generated tremendous concern among business leaders throughout Alaska.

Industry is now reassessing short-term and long-range investment plans for Alaska. It has warned fallout from the governor's action is likely to have immediate consequences on North Slope investments, ultimately costing Alaska jobs, revenues and economic activity.

"The governor's action sets a troubling precedent for establishing tax policy in Alaska," said RDC Executive Director Tadd Owens. "Confidence in Alaska as a place to do business has been shaken – not only for the oil and gas industry, but for all prospective large-scale investors."

Owens said that since the governor's announcement, he has fielded numerous calls from business leaders outside the oil industry expressing disappointment and deep concern over the sudden change in tax policy. They also expressed frustration since this action was outside the context of a



Every barrel of oil produced in Alaska provides revenue to the state through royalties, corporate income taxes and property taxes. No barrel is produced tax free. The Economic Limit Factor (ELF) applies specifically to the severance tax, which is only one piece of the total tax structure.

comprehensive fiscal plan.

"The governor's tax hike on the industry already paying the vast majority of the state's operating budget runs counter to RDC's position on a responsible fiscal plan," Owens said.

Murkowski's administrative ruling increases oil and gas production taxes on small satellite fields in the Prudhoe Bay unit. The administration's new interpretation of the Economic Limit Factor (ELF) links Prudhoe Bay and its six satellites under a single tax-

ation formula, resulting in a \$150 million annual tax increase on North Slope producers. This increase is on top of royalties, property tax and state and federal income taxes the satellite fields currently pay.

The six fields now grouped with the larger Prudhoe Bay field for taxation purposes are Aurora, Borealis, Polaris, Orion, Midnight Sun and Pt. McIntyre. The industry is considering appealing

the governor's decision and would like the state to look at the small satellites on a case-by-case basis when applying

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INVESTORS: ELF DECISION RAISES RISKS, UNCERTAINTY IN ALASKA

(Continued from page 1)

the ELF.

Prudhoe Bay owners have already been forced to defer an appraisal well that could lead to additional drilling and development work at Prudhoe, and they have shelved a major investment in the Orion satellite field.

Speaking at the Alliance's Meet Alaska Conference in Anchorage, ConocoPhillips Alaska president Jim Bowles pointed out that significant investment by industry in North Slope fields is required to achieve the Department of Revenue (DOR) forecast of total Slope daily production of 945,000 barrels by 2008. The DOR forecast states that satellite fields are estimated to contribute more than 200,000 barrels of oil per day in 2008.

However, Bowles said satellite production will require continued investment, and higher taxes could jeopardize that future investment, resulting in lower production. With these investments, North Slope satellite oil fields were also expected to generate an additional \$3 billion in taxes and other revenues to the state over the next ten years, according to DOR.

Bowles said his company would work with the governor to resolve the recently enacted changes to ELF. He

displayed a visual illustrating the impact of current and projected satellite field development on North Slope production.

"One project in particular, the Orion field development at Prudhoe Bay, has been shelved indefinitely because of the impact of the tax increase," Bowles said. "After careful evaluation of the tax increase, the project economics are no longer able to compete with other investment opportunities. The project represents a loss to Alaska of more than \$500 million of capital investment for drilling and facilities work. This project would have also generated an additional 20,000 barrels of daily production of incremental oil."

Satellite fields provide the greatest opportunity to increase oil production in and around Prudhoe Bay. The vast majority of known reserves on the North Slope are

within the existing fields, but all have their development challenges.

The Orion and Polaris fields are considered viscous oil or "heavy oil" reserves handicapped by high-costs and unique production barriers. The oil is thick and sticky, and it comes out of the ground mixed with sand. In BP's portfolio alone, there are 1 billion barrels of heavy oil that are today uneconomic to produce.

In his January announcement, the governor noted viscous fields would not be included or affected by the administrative change. However, with the state now combining Orion and Polaris with the Prudhoe Bay field for taxation purposes, industry believes the state has essentially eliminated ELF production tax relief for viscous oil in those fields.

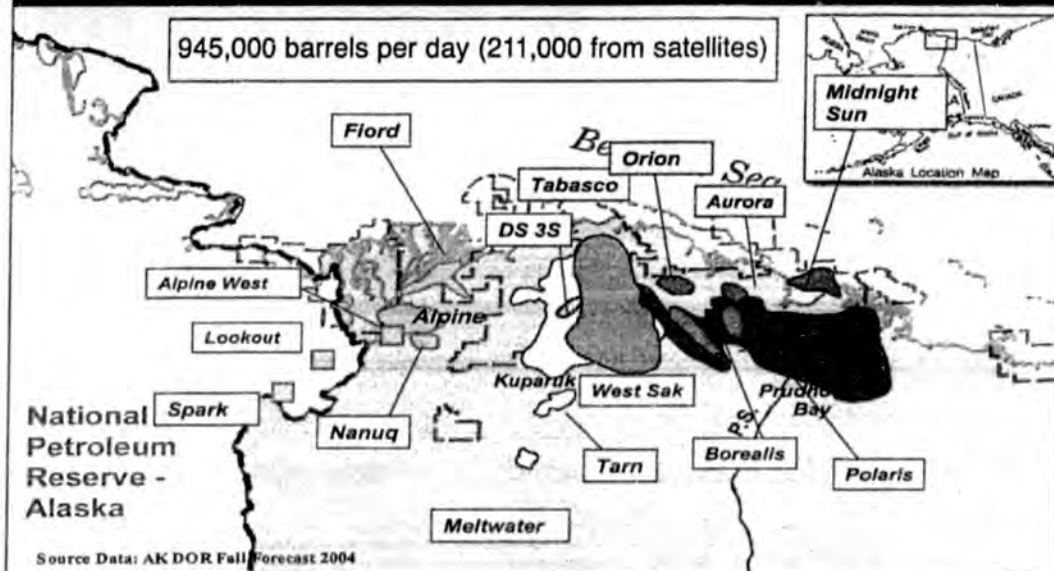
The Murkowski administration spoke earlier this win-

ter of potential adjustments to ELF, but industry insists the administrative change itself was not part of those or any other discussions. Furthermore, there was no opportunity to examine the decision's broad implications, nor any discussion surrounding the important role ELF plays in helping to offset rising costs, thin margins and growing technical challenges facing new investments.

Steve Marshall, Alaska president for BP, warned the governor's action has had a negative effect on investor confidence and has created a high level of uncertainty in Alaska investment opportunities.

"Increasing taxes by more than \$150 million a year at Prudhoe Bay makes all of our Alaskan investments less competitive, and it undermines the confidence of investors," Marshall told the Alliance's Meet Alaska

Satellite Development 2008.



Satellite fields provide the greatest opportunity to increase oil production in and around Prudhoe Bay. The state projects North Slope oil fields will be producing 945,000 barrels of oil daily in 2008. Of that total, 211,000 barrels are expected from satellite fields, some of which have yet to be developed and are dependent on the investment of new capital. Raising taxes on the oil industry makes Alaska less competitive in attracting capital.

audience. "As an industry, we've invested hundreds of millions of dollars since the 1980s to bring ourselves to the brink of unlocking the prize of large-scale viscous oil development. Changing ELF now lends credence to the adage that no good deed goes unpunished."

Marshall explained the current ELF was the basis on which industry invested hundreds of millions of dollars in small field development. Now it believes the state is changing the rules in the middle of the game, once investments have already been committed.

Marshall said BP and its partners are willingly taking on the challenge of drilling more complex, expensive wells and looking to overcome the huge operational challenges viscous wells pose. He said the companies face downtime and costs associated with unanticipated situations, but they're the type of risks industry is able to accept, provided it knows the fiscal and regulatory rules from the start.

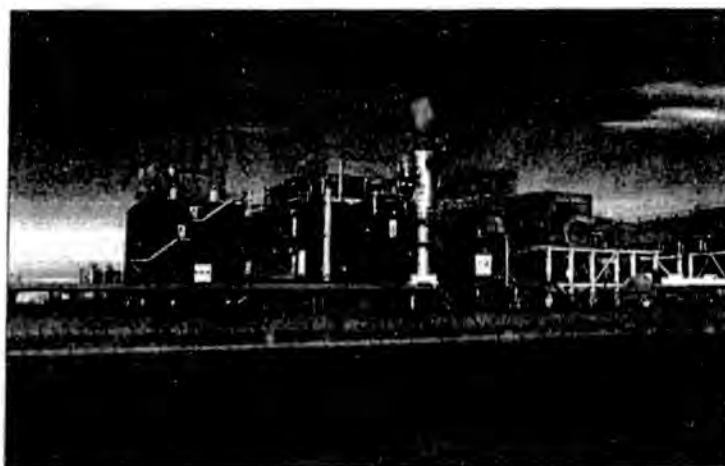
The BP Alaska president offered this analogy with regard to claims by some people that industry can "afford" higher taxes because oil prices are high: "Can you afford to pay a few thousand dollars more to buy a new car from one dealer than you would to buy the same car from another dealer on the next block? Maybe so, maybe not...but the question is: why would you?"

In terms of investment opportunities, Marshall emphasized, "there's a whole world of 'dealerships' competing with Alaska for capital, and if Alaskan projects don't offer competitive returns, the money will go elsewhere."

In a recent interview, Judy Brady, Executive Director of

the Alaska Oil and Gas Association, said the state should not raise taxes just because oil prices are high. "Higher prices are benefiting investment opportunities outside Alaska, just as they benefit the ones here," she said. "Raising taxes will not make Alaskan investments more competitive."

Countering a perception that Alaska is not getting its fair share of revenues from the oil industry when oil prices rise, Brady pointed out Alaska will likely collect over \$3 billion in revenues from North Slope production in FY2005, the first time the state has surpassed that threshold since the 1980s



The oil industry has invested over \$40 billion in North Slope infrastructure since the 1970s and may need to spend \$60 billion over the next ten years to sustain current production.

when daily production was higher.

Brady noted at \$35 per barrel, the state, federal and local governments take approximately 55% of the net revenues derived from each barrel of oil. At \$18, the average price of North Slope crude between 1986-2002, the total government take is 70 percent. While percentage wise, the government take is smaller at higher prices, it yields significantly more revenue. At \$35, the government's 55% share equates to \$4.5 billion; at \$18, its 70%

share equates to \$1.7 billion.

In 2004, the oil industry accounted for 87 percent of Alaska's unrestricted general fund revenues. Over the next decade, DOR projects oil revenues will provide at least 75% of unrestricted general purpose revenues in state coffers.

However, Brady stressed two elements are critical for that healthy revenue stream to materialize – price and production volume. While the state has no control over the price of oil, it can – through a stable and predictable tax regime – encourage new industry investment to offset a 15% forecasted annual decline in production

and predictable tax regime is key to supporting a business climate that can attract billions of dollars in new investments, Brady said.

Industry executives insist the governor's decision underscores the critical need for their companies to have a clear and durable fiscal contract for the proposed gas pipeline – a \$20 billion project requires fiscal certainty. The gas line is anticipated to have a 35-year life, but since the 1970s, the state has increased taxes on the oil and gas industry more than a dozen times, not including increases through changes in administrative interpretations.

Industry believes the governor's decision on ELF brings into serious question whether the state can offer the certainty and stability such a huge investment requires.

"A stable tax environment is absolutely necessary given the scale of investments being considered for Alaska," said Harry McDonald, President of Carile Transportation Systems. "Tax increases, especially those undertaken in a unilateral fashion, create uncertainty for future investors and elevate risk, making it much more difficult for Alaska to attract world-scale investments for world-class projects."

Contractors throughout the oil patch are concerned the tax increase and potential future revisions to the ELF tax structure will put future development and associated jobs at risk.

"Satellite developments in Alaska's maturing oil fields provide the greatest opportunity to increase oil production, as well as jobs in the oil patch," said Larry Houle, General Manager, Alaska

(Continued to page 7)

Governor Defends ELF Decision, Says It Was Fair To Aggregate Six Satellite Fields With Prudhoe For Production Tax Purposes

(Continued from page 5)

Support Industry Alliance. "This action has created more uncertainty than \$9 oil did on industry and its contractors," he added. "Uncertainty leads to delayed investment decisions, and deferred investments mean lost jobs."

Murkowski said he is convinced it was fair to aggregate the six satellite fields with Prudhoe Bay for production tax purposes.

"My decision reflects the producers'

decision to consolidate the individual satellite fields into the Prudhoe Bay unit," Murkowski said. The governor insisted Alaska remains a competitive investment target and the recent decision does not change that.

He said his administration continues to support the intended purpose of ELF, and it is the policy of the state to make certain taxes are never a reason to shut down a field.

The governor sent a letter to RDC

board members last month defending his recent action. The letter is posted on RDC's web site at www.akrdc.org.

Meanwhile, Houle is hopeful there may be some wiggle-room in the state decision with regard to the heavy oil satellites. "Alaska contractors and their employees are concerned about their jobs and hope that reason will prevail and investment will not be reduced so as to ensure a bright future for Alaskans," Houle said.

FISHERY MANAGEMENT COUNCIL TAKES EFH ACTION, REPORT ON IMPACTS TO NON-FISHING ENTITIES REQUIRED

As part of the final essential fish habitat (EFH) Environmental Impact Statement (EIS), consultations will continue to be a requirement of all projects that may have an adverse effect on EFH. However, the National Marine Fisheries Service (NMFS) must now provide an annual report of how its recommended conservation measures waver from those listed in the EIS.

The report must also highlight the impact these conservation measures have on non-fishing activities and their related permits. This report will be presented to the North Pacific Fisheries Management Council on an annual basis.

EFH has been broadly defined by the Magnuson-Stevens Act to include "those waters and substrate necessary to fish for spawning, breeding, feeding, or growth to maturity." The EIS has identified most of Alaska's state waters as being necessary for Council managed anadromous fish (salmon).

The State of Alaska, in an open letter to the Council, expressed its concern regarding the inland reach of EFH and the required consultations. In a plea for states' rights, its letter questioned the need for additional oversight when current state processes adequately protect managed salmon habitat. The state complained the added time and cost to resource agencies, as well as permit applicants, may result in the loss of resource development opportunities without a corresponding benefit to salmon habitat.

Jason Brune, RDC Projects Coordinator, attended the

Seattle hearing, testifying in favor of limiting NMFS' oversight of non-fishing activities.

"The current North Pacific fishery management plans designate EFH in Alaska coastal and inland areas to an excessive and unworkably broad extent," said Brune. "For managed salmon species, the designation extends to virtually all stream and inland water areas salmon may occupy at some point during its life cycle, including wetland areas," Brune noted. "They fail to distinguish habitat truly necessary to managed fisheries from generic habitat, and therefore, render the term 'essential fish habitat' meaningless."

With the final EIS completed, RDC will focus its efforts on modifications to the statutory definition of EFH, as defined in the Magnuson-Stevens Act.

Senator Ted Stevens, Chairman of the Senate Commerce Committee, will be leading efforts to re-authorize the act this year. RDC is encouraging Senator Stevens to limit EFH in Alaska to the Exclusive Economic Zone (EEZ), 3-200 miles offshore.

In approving the final EIS, the Council also took significant action at the meeting to ban bottom trawling on more than 370,000 square miles in federal waters off Alaska. The majority of the new closures were established to protect coral habitats

in the Aleutian Islands. The Council also established numerous site-specific Habitat Areas of Particular Concern (HAPC) which include seamounts and fragile coral gardens, and put in place measures to protect these important habitats as well.



The Pogo Mine, 250 miles from the coast, was required to undergo EFH consultations. NMFS will now be required to provide an annual report of how its recommended conservation measures impact non-fishing activities.

**ELF: PUBLIC PROCESS ABSENT FROM STATE DECISION**

In the past I have used this column to discuss some of the abuses of public process that have bothered me. In this column I want to discuss what happens when there isn't any public process, which was the case recently when the state administration changed the calculation for the Economic Limit Factor (ELF) on the Prudhoe Bay field and surrounding oil developments.

I should begin by saying I am not opposed to revisiting ELF. However, I have always thought the issue should be considered as part of the development of a long-term fiscal plan, and not as a unilateral action affecting the industry already paying most of the state's bills.

I also believe any consideration given to potential ELF revisions should have resulted from a public process, most likely taking place in the legislature. Much to my surprise, the recent decision resulting in a \$150 million to \$200 million annual change in the interpretation of ELF met neither of these two seemingly reasonable criteria.

The results were predictable. The oil industry and many others in the business community were stunned. Those who have been clamoring for higher taxes on the oil industry were cheering. I wonder what their reaction would have been if the state had lowered taxes on the oil industry without any public process. Actually, I don't wonder at all — they would have been screaming for a public review of the decision.

But it is not just the process that concerns me. I also have some major questions about the decision itself.

In essence the state has decided the Prudhoe Bay field and some of the surrounding satellite fields are "economically interdependent" because they share the same processing facilities. The result of this decision is production taxes are increased both on the satellites and on the Prudhoe Bay field because the reserves from all the oil production are aggregated.

My concerns fall into several categories.

First, the state will now collect \$150 million or more annually from the oil industry to help address our fiscal dilemma without having any plan for addressing the rest of the problem. It seems to send the wrong message to the industry that has been the mainstay of support for Alaska's government for the past 30 years, and gives them no comfort we won't be asking more from them next year.

Next, this change in tax policy makes Alaska's fiscal regime even more regressive than it already is because the change made by the Department of Revenue (DOR) will apply to production at any oil price. Most people who advocate for a change in ELF want the change to take into account the current high oil prices. But most of these people are willing to give something up during times of low oil prices. The decision by DOR means we have substantially increased the risk to investors in current and future oil developments around Prudhoe Bay if and when low prices return. This increased

risk will be taken into account when investments in Alaska are measured against those in other parts of the world.

My next concern relates to what seems to be a reversal of the long-standing state philosophy of attempting to minimize construction

of processing facilities on the North Slope. There are both environmental and economic reasons for this philosophy. The environmental reasons are obvious. The economic reasons relate to the very high cost of constructing and operating facilities on the Slope. Using central facilities for processing clearly makes economic sense, but DOR's decision seems to send the message the state would prefer producers to build individual facilities for each new development.

Because the change in tax policy increases the tax rate not only on smaller satellite fields, but also on Prudhoe Bay itself, a particularly difficult situation is confronting the independents we have been attempting to attract to the Slope. The independents are a potential asset to the state because they are probably more interested in and better able to develop the smaller accumulations of oil, which may be the future trend of North Slope development.

However, the decision by DOR increases the cost and risk of these developments. In addition, the owners of existing facilities may be much less willing to allow the use of those facilities by independents, because adding new accumulations of oil to their existing production may up the owners' taxes, too.

DOR's precedent-setting decision leaves open a very important question: will this policy change apply to other areas with centralized facilities such as Alpine and Kuparuk? The administration says "No," but how can anyone be certain the answer won't be "Yes" in some future year or under a different administration?

I am also concerned about how this decision will affect the negotiations on the gas line. It's difficult for me to see how it can improve the odds of a speedy resolution of the difficult economic issues that need to be resolved in order for Alaska's stranded gas to be developed.

Some have suggested the administration was "firing a shot across the bow" to get the attention of the oil companies. If so, I fear the shot may have actually hit the ship, and it may be years before we can fully assess the damage to the unintended target and to the "ship of state."

"Some have suggested the administration was 'firing a shot across the bow' to get the attention of the oil companies. If so, I fear the shot may have actually hit the ship, and it may be years before we can fully assess the damage to the unintended target and to the 'ship of state.'"

Arguing Alaska's ELF issue

AOGA contends ELF doing job it was designed to do; state says Prudhoe satellites didn't require new infrastructure

Kristen Nelson

Petroleum News Editor-in-Chief

The debate over the governor's decision to aggregate Prudhoe Bay satellites for production tax purposes was heard in the Alaska House Special Committee on Oil and Gas in early February, with the Alaska Oil and Gas Association taking the floor Feb. 1, followed by the departments of Revenue and Natural Resources Feb. 3.

AOGA reviewed the history of the economic limit factor or ELF for the committee, while state officials provided the administration's perspective.

AOGA: Both price and volume 'critical'

Judy Brady, executive director of AOGA, introduced Tom Williams as the "conceptual father of ELF." Williams, Alaska tax counsel for BP Exploration (Alaska) and chairman of the AOGA tax committee, went to work for the state in 1973, was commissioner of Revenue from 1979 to 1982, and has been with BP since 1987.

Both the price and volume of oil are "critical for state revenue," Williams told the committee. To hold volume at just under a million barrels a day, the state needs new production — which requires new investment — from four sources: heavy oil, in-field development, satellites and wildcat exploration.

"The question is, does Alaska's fiscal system encourage or discourage new investments in each of these areas?" Williams asked.

There are four components to oil and gas taxes. Royalties, the state's cut from every barrel of oil or cubic foot of gas that comes from a state oil and gas lease, are "the mainstay of Alaska's revenue system," said Williams. Royalties are almost half of the general fund unrestricted revenues and "by far the largest source of oil and gas revenues."

Like production or severance tax, royalties are sensitive to oil and gas price fluctuations. Property tax is not sensitive to prices, and income tax is only moderately sensitive because it is based on a proportion of all of a company's operations, and the range of those operations makes the income tax less sensitive to oil and gas prices, Williams said.

AOGA: ELF aimed at sustaining production

In the 1970s the Alaska Department of Revenue wanted to make sure that the state's production tax, which comes off the top, before any operating costs are figured, did not result in production being shut in.

The ELF, Williams said, first "saw the public light of day" in a 1977 Department of Revenue report as a recommendation to prevent total production costs from overtaking the value of oil or gas as production costs rise later in the life of a field. When ELF was passed by the Legislature, Williams said, the formula proposed by the administration was changed so that the ELF was based on a presumption that 300 barrels a day was needed

for a well to break even at Prudhoe Bay.

In 1989, Williams said, field size was added to ELF, with 150,000 barrels per day added to the formula. The effect of the addition, he said, was that if a field produced more than 150,000 bpd, the 1989 change moved the ELF up towards one (an ELF of one means the field would pay the full production tax rate); if a field produced less than 100,000 bpd, the formula change moved the ELF down towards zero, which moved the production tax toward zero.

AOGA: 1989 ELF change aimed at smaller fields

In 1981 the Legislature reduced the state's corporate income tax on oil and gas and in an attempt to compensate for that tax loss, increased the production tax to 15 percent from 12.25 percent, and suspended the ELF at Prudhoe Bay until 1987. When the Prudhoe Bay suspension ended, the state's revenue was cut by \$135 million for the next fiscal year.

The Legislature, Williams noted, said the 1989 change would increase revenue, give an incentive for small fields and give an incentive for development of West Sak heavy oil.

The 1989 ELF changes reduced production tax rates for all fields except Prudhoe Bay and Kuparuk. The Legislature was told by the administration that Prudhoe Bay and Kuparuk could afford higher taxes; reduced investments as a result of the higher taxes were expected to have a small impact on total production.

The Legislature was also told that marginal fields included all the Cook Inlet fields and Milne Point, Lisburne, Endicott, Niakuk, West Sak, Point Thomson "and probably any other field that will be discovered in Alaska."

Endicott, which then produced some 100,000 bpd, was the largest field to have its taxes reduced under the 1989 ELF change, and the Legislature was

told that under the new ELF, for "marginal fields the severance tax ... will either be sharply reduced or eliminated entirely." The Legislature was also told that smaller fields would pay less tax — even with the same well productivity as larger fields.

AOGA: Williams: marginal equals small

Williams told the committee that in the 1989 discussions, "marginal was not used in a dictionary definition of marginal: small was marginal. Probably any other field that would be discovered in Alaska would be marginal, unless it was a super giant. ... This is a different concept of marginal than the standard concept, the dictionary definition.

"And it's important to understand that, because that's what the Legislature was told, not by the industry, so much, but by the administration," Williams said.

The Legislature was told, he said, that a small field could pay no severance tax.

And the Legislature was told there would be revenue gains, that over the next 20 years the state would be ahead by some \$2.7 billion "and in fact it was."

Williams was asked how Alaska's system compared to other countries, and if other oil provinces had anything similar to ELF, and he said he wasn't an expert on how other countries worked, but he thought the real question for Alaska is: "Are you getting the oil that you should be getting? Are you getting the investments that will keep oil production up?" You don't want to ignore what the rest of the world is doing, he told legislators, "but the real question is, are you seeing the investments here that need to be made? Do you expect to see them continue in the future" to keep production at a million barrels a day.

AOGA: Volume is the issue

Brady said oil will continue to be the mainstay of Alaska's economy and the big issues around oil are price and volume.

"We can't do very much about price," she said.

Volume, however, is a different thing.

In 1989 the Alaska departments of Revenue and Natural Resources said that in 15 years production would be down below 500,000 barrels per day, Brady said. That prediction was made at a time when 2.1 million bpd were moving through the pipeline.

And that prediction was based on Prudhoe Bay and Kuparuk.

"The reason that we didn't go all the way down was because of all the investments that were made in Prudhoe Bay and Kuparuk. And all the technological breakthroughs and all the things that the companies did to make sure that didn't happen."

Without those investments, Brady said, production would be about 300,000 bpd today.

The ELF changes in 1989, she said, were made "to help satellites and heavy oil, but those fields did not start coming on until almost 10 years later." And they have been developed "on the basis of the promise that there would be no tax on those fields. It took about 10 years for them to be developed and starting to produce ... and now we're starting to talk about taxing them again, after the investments have been made."

In 1989, Brady said, the state decided to "hit the big fields hard, but everything else is going to be home free because we need that production" that will come from small fields.

Volume is the issue, she said: "If we don't get this production, no matter what the prices are going to be, we're going to be in a world of hurts."

AOGA: Aggregation by ruling

State law has allowed for aggregation of fields since before Prudhoe Bay came online, Williams said. Because of complicated patterns of leases and ownership in Cook Inlet, where you have economic interdependence you can lump the various pieces together to recognize the whole operation.

Pre-1989, he said, it didn't make much difference if you lumped fields together or not. But the 1989 ELF changes, Williams noted, rewarded smallness, and after that lumping fields together made a big tax difference, "and that's in fact what this recent decision was about, whether the satellite fields, the six satellite fields, that are sharing facilities with the main field at Prudhoe Bay, should be lumped together with that main field."

Williams said the Department of Revenue has adopted regulations allowing it to give rulings in advance on whether satellites will be aggregated.

Companies that are proposing satellites can get rulings from the department on how a satellite will be treated, if it will have a separate ELF from the fields whose facilities it will share.

"And so those rulings have been granted. That's how the administrative response has been to deal with the issue."

The state is counting on new investments and new production from heavy oil, in-field development, satellites and wildcat exploration to keep production at just under a million barrels a day through 2015, Williams said.

"The question is, does Alaska's fiscal system encourage or discourage new investments in each of these areas?"

Brady said the Alaska Oil and Gas Association agrees "right now that the state tax system is working the best a tax system can work. It's not the perfect tax system, but it's pretty darn close. You're getting investments in heavy oil, in satellites, in-field and in wildcats, so we are getting investments that we need right now with this tax system."

The state, she said, gets "a consistently high overall return, especially on the medium prices — and even at high prices you're getting a very substantial return."

Industry hopes, she said, "that the fiscal system will stay the way that it is and as you look at it to see whether it should stay as it is, that you keep in mind that we continue to need these four kinds of investments."

Revenue: Investment in forecast

Dan Dickinson, director of the Alaska Department of Revenue's Tax Division, told the committee Feb. 3 that Revenue made its aggregation decision based on "what we thought was the appropriate way to tax those fields."

And, he noted, Jim Bowles, president of ConocoPhillips Alaska, "sent a letter to the governor that identified the fact that he'd asked us for rulings on Alpine — the satellites at Alpine — that ConocoPhillips hopes to bring on over the next several years."

The company based its economics on separate ELF treatment, Dickinson said, and told the state that if the Alpine satellites don't get separate ELF treatment, those economics will have to be revisited.

And how likely is it ELF treatment will mean less investment in Alaska? Dickinson asked.

There are several factors, he said, one of which is that "most of these

companies are capital constrained; they're going to take capital and they're going to invest it where they think they get the best return over time. And the best return isn't necessarily again a single dimension, but they look at the upsides, the downsides, they ... have a portfolio." Sometimes, he told the committee, "I don't understand" investment decisions the companies make and sometimes people in a company's Alaska office don't understand why headquarters made a decision the way they did.

Revenue: ELF results not what expected

Dickinson said he didn't think the people who redesigned ELF in 1989 "got what they expected."

"A lot of the focus (in 1989) was on standalone facilities, production facilities ... folks went out and made investments and created their own production facilities," he said.

"And that's I think what people were focused on because they talked about the cost of the production facilities and you have all those costs associated with that production."

But, he said, what has happened over time is that new production has been brought on that uses existing facilities and "that's not what was contemplated, that kind of development."

Revenue: Many fields have rulings

Committee Chair Vic Kohring, R-Wasilla, asked Dickinson if other fields with satellites could be hurt by aggregation.

Dickinson said Revenue's regulations provide a process for getting "an advance letter ruling, just like they would from the IRS, that says we will not aggregate this field... essentially giving them some certainty" about

production taxes.

Those letters have been issued, he said, and cover a good deal of production at the Milne Point and Kuparuk River fields. The division was careful, he said, not to overturn any of those existing rulings.

There are issues of taxpayer confidentiality, Dickinson said, and situations differ, but "we'll have to figure out some way of getting that language out to everyone else as we make policy for adjudication..."

The purpose behind the division's regulation, he said, "is to allow folks to understand what their taxes are going to be and I think another thing that it might be important for us to do is to be more precise when we grant these letters: to say, here's the situation, here's the tax situation."

Revenue: Infrastructure differences

Committee Vice Chair Ralph Samuels, R-Anchorage, asked Dickinson about recent decisions at Kuparuk, and Dickinson said there are a series of decisions including West Sak, Tabasco, Tarn and Meltwater. Why, Samuels asked, did decisions go in favor of a separate ELF at Kuparuk, and against it at Prudhoe?

Dickinson said Tarn and Meltwater are examples of the difference: Tarn is some 10 miles from Kuparuk facilities, he said, and was developed from new drill sites. Meltwater is an additional six or seven miles out from Tarn, again on a new drill site.

"If you go to the west end of Prudhoe Bay," where a lot of the Prudhoe satellites are, you find a drill site and "each well is going down to a different — at least before the aggregation decision — what might be a different field."

If you focus on "what's on the surface, on the economics of putting together these systems, I think you'll see that that's a very different situation,"

Dickinson said.

Another difference between Kuparuk and Prudhoe, he said, is that "in Kuparuk there is a slight difference of ownership ... between the satellites and the mother field" so satellite owners sending production to the main field have to deal with the different ownerships.

At Prudhoe, until 2000, "the satellites were owned in very different percentages than the mother field and that, I think, impeded a lot of the development." The equity re-determination at Prudhoe resulted in everybody owning the same percentage of everything — the field and satellites, the roads, the production facility. "So that somebody didn't say well, gee, if you put your production in this production facility on that road and you use that electrical line, I want to get reimbursed each time."

Dickinson said the regulations clearly contemplate that decisions on satellites "would be issued beforehand, in other words, if it's going to be a factor in the decision to invest, then you have the opportunity to get it before and to insist on getting the letter before you make your investment."

Oil and Gas: Economies of scale

Bill Van Dyke, Department of Natural Resources Division of Oil and Gas petroleum manager, told the committee that at Prudhoe, the main field "supported the initial development" and the smaller pools are "like icing on the cake."

There are multiple shared facilities at Prudhoe Bay, Van Dyke said, and for the satellite pools "they didn't go out and build all new facilities to produce pools. No, they're using the existing facilities. And that's good. Because that means obviously development costs are a lot lower, because you're just using what's already there."

The satellites at Prudhoe have been known, because the companies drilled

through them early on, Van Dyke said, but because of disparate ownership development was difficult until the common equity agreement was reached in 2000.

There are a few facilities at Prudhoe that the common equity agreement does not cover, but those are in the minority. But for the most part, he said, "everybody owns the same interest in everything, and it really changed the way business is done in Prudhoe Bay. I don't think it's any coincidence that starting in the year 2000 after this common equity agreement that you could see the satellite production blossom at Prudhoe Bay." The satellites are producing close to 50,000 bpd, he said. "It's like finding a huge new oil field on the North Slope."

Oil & Gas: Other opportunities

There are other investment opportunities on the North Slope, Van Dyke said, but companies will have to be able to make a profit in order to develop them. Companies look at factors such as the flow rate from wells, location in relation to infrastructure and access to that infrastructure, he said.

There are also some big fields that have been discovered but haven't been developed because they're offshore the Arctic National Wildlife Refuge "out in relatively deep water," Van Dyke said, on the federal outer continental shelf.

Because they are remote, "they're going to be very expensive to develop and so today they just sit there."

The offshore wells, like Kuvlum and Hammerhead, even if the federal government decided to charge zero royalty and zero severance tax "those fields are probably uneconomic to develop today. So there's not a whole lot government can do other than pay someone to produce them," he said.

An onshore example of an uneconomic accumulation is the viscous Ugnu

formation at Kuparuk, Prudhoe Bay and Milne Point. The accumulation is known because companies drill through it, but it sits there because it's not economic to develop today.

There is a continuum of projects on the North Slope, he said, "they'll always be projects that are very much uneconomic; they'll be some in the middle that are maybe right on the edge; and they'll be some that are highly economic. And that's true today. That was true 20 years ago. And it will be true probably 20 years out into the future."

Van Dyke said companies make decisions to develop on a case by case basis, looking at factors such as cash flow expected from a development, how much risk is involved and what the company's forecast is for oil prices. A project that's acceptable to one company might not be to another, he said. "They all forecast price differently. And they all evaluate the risks differently, both the geologic risk and the commercial risk and ... the chances of changes in government take down the road."

Alaska's Current Oil and Gas Fiscal System

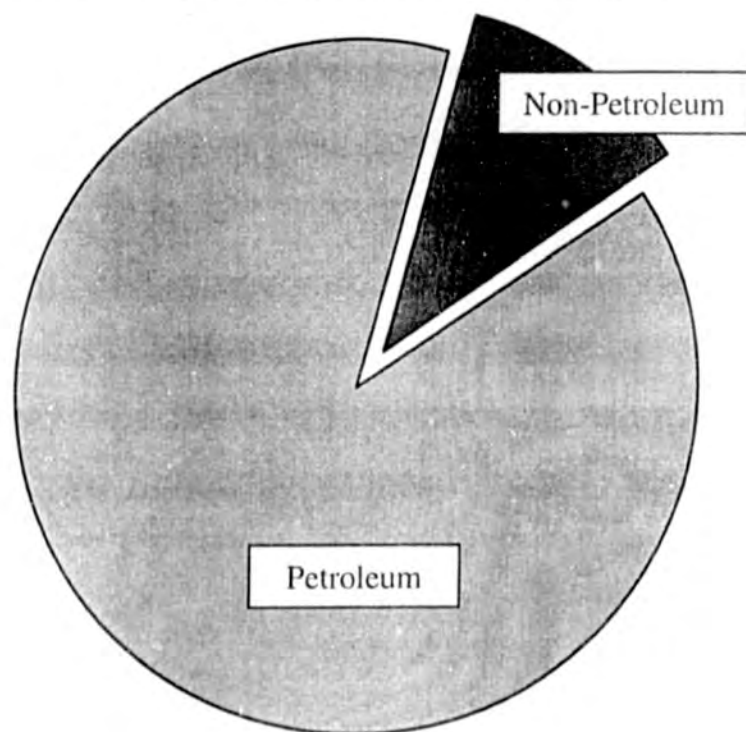
March 18, 2005

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AOGA

Oil & Gas: Vital to Alaska

FY05 Unrestricted Revenue



“Oil revenue will provide at least 75% of forecasted Unrestricted General Purpose Revenue through FY 2014. Two elements are critical to the oil revenue forecast: price and volume.”

Fall 2004 Revenue Sources Book

Present System's Four Elements

	<u>FY2004 Actuals (\$millions)</u>	
	<u>To General Fund</u>	<u>To "Other"</u>
Royalty	1,043.6	485.2
Production Tax	651.9	-
Property Tax	47.3	218.7
Oil & Gas Corp. Income Tax	<u>298.8</u>	<u>-</u> a
TOTAL	2,041.6	703.9
ALL OIL & GAS PAYMENTS	2,745.5	

(Royalty "Other" is the Permanent Fund; property tax "Other" is municipalities taxing the same property.)

Point No. 1

Even if ELF makes the production tax zero for a field, the field –

- **pays full royalty to the State**
- **pays full property taxes on its facilities**
- **contributes fully to the owners' income taxes**
- **increases the netback value by lowering tariffs**
- **creates Alaska jobs**

Production Tax

- A tax on the act of producing oil, gas
- **Tax = ELF × Base Rate × Gross Resource Value**
 - **Gross Resource Value = Netback × Taxable Volume**
 - **Base Rate: gas 10%; oil 12¼% 1st 5 yr, then 15%**
 - **ELF: a field-specific number from zero to one**

Oil ELF is based on field size and well productivity; larger fields have larger ELF's and higher tax rates, as do fields with more productive wells; smaller fields and ones with low well productivity have smaller ELF's and lower tax rates. Gas ELF is based on well productivity only

Netback Methodology



West Coast Spot Price	\$25.00
Marine Transportation	(1.61)
TAPS	<u>(3.05)</u>
Netback at Pump Stn. 1	\$20.34

Why Have an ELF?

To allow a high-rate production tax early in a typical field's life, while avoiding the adverse consequences as the field is depleted