

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

3079 SCOMM 142: HOUSE SPECIAL COMMITTEE ON WAYS & MEANS 2005-2006

Industry examples Manufacturing & Resellers

	manufacturing	resellers	
	bakery	grocery store	attorney
supplies (sale for resale)	flour	meat, canned goods, bread, flour	contract attorneys; process server fees *
directly used in production process	oven, repair of oven, electricity to run oven	n/a	n/a
indirect costs	paper bags for freshly baked goods; storage shelves	shelves, advertising	telephone book advertising; fax machine

* if separately itemized on client invoice

4/1/05

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Industry examples Extractive industries

	oil & gas E & P company	extractive industries	
		mining	fishing
supplies (sale for resale)	n/a	n/a	n/a
directly used in production process	"Christmas Tree", drilling mud	front-end loader, dredge, lubricating oils, arsenic	fishing boat, nets, bait
indirect costs	seismic studies, road making, crew housing, surveys; attorney fees; photocopy machine; paper	equipment used for reclamation; bookkeeping;	crew food, fuel

E & P = exploration & production

Current Issues

4/1/05

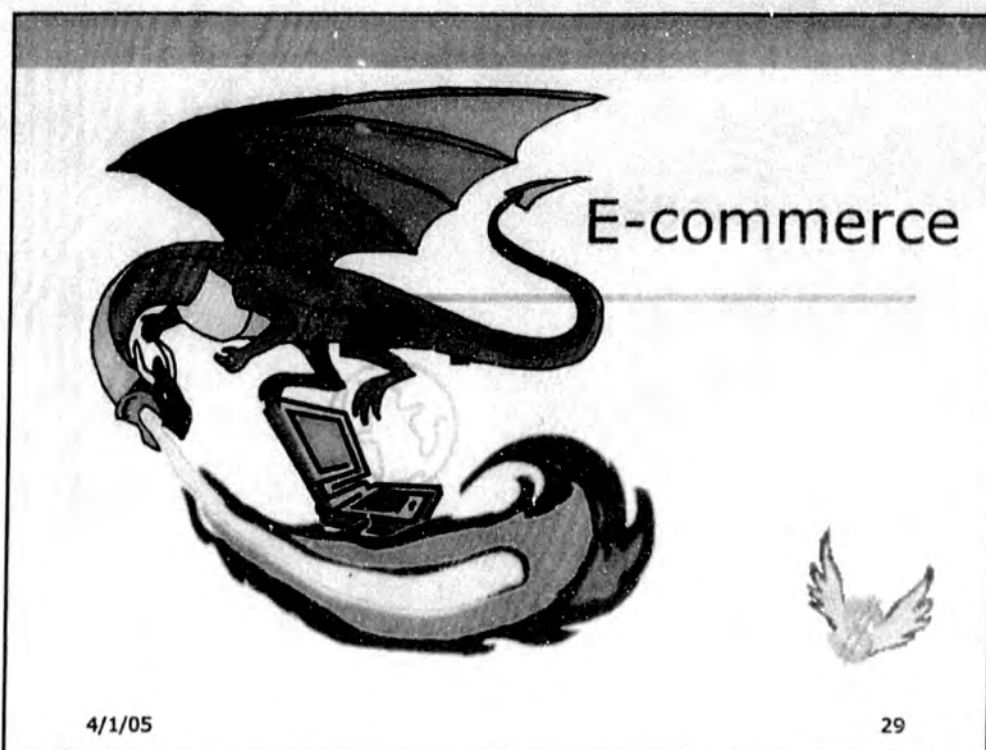
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E-commerce

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Internet Tax Nondiscrimination Act

- Extended moratorium until 11/1/07
- Moratorium on
 - Taxes on internet **access**
 - Taxes in place before 10/1/98 grandfathered
- Did NOT affect duties of remote seller to collect use tax

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Internet Sales Issues

- Taxes on access fees
- What is included in "access fees" ?
- Duties of remote sellers to collect use taxes
- Agency nexus
- Digitally delivered products

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Streamlined Sales Tax Project (SSTP)

- Who: A group of state governments, with input from local governments and the private sector
- Purpose: to design, test and implement a sales and use tax system that radically simplifies sales and use taxes.

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SSTP key provisions

- Rate simplification
- Uniform sourcing rule
- Uniform definitions
- State-level administration of local taxes

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SSTP current status

- 19 states have passed legislation to make their tax compliant
- Governing Board is evaluating those state systems
- SSTP is expected to be operational late 2005
- Voluntary remote collection

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Pertinent Points

- Broad base, low rate
- Clarity = certainty
- Build the sales tax model for the future
- Take advantage of the SSTP

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**Survey on Rounding on State Tax Returns
(Based on Results of Outside Survey)**

December 2004

STATE	Does your state require or permit dropping cents from certain tax returns?		What tax returns do you currently permit require whole dollar reporting?	Does your state allow whole dollar reporting on tax withholding tables?
	<i>permit</i>	<i>require</i>		
Alaska	Yes		Corporate, Motor Fuel, Excise	N/A - No individual income tax
Arizona		Yes	Individual, and Corporate Income tax	We have no tables since our withholding is a percentage of the actual federal withholding, but we do not prohibit it
Arkansas		Yes	Individual, corporate income & Sales and Use Tax	No
California - Franchise Tax Board (Income Tax)	Yes		Individual	No
California - Equalization Tax Board (Property Tax)	Yes - all property statements and related forms	Yes - Tangible Property List	Permit - all property statements and related forms; Require - Tangible Property List	N/A

California - Equalization Tax Board (Sales & Use, Special)		Yes	All returns used by the Sales and Use Tax Department	N/A
Connecticut		Yes	All taxes except sales & use and withholding	No

Delaware	Yes	Yes	Required: Individual and Business; Optional: Withholding	Withholding Tables are calculated to the penny
District of Columbia	Yes		All individual & business returns; Monthly/annual sales & Use returns and Annual property return are dollars/cents (due to legislative oversight	No - received large numbers of complaints when tried
Idaho		Yes	We permit on all Idaho tax returns. We have only Implemented on individual and business income tax forms to date	Yes

Illinois	Yes - permitted for income tax since 1984	Yes - required for sales tax	Sales (mandate); Permit (individual)	Yes
Indiana	Yes		Individual, corporate, trust, estate, sales/use, withholding, food and beverage, county innkeepers	No
Iowa	Yes - Individual & Corporate Income Tax	Yes - Required for sales and withholding tax	Currently, individual and corporation; 2005 for sales and withholding (currently permitted)	Yes
Kansas		Yes	Individual and corporate income tax; privilege tax; rounding not allowed on sales & excise tax (trust fund tax)	No

Kentucky	Yes (Withholding, Sales and Corporate)	Yes - Income	Individual Income Taxes only	No
Louisiana		Yes	Individual and corporate income, corporation franchise, sales/use, hazardous waste, dealer's motor fuels, gift, oilfield restoration fees, withholding	The tax tables are not rounded to whole dollars; tax returns remitting the withholding tax require rounding
Maine	Yes	Yes - required on certain scanned returns (Business, Withholding & Information)	All tax returns - individual, corporate, sales, excise, etc.	No

Maryland (electronic)		Yes - all financial fields on E-filed personal returns are rounded to the nearest whole dollar amount	All electronic - personal/individual	Left Blank
Maryland (paper)	Yes		All	Yes
Massachusetts	Yes (income fiduciary, grantors/owners share of a grantor type trust	Yes (Corporate & Bank, Insurance Forms)	Permit (income, fiduciary, grantors/owners share of a grantor trust) Require (corporate, bank, insurance forms)	No

Minnesota		Yes	Encourage TP's to use rounded numbers; Required rounding on individual income tax (M-1) and property tax (M-1PR). Sales and Use taxes and withholding are required to round as they are required to be e-filed	Amounts are rounded in the withholding tables; ask employers to round but they don't always comply with the request
Mississippi		Yes- we require dropping cents on all of the major taxes	Almost all - our major taxes are income and sales	Yes - the amounts in our tables are whole dollar amounts
Missouri		Yes	Individual, corporate, franchise, withholding & fuel; no to Sales, Cigarettes/OTP	Yes
Montana	Yes		Individual income and other tax returns	Yes
Nevada	No	No - Computer system not able to handle rounding; also would need to amend law;		

New Hampshire	Yes		1987 - interest & dividend tax, business profit tax; 1998 - meals and rentals	No income tax so no withholding table
New Jersey	Yes		All tax returns	Published with dollars and cents but rounding is permitted
New Mexico	Yes		Personal income tax, Corporate income tax, & pass through entity form	No
New York	Yes		All returns	No
North Carolina		Yes	Individual income, corporate, withholding required; sales tax not rounded	Yes

North Dakota	Yes		Income and tax amounts for corporate income tax, individual income tax and withholding tax	Yes; publish withholding tables in whole dollars; Our "percentage of wages method" tax rate tables are published with cents but employers are allowed to round
Oklahoma		Yes	Corporate and individual income tax returns; rounding on all tax forms	Yes
Oregon		Yes	All income tax, corporation and fiduciary (Oregon does not have a sales tax)	Tax Withholding tables show only whole dollar amounts
Pennsylvania	Yes (Individual Income Tax)	Yes (Corporation Tax)	Individual & Corporate	PA is a flat tax state and no tables are required; employers are not permitted to round when remitting tax withheld

Rhode Island	Yes		Individual and all Business Taxes	No
Texas		No; Sales tax rule (3.286) prohibits rounding		
Utah	Yes - Permit on Sales and Corporation Income Tax	Yes - Require on Income & Fiduciary Tax	Individual, sales & use (online only), corporate, partnership and fiduciary	No. Withholding tax return allows for cents to be reported
Vermont	Yes		Individual and Corporate	Yes
Virginia		Yes	Permit on all returns; Required on individual filings (returns, estimated payments, extension payments etc.	Yes - all our withholding tables round all amounts to the nearest dollar except our daily payroll table

Washington	Yes		We do not have an income tax	NA
West Virginia		Yes	Permitted since 1986 on income tax. Required since 1-1-01 on personal income tax, consumer sales and service returns; direct pay permit, corporation income tax, business franchise tax, use tax, & withholding returns	Yes

RESULTS OF WHOLE DOLLAR REPORTING SURVEY WITH STATE TAXING AGENCIES (v.2)

As of December 9, 2004, 37 states and the District of Columbia responded to the IRS survey. That represents a 75% response rate.

The following states do not have income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. Two of these states responded either as a "negative" or provided information about other types of taxes they have (i.e. sales, corporation, etc.)

Of the states who responded to the survey, 66% (25) either require all (15) or part (10) of their taxes to be rounded.

29% (11) permit taxes to be rounded but do not require it.

5% (2) do not require or permit taxes to be rounded (Texas & Nevada).

55% (21) had no difficulty with the public in adjusting to whole dollar reporting. 16% (6) reported "very little" difficulty with the public in adjusting to whole dollar reporting. 13% (5) did report difficulty with the public in adjusting to whole dollar reporting. 11% (4) either had no information, the change was too new to measure, or other changes were made at the same time rounding was implemented. 2 states (5%) reported no rounding efforts have begun.

47% (18) reported cost savings. 26% (10) reported no cost savings. 18% (7) reported no information available and 3% (1) reported "too new to measure". It should be noted that very few who reported cost savings had quantifiable results. 2 states (5%) reported no rounding efforts have begun. (Adds to 99% due to "rounding").

Several states reported resistance to rounding on trust fund taxes from taxpayers and payroll service providers.

Verbatim survey responses are captured in an accompanying EXCEL spreadsheet. There are some responses that were edited due to length. All responses are on file with Patricia.A.Hammond@irs.gov and can be furnished upon request.

2002 State & Local Revenue

	--Total Own Source Revenue--			--Total Tax Collections--		
	(\$ million)	Per Capita	Rank	(\$ million)	Per Capita	Rank
Alabama	17,478	3,930	43	9,719	2,185	51
Alaska	5,420	8,644	1	2,070	3,301	17
Arizona	19,805	3,860	47	14,420	2,810	31
Arkansas	9,614	3,597	50	6,461	2,417	47
California	178,394	5,267	9	120,424	3,555	10
Colorado	21,772	5,062	11	13,900	3,232	18
Connecticut	18,766	5,510	7	15,125	4,441	3
Delaware	4,641	5,920	5	2,687	3,427	14
District of Columbia	4,082	7,137	2	3,228	5,643	1
Florida	71,707	4,487	27	44,840	2,806	32
Georgia	35,002	4,276	34	24,058	2,939	27
Hawaii	5,881	4,852	16	4,240	3,498	11
Idaho	5,204	4,022	39	3,291	2,543	44
Illinois	56,382	4,540	25	41,570	3,347	15
Indiana	26,080	4,289	33	16,987	2,794	34
Iowa	13,245	4,527	26	8,330	2,847	29
Kansas	11,537	4,292	32	7,975	2,967	26
Kentucky	15,817	3,913	45	10,781	2,667	40
Louisiana	19,563	4,377	31	12,182	2,726	35
Maine	6,176	4,844	17	4,541	3,562	9
Maryland	26,391	4,983	12	19,874	3,753	6
Massachusetts	32,826	5,170	10	23,895	3,764	5
Michigan	45,398	4,568	21	30,644	3,084	24
Minnesota	27,105	5,510	6	18,456	3,752	7
Mississippi	10,667	3,750	48	6,524	2,293	49
Missouri	21,733	3,884	46	15,123	2,703	36
Montana	3,532	3,915	44	2,135	2,367	48
Nebraska	7,848	4,587	20	5,316	3,107	23
Nevada	9,785	4,897	14	6,433	3,220	20
New Hampshire	5,110	4,134	38	3,599	2,912	28
New Jersey	46,307	5,504	8	34,629	4,116	4
New Mexico	7,744	4,257	35	4,878	2,681	39
New York	119,356	6,290	3	88,878	4,684	2
North Carolina	33,924	4,215	36	22,576	2,805	33
North Dakota	2,838	4,420	30	1,729	2,693	38
Ohio	51,704	4,554	23	36,165	3,186	21
Oklahoma	13,648	3,955	41	8,782	2,545	43
Oregon	15,187	4,439	28	9,003	2,632	41
Pennsylvania	55,935	4,555	22	37,627	3,064	25
Rhode Island	4,870	4,647	18	3,622	3,456	13
South Carolina	15,907	3,965	40	9,752	2,431	46
South Dakota	2,752	3,645	49	1,841	2,439	45
Tennessee	19,880	3,494	51	12,974	2,281	50
Texas	86,214	4,135	37	58,981	2,829	30
Utah	9,886	4,427	29	6,026	2,699	37
Vermont	2,770	4,549	24	1,965	3,227	19
Virginia	32,791	4,632	19	22,131	3,126	22
Washington	29,303	4,972	13	19,514	3,311	16
West Virginia	7,112	3,934	42	4,641	2,567	42

Wisconsin	26,100	4,866	15	18,610	3,469	12
Wyoming	3,050	6,173	4	1,818	3,681	8
U.S. Total	1,324,241	4,706		904,971	3,216	

Source: U.S. Bureau of the Census.

2002 State & Local Revenue as a Percentage of Personal Income

	--Total Own Source Revenue--			--Total Tax Collections--		
	(\$ million)	% Personal Income	Rank	(\$ million)	% Personal Income	Rank
Alabama	17,478	15.8	20	9,719	8.8	49
Alaska	5,420	26.9	1	2,070	10.3	28
Arizona	19,805	14.3	39	14,420	10.4	22
Arkansas	9,614	15.4	27	6,461	10.4	24
California	178,394	15.7	22	120,424	10.6	17
Colorado	21,772	14.3	40	13,900	9.1	47
Connecticut	18,766	12.7	50	15,125	10.3	27
Delaware	4,641	18.3	3	2,687	10.6	18
District of Columbia	4,082	15.9	16	3,228	12.6	3
Florida	71,707	15.0	36	44,840	9.4	45
Georgia	35,002	14.5	38	24,058	10.0	35
Hawaii	5,881	16.8	12	4,240	12.1	4
Idaho	5,204	15.7	21	3,291	9.9	36
Illinois	56,382	13.8	45	41,570	10.2	30
Indiana	26,080	15.5	26	16,987	10.1	32
Iowa	13,245	16.6	14	8,330	10.5	20
Kansas	11,537	14.9	37	7,975	10.3	26
Kentucky	15,817	15.6	24	10,781	10.6	16
Louisiana	19,563	17.7	4	12,182	11.0	13
Maine	6,176	17.6	5	4,541	12.9	2
Maryland	26,391	13.8	46	19,874	10.4	23
Massachusetts	32,826	13.2	48	23,895	9.6	41
Michigan	45,398	15.2	29	30,644	10.2	29
Minnesota	27,105	16.7	13	18,456	11.3	7
Mississippi	10,667	17.0	11	6,524	10.4	25
Missouri	21,733	13.8	44	15,123	9.6	39
Montana	3,532	15.9	19	2,135	9.6	42
Nebraska	7,848	15.9	17	5,316	10.8	14
Nevada	9,785	15.1	31	6,433	9.9	37
New Hampshire	5,110	12.0	51	3,599	8.4	50
New Jersey	46,307	13.9	42	34,629	10.4	21
New Mexico	7,744	17.6	7	4,878	11.1	11
New York	119,356	17.6	6	88,878	13.1	1
North Carolina	33,924	15.0	35	22,576	10.0	34
North Dakota	2,838	17.2	9	1,729	10.5	19
Ohio	51,704	15.9	18	36,165	11.1	9
Oklahoma	13,648	15.1	30	8,782	9.7	38
Oregon	15,187	15.4	28	9,003	9.1	46
Pennsylvania	55,935	15.0	34	37,627	10.1	31
Rhode Island	4,870	15.1	32	3,622	11.2	8
South Carolina	15,907	15.6	23	9,752	9.6	40
South Dakota	2,752	13.5	47	1,841	9.0	48
Tennessee	19,880	12.9	49	12,974	8.4	51
Texas	86,214	13.9	43	58,981	9.5	43
Utah	9,886	17.6	8	6,026	10.7	15
Vermont	2,770	15.6	25	1,965	11.0	12
Virginia	32,791	14.0	41	22,131	9.5	44

Washington	29,303	15.1	33	19,514	10.0	33
West Virginia	7,112	17.0	10	4,641	11.1	10
Wisconsin	26,100	16.5	15	18,610	11.7	6
Wyoming	3,050	20.3	2	1,818	12.1	5
U.S. Total	1,324,241	15.2		904,971	10.4	

Source: U.S. Bureau of the Census and Bureau of Economic Analysis.

2002 State & Local Own Source Revenue

	---State---		---Local---	
	(\$ million)	% of Total	(\$ million)	% of Total
Alabama	9,711	55.6	7,767	44.4
Alaska	3,866	71.3	1,553	28.7
Arizona	10,600	53.5	9,205	46.5
Arkansas	7,104	73.9	2,510	26.1
California	97,620	54.7	80,774	45.3
Colorado	10,009	46.0	11,764	54.0
Connecticut	11,613	61.9	7,153	38.1
Delaware	3,711	80.0	930	20.0
District of Columbia	--	--	4,082	100.0
Florida	33,854	47.2	37,853	52.8
Georgia	17,503	50.0	17,499	50.0
Hawaii	4,675	79.5	1,206	20.5
Idaho	3,045	58.5	2,160	41.5
Illinois	28,905	51.3	27,477	48.7
Indiana	13,983	53.6	12,097	46.4
Iowa	7,581	57.2	5,664	42.8
Kansas	6,187	53.6	5,350	46.4
Kentucky	10,689	67.6	5,129	32.4
Louisiana	11,610	59.3	7,953	40.7
Maine	3,770	61.0	2,406	39.0
Maryland	14,456	54.8	11,935	45.2
Massachusetts	21,045	64.1	11,781	35.9
Michigan	29,379	64.7	16,019	35.3
Minnesota	16,483	60.8	10,622	39.2
Mississippi	6,509	61.0	4,158	39.0
Missouri	11,835	54.5	9,898	45.5
Montana	2,294	65.0	1,237	35.0
Nebraska	4,164	53.1	3,684	46.9
Nevada	4,829	49.4	4,956	50.6
New Hampshire	3,001	58.7	2,109	41.3
New Jersey	25,220	54.5	21,087	45.5
New Mexico	5,623	72.6	2,121	27.4
New York	55,167	46.2	64,189	53.8
North Carolina	19,771	58.3	14,153	41.7
North Dakota	1,825	64.3	1,013	35.7
Ohio	27,578	53.3	24,127	46.7
Oklahoma	8,641	63.3	5,007	36.7
Oregon	8,594	56.6	6,593	43.4
Pennsylvania	32,811	58.7	23,124	41.3
Rhode Island	3,116	64.0	1,754	36.0
South Carolina	9,042	56.8	6,864	43.2
South Dakota	1,541	56.0	1,211	44.0
Tennessee	10,303	51.8	9,576	48.2
Texas	40,796	47.3	45,418	52.7
Utah	6,345	64.2	3,542	35.8
Vermont	2,142	77.3	628	22.7
Virginia	19,312	58.9	13,480	41.1
Washington	16,427	56.1	12,877	43.9
West Virginia	5,153	72.5	1,959	27.5

Wisconsin	15,843	60.7	10,256	39.3
Wyoming	1,599	52.4	1,450	47.6
U.S. Total	726,882	54.9	597,359	45.1

Source: U.S. Bureau of the Census.

2002 State & Local Tax Collection by Source

(Percentage of Total)

	Property	Sales	Selective Sales	Individual Income	Corporate Income	Other
Alabama	15.2	30.5	18.8	21.9	3.3	10.3
Alaska	40.1	5.9	9.1	n.a.	13.0	31.9
Arizona	29.5	40.1	9.0	14.5	2.4	4.5
Arkansas	15.5	39.3	12.4	24.2	2.7	5.8
California	25.1	26.0	8.5	27.4	4.4	8.5
Colorado	29.9	29.	8.4	25.0	1.5	5.4
Connecticut	39.6	20.1	9.7	24.4	1.0	5.1
Delaware	14.9	n.a.	12.1	28.4	9.4	35.2
District of Columbia	24.9	17.3	11.7	29.4	6.5	10.2
Florida	35.1	33.5	17.6	n.a.	2.7	11.0
Georgia	27.6	31.1	7.9	27.0	2.4	4.0
Hawaii	14.5	38.0	14.9	26.2	1.2	5.1
Idaho	29.1	24.2	10.3	25.6	2.3	8.4
Illinois	38.2	18.1	15.3	18.0	3.3	7.1
Indiana	35.2	22.4	10.1	24.3	4.2	3.9
Iowa	34.5	24.2	10.4	21.8	1.1	8.0
Kansas	31.7	28.8	9.7	23.3	1.5	5.1
Kentucky	18.3	21.4	15.1	32.4	2.8	9.9
Louisiana	15.9	39.7	17.3	14.7	2.2	10.2
Maine	42.1	18.4	8.9	23.6	1.7	5.2
Maryland	27.2	13.5	11.5	38.5	1.8	7.5
Massachusetts	36.5	15.5	7.0	33.1	3.4	4.5
Michigan	32.0	25.4	8.0	21.5	6.7	6.4
Minnesota	28.3	20.5	11.6	29.5	2.9	7.3
Mississippi	25.2	35.9	14.0	15.1	3.0	6.8
Missouri	25.7	28.1	11.9	26.0	2.0	6.4
Montana	39.9	n.a.	17.5	24.2	3.2	15.1
Nebraska	32.9	24.2	10.0	21.7	2.0	9.2
Nevada	26.5	34.5	25.2	n.a.	n.a.	13.8
New Hampshire	60.3	n.a.	16.8	2.0	10.5	10.4
New Jersey	46.3	17.3	8.1	19.8	3.2	5.2
New Mexico	15.5	36.2	11.4	20.2	2.5	14.2
New York	30.2	18.7	6.6	34.0	5.7	4.8
North Carolina	24.0	21.7	13.0	32.2	3.0	6.1
North Dakota	30.8	22.8	17.0	11.5	2.9	14.9
Ohio	29.4	21.3	8.5	32.6	2.1	6.1
Oklahoma	16.9	29.6	9.6	26.0	2.0	15.9
Oregon	34.9	n.a.	9.9	40.8	2.2	12.3
Pennsylvania	29.0	19.9	10.1	25.3	3.2	12.5
Rhode Island	40.4	20.2	12.0	22.7	0.8	4.0
South Carolina	31.8	25.0	10.1	24.1	1.6	7.4
South Dakota	36.3	36.5	14.0	n.a.	2.2	11.0
Tennessee	26.6	45.0	12.5	1.1	3.9	10.9
Texas	41.6	31.1	17.5	0.0	n.a.	9.9
Utah	23.6	32.7	10.8	26.6	1.8	4.5
Vermont	41.9	10.9	18.2	20.8	1.9	6.3
Virginia	30.3	16.2	13.4	30.3	1.4	8.4
Washington	29.7	47.3	14.1	n.a.	n.a.	9.0

West Virginia	19.4	20.7	21.9	22.3	4.7	10.9
Wisconsin	34.7	21.0	9.6	26.7	2.4	5.5
Wyoming	38.1	31.9	6.1	n.a.	n.a.	23.9
U.S. Total	30.8	24.6	11.2	22.4	3.1	7.8

Source: U.S. Bureau of the Census.

--- tax not levied at state level.

Comparison of State and Local Retail Sales Taxes

January 2004

	Food Items [1] Taxable (T) Exempt (E)	State Rate	Maximum Local Rate [2]	Maximum State/Local Rate [2]
Alabama	T	4.00	7.00	11.00
Alaska	T	---	7.00 [3]	7.00
Arizona	E	5.60	4.50	10.10
Arkansas	T	5.125	5.50	10.625
California	E	6.00	2.75	8.75
Colorado	E	2.90	7.00	9.90
Connecticut	E	6.00	---	6.00
District of Columbia	E	5.75	---	5.75
Florida	E	6.00	1.50	7.50
Georgia	E [4]	4.00	3.00	7.00
Hawaii	T*	4.00	---	4.00
Idaho	T*	6.00	3.00	9.00
Illinois	T**	6.25	3.00	9.25
Indiana	E	6.00	---	6.00
Iowa	E	5.00	2.00	7.00
Kansas	T*	5.30	3.00	8.30
Kentucky	E	6.00	---	6.00
Louisiana	E [4]	4.00	6.25	10.25
Maine	E	5.00	---	5.00
Maryland	E	5.00	---	5.00
Massachusetts	E	5.00	---	5.00
Michigan	E	6.00	---	6.00
Minnesota	E	6.50	1.00	7.50
Mississippi	T	7.00	0.25	7.25
Missouri	T**	4.225	4.5	8.725
Nebraska	E	5.50	1.50	7.00
Nevada	E	6.50	1.00	7.50
New Jersey	E	6.00	---	6.00
New Mexico	T	5.00	2.25	7.25
New York	E	4.25	4.50	8.75
North Carolina	E [4]	4.50	3.00	7.50
North Dakota	E	5.00	2.50	7.50
Ohio	E	6.00	2.00	8.00
Oklahoma	T	4.50	6.00	10.50
Pennsylvania	E	6.00	1.00	7.00

Rhode Island	E	7.00	---	7.00
South Carolina	T**	5.00	2.00	7.00
South Dakota	T*	4.00	2.00	6.00
Tennessee	T	7.00	2.75	9.75
Texas	E	6.25	2.00	8.25
Utah	T	4.75	2.25	7.00
Vermont	E	6.00	1.00	7.00
Virginia	T**	3.50	1.00	4.50
Washington	E	6.50	2.40	8.90
West Virginia	T	6.00	---	6.00
Wisconsin	E	5.00	0.60	5.60
Wyoming	T*	4.00	2.00	6.00

[1] Food purchased for consumption off-premises.

[2] Highest local rate known to be actually levied by at least one jurisdiction. Includes local taxes for general purposes and those earmarked for specific purposes (e.g. transit). Taxes applying only to specified sales (e.g. lodging or meals) are excluded.

[3] Alaskan cities and boroughs may levy local sales taxes from 1% to 6%.

[4] Food exempt from state tax, but subject to local taxes.

* Income tax credit allowed to offset sales tax on food.

** Food taxed at lower rate.

Source: Compiled by the Federation of Tax Administrators from various sources.

State Sales Tax Rates

January 1, 2005

State	Tax Rates	-----Exemptions-----		
		Food	Prescription Drugs	Non-prescription Drugs
ALABAMA	4		*	
ALASKA	none			
ARIZONA	5.6	*	*	
ARKANSAS	6		*	
CALIFORNIA (3)	7.25 (2)	*	*	
COLORADO	2.9	*	*	
CONNECTICUT	6	*	*	*
DELAWARE	none			
FLORIDA	6	*	*	*
GEORGIA	4	*(4)	*	
HAWAII	4		*	
IDAHO	6		*	
ILLINOIS (2)	6.25	1%	1%	1%
INDIANA	6	*	*	
IOWA	5	*	*	
KANSAS	5.3		*	
KENTUCKY	6	*	*	
LOUISIANA	4	*(4)	*	
MAINE	5	*	*	
MARYLAND	5	*	*	*
MASSACHUSETTS	5	*	*	
MICHIGAN	6	*	*	
MINNESOTA	6.5	*	*	*
MISSISSIPPI	7		*	
MISSOURI	4.225	1.225	*	
MONTANA	none			
NEBRASKA	5.5	*	*	
NEVADA	6.5	*	*	
NEW HAMPSHIRE	none			
NEW JERSEY	6	*	*	*
NEW MEXICO	5	*	*	
NEW YORK	4.25	*	*	*
NORTH CAROLINA (6)	4.5	*(4)	*	
NORTH DAKOTA	5	*	*	
OHIO	6	*	*	
OKLAHOMA	4.5		*	
OREGON	none			
PENNSYLVANIA	6	*	*	*
RHODE ISLAND	7	*	*	*
SOUTH CAROLINA	5		*	
SOUTH DAKOTA	4		*	
TENNESSEE	7	6%	*	
TEXAS	6.25	*	*	*
UTAH	4.75		*	

VERMONT	6	*	*	*
VIRGINIA	5 (2)	4.0% (5)	*	*
WASHINGTON	6.5	*	*	
WEST VIRGINIA	6		*	
WISCONSIN	5	*	*	
WYOMING (3)	4		*	
DIST. OF COLUMBIA	5.75	*	*	*

* - indicates exempt from tax, blank indicates subject to general sales tax rate.

Source: Compiled by FTA from various sources.

(1) Some state tax food, but allow an (income) tax credit to compensate poor households. They are: HI, ID, KS, SD, and WY.

(2) Includes statewide local tax of 1.25% in California and 1.0% in Virginia.

(3) Tax rate may be adjusted annually according to a formula based on balances in the unappropriated general fund and the school foundation fund.

(4) Food sales are subject to local sales taxes.

(5) Tax rate on food is scheduled to decrease to 3.5% on 1/1/05. Statewide local tax is included

(6) Tax Rate scheduled to decrease to 4% after 6/30/2005.

STATE SALES TAX RATES AND VENDOR DISCOUNTS

(January 1, 2005)

	STATE		VENDOR	
ALABAMA	4.0%	39	5.0%-2.0% (1)	
	-----N/A-----			
ALASKA	-	---	---	
ARIZONA	5.6%	23	1.0%	\$10,000/year (max)
ARKANSAS	6.0%	9	2.0%	\$1,000/month (max)
CALIFORNIA (3)	6.0%	9	None	
COLORADO	2.9%	46	2.33% (4)	
CONNECTICUT	6.0%	9	None	
	-----N/A-----			
DELAWARE	-	---	---	
FLORIDA	6.0%	9	2.5%	\$30/report (max)
			3.0%-0.5%	
GEORGIA	4.0%	39	(1)	
HAWAII	4.0%	39	None	
IDAHO	6.0%	9	None (5)	
ILLINOIS	6.25%	7	1.75%	\$5/year (min)
INDIANA (2)	6.0%	9	0.8%	
IOWA	5.0%	26	None	
KANSAS	5.3%	25	None	
			1.75%-	
KENTUCKY	6.0%	9	1.0% (1)	
LOUISIANA	4.0%	39	1.1%	
MAINE	5.0%	26	None (5)	
			0.6%-	
MARYLAND (9)	5.0%	26	0.45% (1)	
MASSACHUSETTS	5.0%	26	None	
MICHIGAN	6.0%	9	0.5% (6)	\$6/month (min)
MINNESOTA	6.5%	4	None	
MISSISSIPPI	7.0%	1	2.0%	\$50/month (max)
MISSOURI	4.225%	37	2.0%	
	-----N/A-----			
MONTANA	-	---	---	
NEBRASKA	5.5%	24	2.5%	\$75/month (max)
NEVADA	6.5%	4	0.5%	
	-----N/A-----			
NEW HAMPSHIRE	-	---	---	
NEW JERSEY	6.0%	9	None	
NEW MEXICO	5.0%	26	None	
NEW YORK	4.25%	37	3.5%	\$150/quarter (max)
NORTH CAROLINA (11)	4.5%	35	None	
NORTH DAKOTA	5.0%	26	1.5%	\$255/quarter (max)
OHIO	6.0%	9	0.9% (9)	
OKLAHOMA	4.5%	35	1.25% (10)	\$3,300/month (max)
	-----N/A-----			
OREGON	-	---	---	
PENNSYLVANIA	6.0%	9	1.0%	
RHODE ISLAND	7.0%	1	None	
			3.0%-2.0%	
SOUTH CAROLINA	5.0%	26	(1)	\$3,100/year (max)
SOUTH DAKOTA	4.0%	39	None	
TENNESSEE	7.0%	1	None	
TEXAS	6.25%	7	0.5% (7)	
UTAH	4.75%	34	1.5%	
VERMONT	6.0%	9	None (5)	
			4.0%-2.0%	

VIRGINIA (3)	4.0%	39	(8)	
WASHINGTON	6.5%	4	None	
WEST VIRGINIA	6.0%	9	None	
WISCONSIN	5.0%	26	0.5%	\$10/period (min)
WYOMING	4.0%	39	None	
DIST. OF COLUMBIA	5.75%	22	1.0%	\$5,000/month (max)
U. S. MEDIAN	5.6%		1.8%-1.4% (1)	27 states allow vendor discounts

(1) In some states, the vendors' discount varies by the amount paid. In AL and SC, the larger discounts apply to the first \$100. In GA, the larger discount applies to the first \$3,000. In KY, the larger discounts apply to the first \$1,000, while MD applies the larger discount to annual collections of \$6,000. The lower discounts apply to the remaining collections above these amounts.

(2) Utilities are not permitted to take discount.

(3) Rate does not include a statewide local rate of 1.25% in CA and 1.0% in VA.

(4) Vendor discount is scheduled to increase to 3.33% after 6/30/05. Vendor discount applies to the state taxes collected. Discount for local option sales tax varies from 0% to 3.33%.

(5) Vendors are allowed to keep any excess collections prescribed under the bracket system.

(6) Vendor discount only applies to the first 4.0% of the tax. A 0.75% discount if paid by the 7th of the month.

(7) An additional discount of 1.25% applies for early payment.

(8) Discount varies; 4% of the first \$62,500, 3% of the amount to \$208,000, and 2% of the remainder. Applies to the first 3% of the tax

(9) In MD, vendor discount rate will increase to 1.2% and 0.9% on 7/1/06. Discount will decrease to 0.75% on 7/1/05 in OH.

(10) Vendors are allowed a 2.25% discount if they file and pay electronically.

(11) Tax rate scheduled to decrease to 4% after 6/30/2005.

STATE REVENUE REPORT

Fiscal Studies Program
The Nelson A. Rockefeller Institute of Government

December 2004
No. 58

State Tax Revenue on Upward Track

Nicholas W. Jenny

HIGHLIGHTS

- ❖ State tax revenue in the July-September 2004 quarter grew 8.6 percent compared to the same period in 2003.
- ❖ After adjusting for tax law changes and inflation, real underlying state tax revenue increased by 4.3 percent.
- ❖ Newly implemented changes in state tax laws generated a \$500 million net increase in state revenue.
- ❖ Personal income tax revenue grew 8.2 percent.
- ❖ Sales tax revenue grew 5.9 percent.
- ❖ Corporate income tax revenue grew a very strong 21.7 percent.

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Figure 1. Year-Over-Year Change in Total Tax Collections, 1991-2004

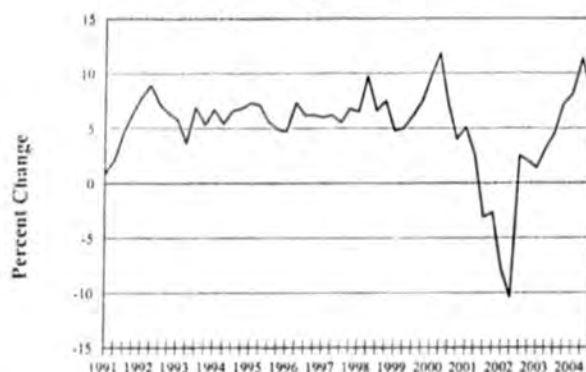


Figure 2. Year-Over-Year Change in Real Adjusted Tax Revenue, 1991-2004

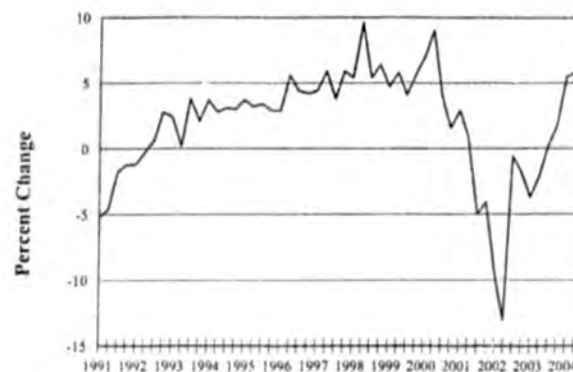


Table 1. Year-Over-Year Change in Quarterly State Tax Revenue, Adjusting for Legislated Tax Changes and Inflation

	Total Nominal Increase	Adjusted Nominal Increase	Inflation Rate	Real Increase
1998				
Jan.-Mar.	6.5	7.0	1.8	5.1
April-June	9.7	11.4	1.8	9.4
July-Sept.	6.6	7.1	1.8	5.2
Oct.-Dec.	7.5	8.0	1.5	6.4
1999				
Jan.-Mar.	4.8	6.5	1.9	4.5
April-June	5.0	8.0	2.7	5.2
July-Sept.	6.1	6.7	3.2	3.4
Oct.-Dec.	7.4	8.4	3.7	4.5
2000				
Jan.-Mar.	9.7	10.4	4.4	5.7
April-June	11.4	11.8	4.3	7.2
July-Sept.	7.1	7.7	4.3	3.3
Oct.-Dec.	4.0	5.0	4.3	0.7
2001				
Jan.-Mar.	5.1	6.3	4.0	2.2
April-June	2.5	4.2	3.4	0.8
July-Sept.	(3.1)	(2.4)	2.3	(4.6)
Oct.-Dec.	(2.7)	(2.2)	1.2	(3.4)
2002				
Jan.-Mar.	(7.8)	(8.2)	0.5	(8.7)
April-June	(10.6)	(12.1)	0.8	(12.8)
July-Sept.	2.5	0.7	1.3	(0.6)
Oct.-Dec.	1.9	0.3	2.0	(1.7)
2003				
Jan.-Mar.	1.4	(1.0)	4.2	(5.0)
April-June	3.2	0.4	3.0	(2.5)
July-Sept.	4.5	2.6	2.8	(0.2)
Oct.-Dec.	7.3	4.9	2.3	2.5
2004				
Jan.-Mar.	8.1	7.0	1.5	5.4
April-June	11.2	9.0	3.2	5.6
July-Sept.	8.6	8.2	3.7	4.3

Note: Inflation is measured by the BEA State and Local Government Inflation Price Deflator.
Please call the Fiscal Studies Program for pre-1998 data.

Table 2. Year-Over-Year Change in Quarterly State Tax Revenue by Major Tax

	PIT	CIT	Sales	Total
1998				
Jan.-Mar.	9.3	2.3	5.6	6.5
April-June	19.5	(2.1)	5.3	9.7
July-Sept.	8.9	(0.2)	5.9	6.6
Oct.-Dec.	9.5	5.2	5.5	7.5
1999				
Jan.-Mar.	6.6	(2.6)	6.1	4.8
April-June	6.0	(2.1)	7.3	5.0
July-Sept.	7.6	1.4	6.7	6.1
Oct.-Dec.	9.1	3.8	7.3	7.4
2000				
Jan.-Mar.	13.6	8.0	8.2	9.7
April-June	18.8	4.2	7.3	11.4
July-Sept.	11.0	5.7	4.7	7.1
Oct.-Dec.	5.7	(7.7)	4.1	4.0
2001				
Jan.-Mar.	8.6	(9.1)	3.3	5.1
April-June	5.6	(13.7)	0.5	2.6
July-Sept.	(3.4)	(25.5)	0.0	(3.1)
Oct.-Dec.	(2.7)	(31.8)	1.0	(2.7)
2002				
Jan.-Mar.	(14.3)	(16.1)	(1.0)	(7.8)
April-June	(22.3)	(11.7)	1.5	(10.4)
July-Sept.	(1.6)	4.8	3.8	2.5
Oct.-Dec.	(0.7)	22.4	0.7	1.9
2003				
Jan.-Mar.	(3.1)	9.6	1.9	1.4
April-June	(0.7)	17.8	2.9	3.2
July-Sept.	5.1	8.4	3.7	4.5
Oct.-Dec.	6.6	11.1	6.6	7.3
2004				
Jan.-Mar.	8.7	15.7	8.3	8.1
April-June	15.6	13.6	7.1	11.2
July-Sept.	8.2	21.7	5.9	8.6

Note: Please call the Fiscal Studies Program for pre-1998 data.

Introduction

State tax revenue increased 8.6 percent in the July-September quarter of 2004 compared to the same quarter the year before. Without the contribution of net enacted tax increases, this growth would have been 8.2 percent. If we also take into account the effects of inflation, real adjusted state tax revenue grew 4.3 percent. This is the fourth straight quarter of real adjusted growth, after nine straight quarters of decline. State tax collections are now growing strongly. (See Table 1.) All three major state taxes — personal income tax, corporate income tax, and sales tax — showed significant growth this quarter.

Tax Revenue Change

Table 1 shows tax revenue changes for the last 27 quarters before and after adjusting for legislated tax changes and inflation. Figure 1 shows the pattern of growth or decline in state tax collections from 1991 to the present. Growth in state tax collections was slightly slower in the July-September quarter than in the prior quarter, possibly because many states received a small windfall with their April personal income tax returns. Tax increases contributed to state tax revenue growth, but the contribution is getting smaller as fewer states have enacted new tax increases affecting this quarter. Figure 2 shows the pattern of growth in state tax revenue adjusted for inflation and enacted tax increases from 1991 to the present. States have now had four quarters of real adjusted growth.

Table 2 shows the last 27 quarters of change in state collections of the major state tax sources. Personal income tax revenue growth slowed a bit in the July-September quarter, but is still quite strong. Corporate income tax growth remains strong. Sales tax growth was slower than the previous three quarters, but is still positive.

Every region experienced revenue growth in the July-September quarter. (See Table 3.) The Southwest region had the strongest growth at 11.6 percent, with the Far West right behind at 11 percent growth. The slowest growth was in the Plains states at 4.5 percent.

The Mid-Atlantic states had most of the net legislated tax increases this quarter. (See Figure 3.) The other regions had relatively small tax increases or cuts that had little effect on tax revenue growth. Figure 4 shows state revenue growth adjusted for legislated revenue changes. Figure 5 shows the change in the major taxes over the last four quarters.

Table 4 shows the overall effect of legislated tax changes and processing variations. In all, states implemented net tax hikes generating \$500 million in the July-September 2004 quarter. Table 5 shows the percentage change in each state's total tax revenue adjusted for legislated tax changes and inflation.

Personal Income Tax

Personal income tax revenue grew 8.2 percent in the July-September quarter compared to the same quarter the year before. This was a considerable decline from the 15.6 percent growth of the previous quarter, which was boosted by strong payments with returns. This was, however, the fifth straight quarter of growth after two years of decline. The strongest growth was in the Mid-Atlantic region at 11.9 percent, aided by significant legislated personal income tax increases in New Jersey, New York and Pennsylvania. The weakest growth was in the Great Lakes region at 4.7 percent. Growth was widespread, affecting all of the 39 states that reported their personal income tax except for Michigan — which had a 1.1 percent decline. Maryland had the strongest growth with a 29.1 percent increase. Nine other states had double-digit increases.¹

The July-September quarter is probably the least important of the four quarters for personal income tax collections. Final settlements are not a significant factor in this quarter. Only the third estimated tax payment is due this quarter. Withholding is mostly influenced by salaries and wages, since bonuses are usually not paid until December or January. So it is in the July-September quarter that the underlying trends affecting the general economy tend to be most obvious.

Withholding

Withholding is a good indicator of the current strength of personal income tax revenue because it comes largely from current wages and because it is much less volatile than estimated payments or final

Figure 3
Percent Change in Tax Revenue by Region,
Adjusted for Legislated Changes
July-September, 2003 to 2004

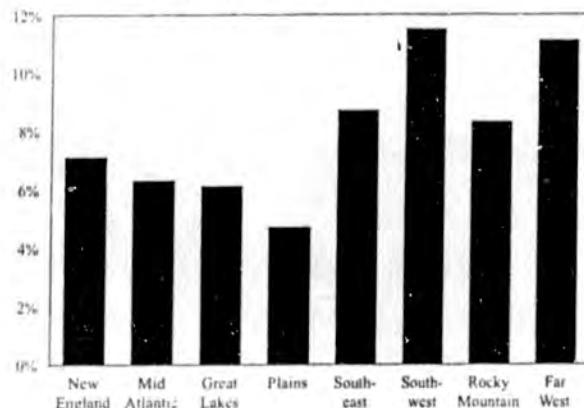


Figure 4
Change in Quarterly Tax Revenue by State, Adjusted for
Legislated Changes, July-September, 2003 to 2004



Figure 5
Change in Quarterly Tax Revenue by Tax,
Last Four Quarters

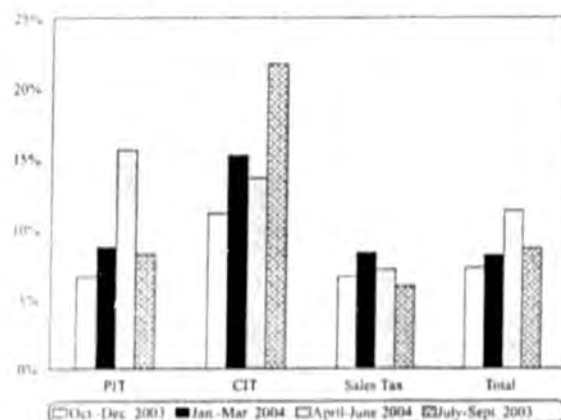


**Table 3. Change in Quarterly Tax Revenue by State,
July-September, 2003 to 2004**

	PIT	CIT	Sales	Total
United States	8.2%	21.7%	5.9%	8.6%
New England	8.7	5.1	2.8	7.4
Connecticut	ND	ND	ND	ND
Maine	9.2	56.7	(0.5)	17.5
Massachusetts	8.3	(2.3)	3.7	5.8
New Hampshire	NA	4.5*	NA	8.6*
Rhode Island	12.3*	27.3*	4.5	9.1*
Vermont	7.8	68.3*	(8.3)	8.4
Mid-Atlantic	11.9	6.0	5.1	8.8
Delaware	4.9	30.5	NA	11.6
Maryland	29.1*	122.5*	6.8	25.5*
New Jersey	17.2	(3.7)*	4.9	7.7*
New York	7.7	(4.0)*	6.6*	6.8*
Pennsylvania	14.8*	0.4	2.9	8.2*
Great Lakes	4.7	18.0	6.4	6.3
Illinois	3.1*	42.6*	6.0	7.9
Indiana	8.5	37.8	6.4	8.2
Michigan	(1.1)	0.6	3.1	2.0
Ohio	8.0	15.0*	12.1	8.9
Wisconsin	7.3	24.6	1.9	6.8
Plains	3.5	24.8	3.9	4.5
Iowa	7.5	29.6	5.3*	8.8*
Kansas	2.5	45.7	0.1	3.1
Minnesota	1.6	34.5	1.5	2.0
Missouri	2.5	(7.6)	4.1	2.7
Nebraska	8.4	28.6	10.5	12.0
North Dakota	8.2	12.5	16.9	12.5
South Dakota	NA	NA	6.1	6.2
Southeast	7.9	32.6	6.3	8.7
Alabama	2.9	(6.9)	9.7	7.0*
Arkansas	8.3	4.8*	7.0*	7.0*
Florida	NA	75.0	8.3*	12.7*
Georgia	11.3	64.8	14.0	14.0
Kentucky	5.4	49.2	4.1	6.8
Louisiana	10.5	233.0	0.4*	8.7
Mississippi	5.4	(27.3)	3.0	1.9
North Carolina	4.9	49.4	0.5	6.3
South Carolina	5.1	6.3	4.6	5.0
Tennessee	NA	(4.8)	3.5	2.7
Virginia	11.7	8.1	7.3	10.5*
West Virginia	5.7*	25.9	2.4	10.1
Southwest	8.9	40.7	6.3	11.6
Arizona	11.7	46.8	9.7	14.2
New Mexico	ND	ND	ND	ND
Oklahoma	5.9	19.4	7.6	6.6
Texas	NA	NA	5.5	11.9
Rocky Mountain	7.2	37.1	7.5	8.3
Colorado	6.4	29.5	5.1	6.5
Idaho	6.0	38.7	10.1	9.2
Montana	12.7	62.9	NA	12.9
Utah	7.5	42.2	8.6	8.7
Wyoming	NA	NA	9.5	16.1
Far West	9.3	28.9	6.1	11.0
Alaska	NA	38.7	NA	31.9
California	9.3	29.6	5.4	9.9
Hawaii	18.8	84.1	9.7*	15.5
Nevada	NA	NA	17.0	26.2
Oregon	6.9	7.1	NA	6.8
Washington	NA	NA	3.3	11.5

See p. 5 for notes

State Tax Revenue on Upward Track

**Table 4. Change in Quarterly Tax Revenue,
Adjusting for Legislated Tax Changes**

	PIT	Sales	Total
1998			
Jan.-Mar.	10.0	6.5	7.0
April-June	23.3	5.9	11.4
July-Sept.	9.3	6.4	7.1
Oct.-Dec.	10.2	5.9	6.9
1999			
Jan.-Mar.	9.9	6.2	6.5
April-June	12.4	7.3	8.0
July-Sept.	8.3	6.9	6.5
Oct.-Dec.	11.0	7.5	8.4
2000			
Jan.-Mar.	13.8	8.8	10.4
April-June	18.6	7.8	11.8
July-Sept.	11.6	5.6	7.7
Oct.-Dec.	6.5	5.0	5.0
2001			
Jan.-Mar.	10.1	3.7	6.3
April-June	7.9	0.6	4.2
July-Sept.	(2.8)	0.4	(2.4)
Oct.-Dec.	(2.1)	1.2	(2.3)
2002			
Jan.-Mar.	(14.5)	(2.4)	(8.4)
April-June	(22.5)	0.1	(11.9)
July-Sept.	(2.1)	2.7	0.7
Oct.-Dec.	(1.6)	0.7	0.3
2003			
Jan.-Mar.	(4.4)	1.0	(1.0)
April-June	(2.0)	1.3	0.4
July-Sept.	3.9	1.9	2.6
Oct.-Dec.	5.3	4.2	4.9
2004			
Jan.-Mar.	7.7	6.8	7.0
April-June	12.6	6.4	9.0
July-Sept.	7.5	5.7	8.2

Note: The corporate income tax is not included in this table. The quarterly effect of legislation on this tax's revenue is especially uncertain. (See Technical Notes, page 15.)
For pre-1998 data, call the Fiscal Studies Program.

settlements. Table 6 shows that withholding for the July-September 2004 quarter increased 6.7 percent over the same quarter the year before. Enacted changes in withholding boosted collections by about six-tenths of a percent this quarter. This was somewhat faster growth than the previous quarter, and would seem to indicate that underlying personal income tax growth remains steady.

Estimated Payments

The highest-income taxpayers generally pay most estimated tax payments (also known as declarations) on their non-wage income. This income often comes from investments, especially capital

**Table 5. Percent Change in Quarterly
Total Tax Revenue by State,
Adjusted for Legislation and Inflation,
July to September 2003 to 2004**

United States	4.3%
New England	3.3
Connecticut	ND
Maine	12.7
Massachusetts	2.0
New Hampshire	3.8
Rhode Island	2.5
Vermont	4.1
Mid-Atlantic	2.5
Delaware	7.6
Maryland	19.8
New Jersey	(2.5)
New York	1.9
Pennsylvania	1.1
Great Lakes	2.3
Illinois	3.3
Indiana	4.3
Michigan	(1.3)
Ohio	5.0
Wisconsin	3.0
Plains	1.0
Iowa	6.5
Kansas	(0.6)
Minnesota	(1.6)
Missouri	(1.1)
Nebraska	8.0
North Dakota	8.5
South Dakota	2.8
Southeast	4.8
Alabama	1.5
Arkansas	0.2
Florida	10.6
Georgia	9.7
Kentucky	3.0
Louisiana	4.9
Mississippi	(1.8)
North Carolina	2.6
South Carolina	1.8
Tennessee	(1.0)
Virginia	5.4
West Virginia	6.1
Southwest	7.5
Arizona	10.1
New Mexico	ND
Oklahoma	2.8
Texas	7.9
Rocky Mountain	4.4
Colorado	2.7
Idaho	5.3
Montana	8.9
Utah	4.7
Wyoming	12.4
Far West	7.1
Alaska	27.2
California	6.0
Hawaii	12.1
Nevada	21.7
Oregon	3.6
Washington	8.1

Inflation measured by BEA State and Local Government Implicit Price Deflator.

Table 6. Change in Personal Income Tax Withholding by State, Last Four Quarters

	2003		2004	
	Oct.-Dec.	Jan.-Mar.	Apr.-June	July-Sept
United States	6.1%	9.4%	5.6%	6.7%
New England	5.1	8.0	5.1	5.2
Connecticut	10.1	14.9	2.7	ND
Maine	4.4	6.5	9.8	3.7
Massachusetts	2.9*	4.9	5.4	4.7
Rhode Island	6.2	10.6	5.7	11.5*
Vermont	8.2	7.3	5.3	7.4
Mid-Atlantic	11.8	17.8	3.9	11.4
Delaware	5.9	8.6	8.7	4.3
Maryland [†]	23.3*	27.5*	(14.0)†	38.1*
New Jersey	15.2	10.0	0.0	7.8*
New York	9.2*	19.0*	7.4*	4.4
Pennsylvania	3.2	10.1	13.6*	14.4*
Great Lakes	1.5	4.4	3.9	4.1
Illinois	ND	6.7	3.3	2.8*
Indiana	3.8	4.5	5.9	5.3
Michigan	(1.7)†	0.5†	1.0†	1.1
Ohio	2.0	5.0	5.2	5.2
Wisconsin	3.1	5.1	5.0	8.1
Plains	2.3	6.1	5.8	2.6
Iowa	6.2	8.4	8.0	5.5
Kansas	3.4	4.3	6.8	4.2
Minnesota	1.0	4.8	6.6	0.5
Missouri	0.4	7.8	2.6	1.8
Nebraska	4.7*	4.6*	6.5*	5.5
North Dakota	9.1	4.9	5.7	9.3
Southeast	5.4	6.8	8.4	6.6
Alabama	7.5	2.7	8.6	4.6
Arkansas	4.8	5.8	8.5	5.7
Georgia	2.9	12.3	16.7	7.6
Kentucky	2.2	4.6	ND	ND
Louisiana	18.7*	6.8*	9.1*	5.6
Mississippi	(6.6)	5.0	5.2	5.5
North Carolina	6.3	7.2	4.6	4.6
South Carolina	3.1	4.5	3.6	4.4
Virginia	8.1	9.1	6.7	10.1
West Virginia	2.9	0.5	5.8	5.7*
Southwest	3.2	4.9	2.5	6.6
Arizona	1.0	4.8	(0.9)	9.2
New Mexico	6.3†	(2.8)†	3.2†	ND
Oklahoma	4.4	8.3	4.0	4.1
Rocky Mountain	2.2	4.8	5.5	5.5
Colorado	0.2	3.8	5.1	5.3
Idaho	3.1	7.9	8.0	5.9
Montana	13.8	3.3	6.1	7.5
Utah	3.0	5.8	5.1	5.1
Far West	6.4	8.5	7.1	6.0
California	6.8	8.7	7.2	6.1
Hawaii	5.2†	3.9†	6.3†	6.4
Oregon	4.6	7.9	6.2	5.2

Note: Nine states — Alaska, Florida, New Hampshire, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming — have no personal income tax and are therefore not shown in this table.
See page 5 for notes.

gains realized in the stock market. A strong stock market should eventually translate into capital gains and higher estimated tax payments.

In the 36 states for which we have data, estimated tax payments in September (the third quarterly payment) increased 14.3 percent. This was probably inflated somewhat by tax increases in a few states, including an increase in the top personal income tax rate in New Jersey, where most taxpayers who make estimated payments pay the top rate. The median increase in the states' September payments was 10.5 percent. Cumulatively, the first three quarterly estimated payments in 2004 increased 18.9 percent over the year before; median growth was 13.5 percent. Since final payments often mirror the strength and direction of estimated payments, this would seem to be a good sign for April 2005. The decline to the third payment growth from the previous two payments may or may not be significant. We will know more when we get the results of the final estimated payment that comes in December and January.

General Sales Tax

Sales tax revenue in the July-September 2004 quarter increased 5.9 percent over the same quarter the year before. Sales tax revenue growth has been slowing for the last two quarters, but remains relatively strong.

Key to Interpreting Tables

All percent change tables are based on year-over-year changes.

† indicates data through August only.

* indicates legislation or processing/accounting changes significantly increased tax receipts (by one percentage point or more).

† indicates legislation or processing/accounting changes significantly decreased tax receipts.

NA indicates not applicable.

ND indicates no data.

Historical Tables (Tables 1, 2 and 4) have been shortened to provide data only back to 1998. For data through 1991 call the Fiscal Studies Program.

Figure 6
Change in Non-Farm Employment
July-September 2003 to 2004



Sales tax revenue grew fastest in the Rocky Mountain region with 7.5 percent growth. The weakest growth was in the New England region, where sales tax revenue increased 2.8 percent. Six states had double-digit growth in sales tax revenue.² Two states — Maine and Vermont — had sales tax revenue declines.

Corporate Income Tax

Corporate income tax revenue grew 21.7 percent in the July-September quarter, up from the previous quarter's 13.6 percent. Corporate income tax revenue has had double-digit growth for six of the last eight quarters.

Underlying Reasons for Trends

These revenue changes result from three kinds of underlying forces: differences in state economies, how these differences affect each state's tax system, and recently legislated tax changes.

State Economies

The national economy is now experiencing sustained growth, though still with some areas of continued weakness. The Bureau of Economic Analysis' (BEA's) preliminary estimate for the real Gross Domestic Product (GDP) showed

Table 7. Estimated Payments/Declarations
(change year-over-year)

State	April to September 2003 to 2004	September 2003 to 2004
Average (Mean)	18.9%	14.3%
Median	13.5	10.5
Alabama	9.2	(24.2)
Arizona	89.4	544.4
Arkansas	26.8	18.7
California	16.7	14.8
Colorado	17.6	14.3
Delaware	13.5	14.9
Georgia	10.5	24.2
Hawaii	40.6	27.9
Illinois	13.9	8.0
Indiana	3.9	8.3
Iowa	10.9	16.6
Kansas	11.5	8.4
Louisiana	49.7	61.1
Maine	10.9	6.4
Maryland	20.2	21.6
Massachusetts	15.2	10.6
Michigan	1.4	(1.2)
Minnesota	35.6	12.1
Mississippi	(87.1)	(91.9)
Missouri	7.3	6.6
Montana	20.6	26.4
Nebraska	15.3	10.4
New Jersey	ND	30.9
New York	40.9	14.9
North Carolina	8.6	8.1
North Dakota	11.0	4.4
Ohio	7.5	7.6
Oklahoma	15.1	5.4
Oregon	(19.5)	9.7
Pennsylvania	20.5	18.5
Rhode Island	17.6	4.9
South Carolina	16.0	14.9
Vermont	8.1	2.1
Virginia	12.5	13.6
West Virginia	6.8	7.7
Wisconsin	12.2	2.2

growth of 3.9 percent for the third quarter of 2004.³ The national unemployment rate was 5.5 percent for the third quarter, down from the post-recession high of 6.1 percent the year before.⁴

The difficulty with assessing state economies in a report such as this is a general lack of timely state indicators. Data on non-farm employment, tracked by the Bureau of Labor Statistics (BLS), are the only broad-based, timely, high-quality state-level economic indicators available. Yet, these data are far from ideal indicators of revenue growth. For one thing, most taxes are based upon nominal

Table 8. Year-Over-Year Percentage Change In Non-Farm Employment by State, Last Four Quarters

	2003		2004	
	Oct.- Dec.	Jan.- Mar.	Apr.- June	July- Sept.
United States	(0.2)%	0.2%	1.0%	1.3%
Sum of States	(0.1)	0.5	0.8	1.0
New England	(0.9)	(0.4)	(0.1)	0.2
Connecticut	(1.0)	(0.6)	(0.1)	0.2
Maine	0.4	0.6	0.8	0.8
Massachusetts	(1.8)	(1.1)	(0.7)	(0.3)
New Hampshire	0.5	1.1	1.5	1.6
Rhode Island	1.0	1.5	0.7	0.9
Vermont	0.2	0.7	0.9	0.6
Mid Atlantic	(0.2)	0.3	0.8	1.1
Delaware	0.2	1.1	1.4	1.6
Maryland	0.6	0.9	1.4	1.8
New Jersey	0.6	1.2	1.5	1.6
New York	(0.6)	0.1	0.6	0.8
Pennsylvania	(0.7)	(0.4)	0.2	0.8
Great Lakes	(0.9)	(0.2)	(0.1)	0.1
Illinois	(0.8)	(0.3)	(0.2)	0.2
Indiana	(0.1)	0.7	0.5	0.5
Michigan	(1.6)	(1.1)	(0.9)	(1.0)
Ohio	(1.1)	(0.3)	(0.5)	(0.4)
Wisconsin	(0.3)	1.1	1.4	1.8
Plains	(0.2)	0.3	0.8	0.9
Iowa	0.0	0.7	0.6	0.6
Kansas	(1.1)	0.0	0.5	1.2
Minnesota	0.0	0.5	1.0	0.7
Missouri	(0.5)	0.2	1.1	1.4
Nebraska	(0.1)	(0.3)	0.2	0.5
North Dakota	1.0	1.0	0.3	0.3
South Dakota	0.4	0.9	1.0	0.8
Southeast	0.5	1.0	1.3	1.3
Alabama	(0.5)	0.2	0.2	0.5
Arkansas	0.2	0.3	0.7	0.8
Florida	1.8	1.9	2.3	2.0
Georgia	0.1	0.6	1.1	0.9
Kentucky	(0.1)	0.7	0.3	0.7
Louisiana	0.6	0.3	0.0	0.2
Mississippi	0.3	0.4	0.8	0.9
North Carolina	(0.4)	0.5	1.0	1.2
South Carolina	0.6	0.8	1.1	1.3
Tennessee	0.3	1.1	0.8	0.6
Virginia	0.6	2.2	2.5	2.4
West Virginia	(1.1)	(0.3)	(0.1)	0.9
Southwest	(0.2)	0.4	1.1	1.4
Arizona	1.5	2.2	2.4	2.4
New Mexico	1.4	1.3	2.0	2.1
Oklahoma	(2.1)	(1.0)	0.5	1.5
Texas	(0.4)	0.2	0.8	1.1
Rocky Mountain	(0.2)	0.4	1.2	1.7
Colorado	(1.1)	(0.6)	0.7	0.9
Idaho	0.1	1.3	2.2	2.7
Montana	0.7	1.3	1.2	1.6
Utah	0.6	1.3	1.6	2.7
Wyoming	1.8	2.1	1.9	1.8
Far West	0.1	0.7	1.2	1.4
Alaska	1.4	1.6	1.0	1.3
California	(0.2)	0.4	0.7	0.9
Hawaii	1.6	1.8	2.3	2.7
Nevada	3.9	4.2	4.5	4.5
Oregon	(0.3)	0.4	2.2	2.5
Washington	0.5	1.1	1.9	2.0

Source: Bureau of Labor Statistics

measures such as income, wages, and profits, rather than employment. Unfortunately, state-level data on these nominal measures — when they are available at all — usually are reported too late to be of much use in analyzing recent revenue collections.

Table 8 shows year-over-year employment growth for the nation and for each state during the last four quarters using BLS data. Figure 6 maps the change in third quarter 2004 employment compared to the same period in 2003. By this measure, employment in the July-September 2004 quarter grew 1.3 percent compared to the year before. This is the third quarter of growth in national employment numbers, after nine straight quarters of decline. The growth is gathering steam, and has now extended to every region of the country.

Employment growth was strongest in the Rocky Mountain region at 1.7 percent. Employment has finally shown growth in the Great Lakes and New England regions, though the growth was only 0.1 percent and 0.2 percent, respectively.

Employment grew in 47 states, up from 44 in the previous quarter. Like last quarter, twenty-four states had employment growth of one percent or more, led by Nevada with a strong 4.5 percent growth. Michigan continues to have the worst employment decline at one percent this quarter.

Overall, the employment picture has moved into solid growth over the first three quarters of 2004. The states with the strongest growth are concentrated in the southern and western regions of the country, the pattern seen before the recent recession, and consistent with the overall pattern of population growth. There seem to be ever fewer problem areas where employment is still declining.

Nature of the Tax System

Even if economic growth affected all regions and states to exactly the same degree and at exactly the same time, the impact on state revenue would still vary because states' tax systems react differently to similar economic

situations. States that rely heavily on the personal income tax will tend to see stronger growth in good times, since they benefit from growth in income earned by the highest income individuals, the income that is taxed most heavily. This is most evident in states with more progressive income tax structures. The sales tax is also very responsive to economic conditions, but is historically less elastic than the personal income tax, dropping more slowly in bad times and increasing more slowly in good times. The states that rely heavily on corporate income taxes or severance taxes often see wild swings in revenue that are not necessarily related to general economic conditions. (Severance taxes are taxes on the removal of natural resources, such as oil and natural gas.)

Because high-end incomes are based more heavily upon volatile sources such as stock options and capital gains, growth in personal income tax revenue was far more subject to dramatic fluctuations than it would be if it were based entirely on wages and salaries. In the recent recession, we saw the downside of this volatility. While initially the market downturn affected relatively few wage earners, it turned gains into losses for investors, thus sharply contracting a hitherto rich source of revenue almost overnight. Meanwhile, stock options became both less common and less lucrative. The recession lasted only eight months, but it had significant aftereffects as the loss of investment capital manifested itself in weak employment numbers, which in turn depressed withholding. However, now the stock market recovery seems to be leading to stronger growth again.

States have also learned more about how sales tax revenue responds to an economic slowdown. There has been some fear that as states have removed more stable elements of consumption, such as groceries and clothing from their bases, their sales taxes were more subject to plunges as state residents became nervous about spending on optional and big-ticket items. Most state sales taxes also do not capture spending on services well. In the latest economic downturn, however, the sales tax generally maintained slow growth. It is now growing as the general economic conditions improve, though less rapidly than the personal income or corporate income taxes.

Oil has been a wild card in state tax revenue in recent years. When the price of oil increases, oil-producing states such as Alaska, Oklahoma, and Wyoming benefit. Conversely, when the price falls, these states' revenue tends to follow suit. This dynamic often operates largely independently of the general economy.

Tax Law Changes Affecting This Quarter

The final element affecting trends in tax revenue growth is changes in states' tax laws. When states boost or depress their revenue growth with tax increases or cuts, it can be difficult to draw any conclusions about their current fiscal condition from nominal collections data. That is why this report attempts to note where such changes have significantly affected each state's revenue growth. We also occasionally note when receipts' processing changes have had a major impact on revenue growth, even though these are not due to enacted legislation, as it helps the reader to understand that the apparent growth or decline is not necessarily indicative of underlying trends.

During the July-September 2004 quarter, enacted tax changes and processing variations increased state revenue by an estimated net of \$500 million, compared to the same period in 2003. There now have been net enacted state tax increases for the last eleven straight quarters.

Enacted tax changes increased personal income tax collections by a net of about \$300 million. New Jersey raised its top personal income tax rate, most of the effects of this increase will not be seen until the final estimated tax payment and final settlements, but it probably boosted revenue by about \$100 million this quarter. A higher flat tax rate in Pennsylvania raised over \$150 million more in revenue.

New York re-instituted its sales tax on clothing, boosting collections by about \$100 million. Florida had a one-week holiday from its sales tax on clothing and school supplies, and a one-month reduction in its motor fuels tax, which altogether reduced revenue by almost \$100 million. There were also many other smaller tax increases and cuts.

Conclusions

July-September 2004 was the first quarter of fiscal year 2005 for most states. As such it is a strong beginning to the fiscal year, and is building on what turned out to be a strong prior fiscal year for state revenues. Legislated tax increases are still adding to collections, but to a lesser degree than in the two previous years. Most revenue growth is from economic factors. States can now face with confidence the budget cycle that is just starting.

Endnotes

- 1 Arizona, Georgia, Hawaii, Louisiana, Montana, New Jersey, Pennsylvania, Rhode Island, and Virginia.
- 2 Georgia, Idaho, Nebraska, Nevada, North Dakota, and Ohio.
- 3 United States Department of Commerce, Bureau of Economic Analysis News Release, November 30, 2004.
- 4 United States Department of Labor, Bureau of Labor Statistics, *Labor Force Statistics From the Current Population Survey*, www.bls.gov.

Technical Notes

This report is based on information collected from state officials, most often in state revenue departments, but in some cases from state budget offices and legislative staff. This is the latest in a series of such reports published by the Rockefeller Institute's Fiscal Studies Program (formerly the Center for the Study of the States).

In most states, revenue reported is for the general fund only, but in several states a broader measure of revenue is used. The most important category of excluded revenues in most states is motor fuel taxes. Taxes on health-care providers to fund Medicaid programs are excluded as well.

California: Non-general fund revenue from a sales tax increase dedicated to local governments is included.

Michigan: The Single Business Tax, a type of value-added tax, is treated here as a corporation income tax.

Missouri: The total taxes are the sum of the three major taxes.

Several caveats are important. First, tax collections during a period as brief as three months are subject to influences that may make their interpretation difficult. For example, a single payment from a large corporation can have a significant effect on corporate tax revenues.

Second, estimates of tax adjustments are imprecise. Typically the adjustments reflect tax legislation, however they occasionally reflect other atypical changes in revenue. Unfortunately, we cannot speak with every state in every quarter. We discuss tax legislation carefully with the states that have the largest changes, but for states with smaller changes we rely upon our analysis of published sources and upon our earlier conversations with estimators.

Third, revenue estimators cannot predict the quarter-by-quarter impact of certain legislated changes with any confidence. This is true of almost all corporate tax changes, which generally are reflected in highly volatile quarterly estimated tax payments; to a lesser extent it is true of personal income tax changes that are not implemented through withholding.

Finally, many other non-economic factors affect year-over-year tax revenue growth: changes in payment patterns, large refunds or audits, and administrative changes frequently have significant impacts on tax revenue. It is not possible for us to adjust for all of these factors.

This report contains third calendar quarter revenue data for 48 states. Connecticut and New Mexico had not provided their data as of the publication of this report.

State Tax Revenue on Upward Track

Table 9
State Tax Revenue, July to September, 2003 and 2004 (In Millions of Dollars)

	2003				2004			
	Personal Income	Corporate Income	Sales	Total	Personal Income	Corporate Income	Sales	Total
United States	\$43,789	\$6,191	\$43,741	\$110,491	\$47,380	\$7,532	\$46,301	\$120,045
New England	2,560	320	1,413	5,312	2,781	337	1,453	5,707
Connecticut	ND	ND	ND	ND	ND	ND	ND	ND
Maine	221	21	179	500	242	33	178	587
Massachusetts	2,021	247	961	3,799	2,189	242	997	4,017
New Hampshire	NA	33	NA	297	NA	35	NA	323
Rhode Island	209	11	217	496	234	14	227	541
Vermont	108	8	56	220	117	14	52	239
Mid Atlantic	9,463	1,417	6,007	19,927	10,585	1,502	6,313	21,677
Delaware	184	15	NA	403	193	20	NA	449
Maryland	818	96	465	1,536	1,056	215	496	1,927
New Jersey	1,120	381	1,048	3,026	1,313	367	1,100	3,259
New York	5,688	608	2,523	10,242	6,124	584	2,689	10,936
Pennsylvania	1,653	316	1,971	4,721	1,899	318	2,028	5,106
Great Lakes	7,100	924	7,220	17,870	7,431	1,090	7,683	18,992
Illinois	1,812	197	1,587	4,321	1,869	281	1,683	4,661
Indiana	904	114	1,173	2,470	981	157	1,247	2,672
Michigan	1,606	459	1,984	5,286	1,588	462	2,046	5,389
Ohio	1,767	17	1,800	3,870	1,909	19	2,017	4,216
Wisconsin	1,011	137	677	1,924	1,084	171	690	2,055
Plains	3,819	357	3,027	7,849	3,952	446	3,145	8,200
Iowa	571	38	443	1,113	613	50	466	1,210
Kansas	457	36	476	1,061	469	53	476	1,094
Minnesota	1,425	162	956	2,892	1,448	217	970	2,950
Missouri	1,009	77	645	1,730	1,034	71	671	1,777
Nebraska	308	33	280	665	334	43	309	745
North Dakota	49	11	91	205	53	13	107	231
South Dakota	NA	NA	137	183	NA	NA	145	194
Southeast	8,618	1,105	11,140	24,813	9,301	1,465	11,838	26,966
Alabama	574	67	438	1,504	591	62	481	1,610
Arkansas	426	62	462	1,025	461	65	494	1,096
Florida	NA	189	3,663	4,727	NA	331	3,968	5,327
Georgia	1,563	74	1,114	3,014	1,741	122	1,270	3,437
Kentucky	704	79	725	1,683	742	118	754	1,798
Louisiana	478	19	542	1,392	528	62	544	1,513
Mississippi	284	71	534	1,204	299	52	550	1,227
North Carolina	1,855	188	1,111	3,348	1,947	280	1,117	3,561
South Carolina	727	40	361	1,250	764	43	377	1,313
Tennessee	NA	155	1,448	2,196	NA	148	1,498	2,255
Virginia	1,760	113	489	2,724	1,967	122	524	3,009
West Virginia	247	48	255	745	261	61	261	821
Southwest	1,124	145	5,514	9,921	1,225	203	5,861	11,070
Arizona	579	112	800	1,592	647	165	877	1,817
New Mexico	ND	ND	ND	ND	ND	ND	ND	ND
Oklahoma	546	32	375	1,192	578	39	404	1,271
Texas	NA	NA	4,339	7,136	NA	NA	4,580	7,983
Rocky Mountain	1,555	138	1,173	3,266	1,666	189	1,261	3,538
Colorado	830	68	490	1,428	883	87	515	1,520
Idaho	201	24	270	588	213	33	298	642
Montana	139	12	NA	236	156	19	NA	267
Utah	385	35	375	938	414	50	408	1,020
Wyoming	NA	NA	38	77	NA	NA	41	89
Far West	9,550	1,785	8,247	21,534	10,440	2,300	8,747	23,896
Alaska	NA	11	NA	271	NA	15	NA	357
California	8,231	1,682	5,563	16,190	8,997	2,180	5,862	17,798
Hawaii	274	8	473	819	326	15	519	946
Nevada	NA	NA	597	725	NA	NA	698	915
Oregon	1,045	84	NA	1,169	1,117	90	NA	1,248
Washington	NA	NA	1,614	2,360	NA	NA	1,668	2,632

See p. 5 for notes

About The Nelson A. Rockefeller Institute of Government's Fiscal Studies Program

The Nelson A. Rockefeller Institute of Government, the public policy research arm of the State University of New York, was established in 1982 to bring the resources of the 64-campus SUNY system to bear on public policy issues. The Institute is active nationally in research and special projects on the role of state governments in American federalism and the management and finances of both state and local governments in major areas of domestic public affairs.

The Institute's Fiscal Studies Program, originally called the Center for the Study of the States, was established in May 1990 in response to the growing importance of state governments in the American federal system. Despite the ever-growing role of the states, there is a dearth of high-quality, practical, independent research about state and local programs and finances.

The mission of the Fiscal Studies Program is to help fill this important gap. The Program conducts research on trends affecting all 50 states and serves as a national resource for public officials, the media, public affairs experts, researchers, and others. Donald J. Boyd, who has spent two decades analyzing state and local fiscal issues, is director of Fiscal Studies.

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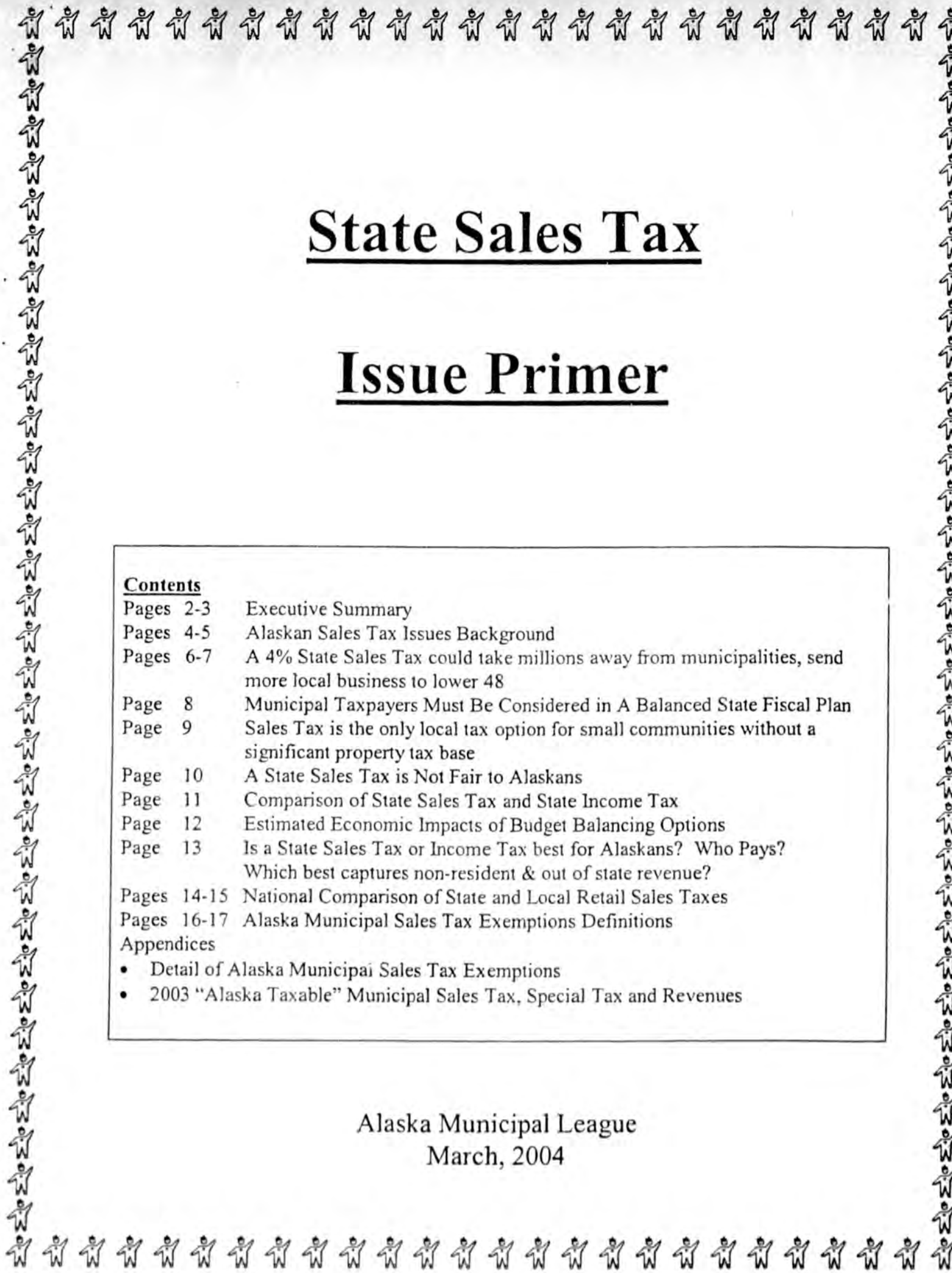
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State Sales Tax

Issue Primer

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Alaska Municipal League
March, 2004

Executive Summary

1. Many states have state sales tax, but at statehood Alaska gave sales tax authority to its communities because: (See pages 4-5)

- Alaska's constitution designed the strongest communities in the U.S., **but without a major revenue source, local control guarantees are meaningless.** Most mid-size to larger communities, like Juneau, Ketchikan, Kodiak, Kenai, etc. must have access to both a property and sales tax to provide needed services and infrastructure now and in the future.
- Alaska's vast rural areas lack a property tax base because much of the land is federal or state owned. Therefore, **sales tax is the only viable local option to avoid making Alaska's rural communities fully dependent on the state for revenue;** (See page 9)
- **Variations in Alaska's cost of living** are far greater than any other state, therefore a state sales tax is unfair because it requires paying higher state sales taxes depending on where an item is purchased; (See page 10)

2. Mandating a State Sales Tax on top of voter approved local sales taxes will push additional commerce and jobs to the lower 48 states, and cut local government revenue:

- Out of state and internet purchases will become a greater problem for Alaska business as sales taxes increase to the highest levels in the U.S. for many communities in Alaska. **Note:** Even though the maximum sales tax rate in the U.S. is 11% in Alabama, the average sales tax rate in Alabama is 7% to 8% according to Alabama officials. (See pages 6-7 and 14-15)
- **Additional state mandated sales tax will hurt the economic recovery of the nearly 75% of communities facing local economic downturns.** (Alaska Municipal League Municipal Fiscal Conditions Survey, March 2004).
- Local sales tax exemptions and rules have been carefully developed since statehood in each community to encourage local commerce and industry. They are **complex and different** because **Alaska's communities and economies are different.** Mandated statewide "one size fits all" rules and exemptions will further hurt local economies and revenues. (See pages 16-24)

3. A legislatively mandated state sales tax will out-compete voter approved local sales taxes – Many communities will have no revenue options for schools and other growing local needs:

- Voters in Alaska's communities have already set local sales tax rates as high as the economy and voters feel is appropriate. It is likely that voters in many communities will reduce local sales taxes because they cannot reduce the state sales tax. (See pages 6-7)
- If the state adds a state sales tax, it is likely that no municipality will be able to successfully ask for a voter approved sales tax increase in the future for capital projects or other local needs.
- The state sales tax is likely to rise in the future. According to the National Conference of State Legislatures, "The sales tax has been a stable state revenue source, although rate increases have been necessary to preserve its share of the state revenue mix." (See page 11)
- Local sales and property taxes are already high – nearly One Billion Dollars in 2003. To have a balanced fiscal plan for Alaska, the State should focus on untapped revenues – use of some Permanent Fund earnings, or a state income tax. (See page 8). The average sales tax rate in the U.S. is 6.25%, if a 4% state sales tax is added, 68 municipalities that now have sales tax would be above the national average and Wrangell would have the highest sales tax in the U.S. (See pages 6-7, 14-15)

4. If Alaska needs a broad-based tax, and state income tax simply beats a state sales tax:

- The University of Alaska estimates that a \$250 million state sales tax would cost Alaska at least an additional 2,325 jobs in the private sector, many more than an income tax. Use of Permanent Fund earnings under a "percent of market value approach" while maintaining a PFD would cost no jobs. (See page 12)
- 7% to 10% of a state sales tax would be paid by out of state residents, while 22% to 25% of a state income tax would be paid by out of state residents and the federal IRS in tax deductions, according to the University of Alaska and Department of Revenue (2002). (See page 13)
- According to the National Conference of State Legislatures, "The personal income tax is a reliable and stable source of state revenue...The responsiveness of the income tax to economic growth also helps explain why state income tax reliance has increased over time." (See page 11)

Alaskan Sales Tax Issues Background

- ❖ **Alaska is unique and requires unique solutions:** While many states have state sales taxes, Alaska has given sales tax authority only to its cities and boroughs because of Alaska's unique conditions. Alaska is unique because:
 - Alaska's **wide range of cost of living** across the state makes a statewide sales tax inequitable and unfair. Under a statewide sales tax, residents in different parts of Alaska would have to pay as much as three times the amount of state sales tax to purchase something as simple as a glass of milk for a child.
 - Alaska's **vast rural areas lack a sufficient property tax base** in private ownership to establish property taxes. Therefore, sales tax is the only major local revenue source for the majority of Alaska's communities.
 - Alaska's Constitution has the strongest local control provisions of any state and guarantees "maximum local self-government." **Without a major revenue source, constitutional local control guarantees are meaningless.**
 - Alaska's communities have built **very different sales tax systems that work for their specific local economy.**
 - State imposition of an additional 4% (giving some municipalities the highest sales tax rates in the U.S.), preemption of local sales tax exemptions, rules, and collection will increase out of state and internet purchases and reduce local tax revenues.
- ❖ Alaska has 94 municipalities that depend on general local sales taxes. Current local tax rates are:

<u>Sales Tax Rate</u>	<u>Number of Municipalities</u>	
	<u>1999</u>	<u>2003</u>
7 %	1	1
6 %	3	6
5% or 5.5%	11	18
4% or 4.5%	12	11
3% or 3.5%	37	30
2 %	31	25
1% or 1.5%	3	3

- ❖ According to the 2003 "Alaska Taxable", General Sales Taxes provided \$132,839,856, and Special Sales Taxes (on fish, hotel beds, alcohol, tobacco, etc.) provided \$43,734,035 to operate municipal services. (**Total 2003 Sales Tax = \$176,537,891**)

Issues concerning the creation of a State sales tax:

- ❖ Conflicts with local sales tax exemptions: Municipalities have their own exemptions designed for the local economic needs. (See attached summary of municipal sales tax exemptions on pages 14-18) A state sales tax would require standard exemptions that would necessarily conflict with the local exemptions. If the State requires municipalities to conform to the State's exemptions, huge local revenue losses would likely occur. (Note: while current sales tax proposals have limited exemptions, it is highly likely that industry proposals will arise and put intense pressure on the legislature to expand exemptions.)
- ❖ Total State/Local Sales Taxes would be too high: Municipal sales taxes vary from 1% to 7%. A State general sales tax on top of local sales taxes would almost certainly require many municipalities to lower the local sales tax and raise property taxes. In many small municipalities, there is practically no local property tax base, so there is no practical revenue alternative.
- ❖ Forestall future growth in municipal sales taxes: If a State sales tax is created, it will almost certainly forestall any increase in local sales tax rates to meet capital needs or to finance unfunded state or federal mandates.
- ❖ Federal Internet Sales Tax Exemption: Some feel that if the State of Alaska took control of sales tax away from municipalities, the state could collect sales tax on out of state and internet purchases, and thereby raise additional revenue. There are two bills in Congress on this topic: One bill calls for an additional two year moratorium before any decision is made: the other calls for a permanent exemption for internet and out of state sales.

A 4% State Sales Tax could take millions away from municipalities, send more local business to lower 48

(Data from "Alaska Taxable" 2002-2003 DCED, Office of the State Assessor)

Summary of Sales Taxes in Alaska:

- 94 cities and boroughs have **general** sales taxes on good and services.
- 52 cities and boroughs have **special** sales taxes on hotels, alcohol, tobacco, etc.
- 114 cities and boroughs have a **general or special or both** types of sales tax.

Impact Narrative:

- **State Sales tax would be a statutory mandate, while almost all municipalities must seek voter approval for sales tax.** Local voters have already set their sales tax at the highest rate acceptable to the community and the local economy. High sales taxes hurt local businesses. Therefore, an additional mandated 4% state sales tax without voter approval would likely force communities to reduce their local sales tax rates by up to 3% to avoid excessive tax rates on local purchases.
- **State Sales Tax Exemptions would replace local exemptions specifically crafted to encourage local business.** Loss of local control of exemptions could cause significant loss of local revenue or disadvantage local businesses.

<u>Municipality</u>	<u>Current Rate</u>	<u>With State 4%</u>	<u>If Munis Lose 3%</u>
• Wrangell	7%	11%	\$807,000
• Cordova	6%	10%	\$1,174,000
• Kodiak	6%	10%	\$3,570,000
• Kotzebue	6%	10%	\$1,220,000
• <u>Seward*</u>	<u>6%</u>	<u>10%</u>	<u>\$2,197,000</u>
• Petersburg	6%	10%	\$1,152,000
• <u>Dillingham</u>	<u>6%</u>	<u>10%</u>	<u>\$1,030,000</u>
• Ketchikan City*	5.5%	9.5%	\$5,951,000
• Klawock	5.5%	9.5%	\$258,000
• Haines Borough	5.5%	9.5%	\$1,033,000
• Homer*	5.5%	9.5%	\$2,968,000
• Sitka	5%	9%	\$3,826,000
• Juneau	5%	9%	\$17,271,000
• Bethel	5%	9%	\$2,516,000
• Soldotna*	5%	9%	\$4,827,000
• Kenai*	5%	9%	\$3,809,000
• <u>Thorne Bay</u>	<u>5%</u>	<u>9%</u>	<u>\$91,000</u>
• Seldovia*	4%/6.5%	8%/10.5%	\$73,000
• Craig	5%	9%	\$786,000
• Aleknagik	5%	9%	\$22,000
• Clarks Point	5%	9%	\$18,000

(Note: Cities or boroughs in **bold** increased local sales tax since 2001)

(* Includes total City and Borough General Sales Tax Rates)

• Hoonah	5%	9%	\$211,000
• Kake	5%	9%	\$100,000
• Kwethluk	5%	9%	\$56,000
• Unalakleet	5%	9%	\$146,000
• Skagway	4%	8%	\$2,331,000
• Alakanuk	4%	8%	\$84,000
• Hooper Bay	4%	8%	\$190,000
• Hydaburg	4%	8%	\$8,500
• Nenana	<u>4%</u>	<u>8%</u>	\$94,000
• Nome	4%	8%	\$1,917,000
• Marshall	4%	8%	\$47,000
• Pelican	4%	8%	\$43,000
• Pilot Station	4%	8%	\$35,000
• Port Alexander	4%	8%	\$6,000
• St Michael	4%	8%	\$54,000
• Yakutat	4%	8%	\$480,000
• Saxman	<u>3.5%</u>	<u>7.5%</u>	?
• North Pole	3%	7%	\$1,219,000
• Palmer	3%	7%	<u>\$2,464,000</u>
			\$64,000,000

- 3% : **Adak 3%**, Ambler, **Angoon 3%**, Brevig Mission, Chevak, Deering, Diomed, Emmonak, Fort Yukon, Galena, **Gambell 3%**, King Cove, Kotlik, Larsen Bay, **Mountain Village 3%**, **Nondalton 3%**, Noorvik, **Nunapitchuk 3%**, Ouzinkie, Quinhagak, St Mary's, Saint Paul, Sand Point, Savoonga, Selawik, Stebbins, **Teller 3%**, Unalaska, Whittier
- 2% : Aniak, Buckland, Chefornak, Eek, Elim, False Pass, Kenai Peninsula Borough, Ketchikan Gateway Borough, Kiana, Kivalina, Koyuk, Manokotak, Mekoryuk, **Napakiak 2%**, Newhalen, Nightmute, Scammom Bay, Shaktoolik, **Shishmaref 2%**, Nunam Iqua, Shungnak, **Tanana 2%**, Togiak, Toksook Bay, Wasilla
- 1% : Tenakee Springs, **White Mountain 1%**.

(Note: Cities or boroughs in bold increased local sales tax since 2001)

(Note: List and figures do not include the 52 Special Sales Taxes on hotel, etc.)

Municipal Taxpayers Must Be Considered in A Balanced State Fiscal Plan

Alaskans in municipalities already pay close to \$1 Billion per year in local property and sales taxes to pay for schools, public safety, roads, and other local services. Therefore, instead of state preemption of local sales tax authority, a **balanced state fiscal plan** should **focus on totally untapped revenue measures**, e.g. the use of some Permanent Fund earning or a state income tax, not preemption of local sales tax authority.

If the State decides to mandate a local sales tax, **local taxpayers in many municipalities would pay the highest sales tax rates in the U.S.** This will hurt both Alaskan taxpayers and Alaskan businesses that must compete with out of state and internet sales.

Major Municipal Taxes 2001 and 2003

Office of the State Assessor, "Alaska Taxable," 2001 and 2003

	<u>2001</u>	<u>2003</u>
Property tax (not include oil)	\$497,339,323	\$560,869,163
Oil property in municipalities	\$214,758,724	\$220,865,409
Municipal General Sales Tax	\$125,134,493	\$132,839,856
Special Sales Tax (hotel, etc.)	<u>\$ 40,728,724</u>	<u>\$ 43,734,035</u>
TOTAL	\$877,961,380	\$958,308,464

Sales Tax is the only local tax option for small communities without a significant property tax base

Even though all municipalities have property tax "authority," most do not have sufficient local property tax bases. Bethel, for example, is a large rural municipality:

- **Bethel would have to levy a 50 mill property tax**, (which is 20 mills over the current 30 mill statutory property tax limit in Alaska) to equal the revenue from its current 5% sales tax, according to estimates by the State Assessor. Bethel has a very little taxable property.
- **A property tax is not feasible in Bethel** because many residents living on federal land or in federal housing would pay nothing while their neighbors on private land would pay among the highest property rates of any city in the U.S.

Sales tax has been the key local revenue of the majority of Alaska's cities and boroughs since statehood. In almost every community, sales tax must be approved by local voters. If the state mandates state sales tax without a vote, and preempts local sales tax exemptions and rules, many cities and boroughs will have to lower or eliminate their sales taxes and become fully dependent on the state. **Without this key local revenue source communities will lose "maximum local self-government" guaranteed by our constitution.**

Note 1: Many rural communities have only 10% to 25% of urban property taxes

For example: (Per Capita Full Values from 2001 Alaska Taxable)

Anchorage	\$69,849 per capita
Fairbanks NSB	\$59,899 per capita
Bethel (5,449 pop.)	\$17,000 per capita *
Emmonak (804 pop.)	\$8,428 per capita

Note 2: 2001 Bethel SALES TAX Revenue (population 5,449)

General 5%	\$4,194,997
Alcohol 5%	\$65,686
Bed 3%	\$61,960
Local Fish 5%	\$80,450
Motor Vehicle Flat	\$62,251
Gaming	\$406,711
Total	\$4,875,025

*** Note 3: Details on the Property Tax Estimate for Bethel**

"Full and true" Assessed Value estimated by Assessor in "Alaska Taxable) is \$186,653,400 however, the State Assessor feels that actual taxable property based on exemptions (e.g. exemption for federally constructed housing) in most municipalities would be about 40 to 50% of that, or \$93,500,000. Therefore, a 10 mill property tax would yield approximately \$935,000, and a 50 mill property tax would yield about \$4,675,000.

A State Sales Tax is Not Fair to Alaskans

Why, should a family in one part of Alaska buying milk pay far more than a family in a large city to support state government ?



A state sales tax is unfair because it is based on a percentage of the cost of goods and services. The cost of goods and services vary widely across the state. This makes a state sales tax regionally regressive due to differences in basic cost of living purchases.

For Comparison on a ½ Gallon of 2% milk (AC or Safeway/Carrs 3/22/04)

- Nuiqsut \$6.99
- Kaktovik \$6.18
- Fort Yukon \$4.49
- Kotzebue \$3.95
- Dillingham \$3.59
- Anchorage \$2.65
- Fairbanks \$2.35
- Juneau \$2.19

Also, for example, according to the Alaska Department of Labor "Alaska Economic Trends" in 2002 food for a family of four in Nome, Dillingham, or Bethel cost 180% to 190% of similar purchases in Anchorage or Fairbanks. While a family of four in Cordova pays 163%, Kodiak 143%, and Homer 138%.

On the other hand, the current municipal sales tax is fair (not regionally regressive) because everyone in the taxing area faces equal costs for goods and services.

Comparison of State Sales Tax and State Income Tax

According to the National Conference of State Legislators (NCSL), there are "six principles that are appropriate for evaluating individual tax sources." The excerpts below are from the NCSL's "Tax Policy Handbook for State Legislators."

State Sales Tax	State Income Tax
Reliability "The sales tax has been a stable state revenue source, although rate increases have been necessary to preserve its share of the state revenue mix."	Reliability "The personal income tax is a reliable and stable source of state revenue...The responsiveness of the income tax to economic growth also helps explain why state income tax reliance has increased over time."
Equity Two primary issues dominate the debate over the equity of the sales tax. The first is regressivity, in which sales taxes claim a larger share of low-income taxpayer incomes. The second issue involves whether exemptions for certain goods and services make the sales tax inequitable."	Equity "The personal income tax scores well on both vertical and horizontal equity...inclusion of personal income taxes in the overall mix of state taxes helps minimize the regressivity of the system."
Administration and Compliance "Much of the administrative burden is shifted to the vendor."	Administration and Compliance "States that link personal income tax to the federal code gain efficiency in administration and reduce compliance costs for businesses and individuals."
Interstate and International Competition "In a competitive interstate and international marketplace, States that tax business inputs may put firms at a competitive disadvantage." "(States) cannot require the out of state retailer to collect and remit sales tax..."	Interstate and International Competition "Since firms do not pay a personal income tax, this is more an intangible concern in the mind of senior executives than a direct cost of doing business."
Economic Neutrality "States that tax services may disproportionately burden small business because larger firms may provide services (legal, accounting) in-house." "For example, States that exempt labor repairs but tax new purchases may affect decisions about whether to fix a machine or buy a new one."	Economic Neutrality "State income taxes may be a factor in decisions about work effort, but they probably are not the deciding factor for most taxpayers."
Accountability "Most taxpayers are unaware of the total annual sales tax burden."	Accountability "The personal income tax is the most visible tax paid by individuals."
Additional Issues "...Congress repealed the federal income tax deduction for sales taxes..."	Additional Issues "The state income tax can be claimed as an itemized deduction ... This deduction reduces the effective state tax rate by up to 40 percent for taxpayers in the highest federal tax bracket."

Source: "Tax Policy Handbook for State Legislators" by the National Conference of State Legislatures, December 1997 pp.9-18.

Estimated Economic Impacts of Budget Balancing Options

Based on \$250 million in cuts or new revenue
(University of Alaska – Institute of Social and Economic Research, 7/03)

- State Budget Cuts – **4,650 estimated job loss** due to both direct and indirect job loss. Budget cuts can double the job loss versus taxes due to direct loss of eliminated government jobs, plus secondary loss of jobs from less money spent on goods and services throughout the economy.
- State Sales Tax – **2,325 estimated job loss** due to indirect job loss only. Taxes have only secondary job loss because taxes mean a little less income for each household, i.e. no jobs are directly eliminated. **In addition to job loss calculated above**, community job loss would also occur from the loss of sales in Alaska due to competition with tax-free internet sales.
- State Income Tax – **1,875 estimated job loss**. Indirect job loss only, but significantly lower than state sales tax because 23% to 25% of the income tax is paid by out of state workers and IRS deductibility. Also, an income tax does not add to the cost of goods and services so there is no additional Alaska job loss due to the incentive to purchase more goods and services over the internet or from out of state.
- Use of PF Earnings – **0 estimated job loss** If voters approve 5% POMV, maintain PFD's at \$1000 (higher than estimated for next year), & use up to \$600 million for state/municipal support. Use of Permanent Fund Earnings, under a POMV (Percent of Market Value) fund management system, does not take any money out of the economy so there are no direct or indirect job losses. In fact, for at least the next two years it would add money to Alaska's economy through higher PFDs.

Is a State Sales Tax or Income Tax best for Alaskans?

Who Pays?

Which best captures non-resident & out of state revenue?

According to separate studies by the University of Alaska Institute of Social and Economic Research and the Alaska Department of Revenue in 2002, a state sales tax costs Alaskans significantly more than other major taxes.

Here are the results:

	% paid by Non-Residents	% paid by Non-Residents + IRS deduction
	<u>Sales Tax</u>	<u>Income Tax</u>
By U of A – ISER	7%	25%
By AK Dept of Revenue	10%	22%

Narrative:

While both a sales and income tax can collect tax from out of state wage earners working in Alaska, federal deductibility of state income tax benefits Alaskans. **State income tax is deductible from federal income tax**, sales tax is **not**. That means that the federal government essentially subsidizes the state income tax by allowing Alaskans to pay less federal income tax.

What does it mean? For Example, using the higher U of A estimates:

If the State needs \$300 million in revenue:

- **Sales tax:** \$279 million from Alaskans, **\$21 million by non-residents**
- **Income tax:** \$225 million from Alaskans, **\$75 million by non-residents & IRS**
- **Savings to AK** \$ 54 million Saved by state income tax (\$86 less per Alaskan/year)

U.S State and Local Sales Taxes

Note by Alaska Municipal League: The "maximum rate" in the Federal Tax Administrators chart below is footnoted as applying to "at least one jurisdiction" is misleading. For example, Alabama is shown as having a maximum rate of 11%, the average combined state and local sales tax is 7% to 8%. Only one county in the U.S. has a rate of 11%.

According to the Sales Tax Clearinghouse (<http://thestic.com/STRates.stm>):

What is the average sales tax nationally?

The average sales tax across the nation is 6.25%, including all county and city taxes.

Louisiana, Tennessee, and Washington have the dubious distinction of having the highest average sales tax rates in the nation, of 8.25% or more.

Delaware, Montana, New Hampshire, and Oregon have no sales taxes at all.

Arab, AL (Cullman County) has the highest combined rate of 11%, while many locations in AL, LA, and OK have combined rates of 9% or more. Chicago has the highest combined rate for a metropolitan area at 8.75%.

Federation of Tax Administrators - Comparison of State and Local Retail Sales Taxes January 2004

****Added below in states with the highest maximum sales tax rates are the actual total sales tax rates for 12 counties in each state listed in the "Sales Tax Clearinghouse" site.**

	Food Items [1] Taxable (T) Exempt (E)	State Rate	Maximum Local Rate [2]	Maximum State/Local Rate [2]
Alabama	T	4.00	7.00	11.00 **(2 at 7%, 9 at 8%, 1 at 8.5%)
Alaska	T	---	7.00 [3]	7.00
Arizona	E	5.60	4.50	10.10 **(2 at 7.1% to 7.8%, 10 at 8.1% to 8.8%)
Arkansas	T	5.125	5.50	10.625 **(4 at 8% to 8.7%, 4 at 9%, 1 at 10%, 1 at 10.5%, 1 at 10.75%)
California	E	6.00	2.75	8.75
Colorado	E	2.90	7.00	9.90 **(11 at 3.15% to 7.5%, 1 at 8.15%)
Connecticut	E	6.00	---	6.00
District of Columbia	E	5.75	---	5.75
Florida	E	6.00	1.50	7.50
Georgia	E	4.00	3.00	7.00
Hawaii	T*	4.00	---	4.00
Idaho	T*	6.00	3.00	9.00
Illinois	T**	6.25	3.00	9.25

Indiana	E	6.00	---	6.00
Iowa	E	5.00	2.00	7.00
Kansas	T*	5.30	3.00	8.30
Kentucky	E	6.00	---	6.00
Louisiana	E [4]	4.00	6.25	10.25
**(7 at 7.5% to 8%, 5 at 8.5% to 9%)				
Maine	E	5.00	---	5.00
Maryland	E	5.00	---	5.00
Massachusetts	E	5.00	---	5.00
Michigan	E	6.00	---	6.00
Minnesota	E	6.50	1.00	7.50
Mississippi	T	7.00	0.25	7.25
Missouri	T**	4.225	4.5	8.725
Nebraska	E	5.50	1.50	7.00
Nevada	E	6.50	1.00	7.50
New Jersey	E	6.00	---	6.00
New Mexico	T	5.00	2.25	7.25
New York	E	4.25	4.50	8.75
**(9 at 7%, 2 at 7.5%, 1 at 8.65%)				
North Carolina	E [4]	4.50	3.00	7.50
North Dakota	E	5.00	2.50	7.50
Ohio	E	6.00	2.00	8.00
Oklahoma	T	4.50	6.00	10.50
**(9 at 7% to 8.5%, 3 at 8.85% to 9%)				
Pennsylvania	E	6.00	1.00	7.00
Rhode Island	E	7.00	---	7.00
South Carolina	T**	5.00	2.00	7.00
South Dakota	T*	4.00	2.00	6.00
Tennessee	T	7.00	2.75	9.75
Texas	E	6.25	2.00	8.25
Utah	T	4.75	2.25	7.00
Vermont	E	6.00	1.00	7.00
Virginia	T**	3.50	1.00	4.50
Washington	E	6.50	2.40	8.90
West Virginia	T	6.00	---	6.00
Wisconsin	E	5.00	1.00	6.00
Wyoming	T*	4.00	2.00	6.00

****Added above** in states with the highest maximum sales tax rates are the actual total sales tax rates for 12 counties in each state listed in the "Sales Tax Clearinghouse" site.

[1] Food purchased for consumption off-premises.

[2] Highest local rate known to be actually levied by at least one jurisdiction. Includes local taxes for general purposes and those earmarked for specific purposes (e.g. transit). Taxes applying only to specified sales (e.g. lodging or meals) are excluded.

[3] Alaskan cities and boroughs may levy local sales taxes from 1% to 6%. (AML NOTE: incorrect)

[4] Food exempt from state tax, but subject to local taxes.

* Income tax credit allowed to offset sales tax on food.

** Food taxed at lower rate.

Source: Compiled by the Federation of Tax Administrators from various sources.

Municipal Sales Tax Exemptions Definitions (1999)

- ❑ **Causal Sales** A casual and isolated sale not made in the regular course of business is exempt
- ❑ **Dues and Fees** Dues and fees paid to clubs, labor unions and fraternal organizations are exempt.
- ❑ **Gov't Prohibitions** A sale which the municipality is prohibited from taxing under the Constitution and laws of the United States or the Constitution of the state of Alaska is exempt
- ❑ **Gov't Agency** A sale directly to the United States government, the state of Alaska and its political subdivisions, the city and borough, or any departments thereof, is exempt. A sale made to a contractor to be utilized in the manufacture and production of property for sale to an agency of any of the above governments under a cost plus contract is taxable as the contractor is deemed the consumer. A sale to a government contractor, which does not become a physical part of the property being constructed for any of the above governments is taxable.
- ❑ **Funeral** Sale of cemetery plots, caskets, funeral and burial related items and services by a funeral home.
- ❑ **Medical** Medical, dental, hospital, and veterinary services are exempt. The sales of hearing aides and medicinal preparations when prescribed by a licensed practitioner are exempt. Medical, dental, hospital, and veterinary services do not include services rendered by chiropodists, barbers, cosmeticians, masseurs, nor do they include the clipping, grooming or boarding of animals.
- ❑ **Newspapers & Pubs.** The sale of daily newspapers to a consumer is exempt
- ❑ **Nonprofits Charitable Org.** Sales made by nonprofit charitable organizations which do not have paid employees and which do not keep normal business hours are exempt.
- ❑ **Student Transportation** The service of transporting students to and from a school in vehicles is exempt.
- ❑ **Food Stamps** Sales of goods made with food coupons, food stamps, or other type of certificate issued under the Food Stamp Act or Special Supplemental Food Program for Women, Infants, and Children.
- ❑ **Food at Schools** The sale of food and beverages to the public in high school or college cafeterias or lunchrooms which are operated primarily for teachers and students and not for profit is exempt.

- ❑ **Residential Rentals** Residential rentals other than rentals to transients who occupy or rent a suite, room or rooms in a hotel-motel for fewer than thirty consecutive days for the purpose of habitation.
- ❑ **Utilities** Sales of electricity, water/sewer, or services provided by the city.
- ❑ **Child Care** The sale of child care services is exempt.
- ❑ **Freight & Wharfage** Freight and wharfage charges, whether arising out of foreign, interstate or intrastate commerce, are exempt. Warehouse and storage services are taxable.
- ❑ **Insurance** The sale of insurance policies, guaranty bonds and fidelity bonds are exempt.
- ❑ **Banking Services** Services associated with any deposit accounts, including service fees, NSF fees, fees for the purchase of bank checks, money orders, travelers checks, loan fees, pass-through charges on loan transactions, services associated with the sale, exchange or transfer of currency, stocks, bonds and other securities.
- ❑ **Manufacturing and Contracting** A sale to a manufacturer or contractor is exempt if the article becomes a physical part of a manufactured product or structure which when sold is subject to this tax. A "physical part of a manufactured product or structure" means that the article must be easily and readily identifiable in the manufactured article or the structure, as the case may be.
- ❑ **Catalog Sales** Sales of goods resulting from orders received from outside a city by mail, telephone or other similar public communication where delivery of the property ordered is made outside the city by mail or common carrier.
- ❑ **Games of Skill & Chance** Sales of lottery tickets and other forms of games of skill and chance
- ❑ **Other** Salaries, Veteran's Org., Drugs, Travel and Adventure Services, Arts & Crafts, lobbying, ATV's, Boats, Counseling, Animal Food, Advertising, Jet Fuel, Printing Services outside of city, Personal Property, Video Games, etc.

Municipal Sales Taxes And Exemptions (Compiled in 1999)

Municipalities	Mun. of Anchorage	Fairbanks NS Borough	City of Fairbanks	City of North Pole	Mat-Su Borough	City of Palmer	City of Wasilla	City of Houston	Kenai Borough	City of Kenai	City of Soldotna	City of Homer	City of Seward	City of Seldovia	C/B of Juneau
Population	258,782	83,928	31,601	1,619	55,747	4,318	5,134	939	48,815	7,058	4,134	4,155	3,040	281	30,684
Special Sales Taxes:															
Bed Tax	8%	8%	8%		5%	5%	5%	5%					4%		7%
Raw Fish															
Liquor			5%												3%
Tobacco	15%		8%	8%											6%
Other															
General Sales Tax				3%		3%	2%		2%	3%	3%	3.5%	3%	3%	5%
Exemptions:									Same as Kenai Peninsula Borough						
Seniors (age)				65											65
Tax Cap (amt)						\$500									
Wholesale Sales				x		x			x						x
Services & Fees				x		x			x						x
Alcohol Prohibitions						x			x						x
Alcohol Agencies				x		x			x						x
General						x			x						x
Medical				x		x			x						x
Newspapers & Pubs.				x		x			x						x
Nonprofits						x			x						x
Student Trans.						x									x
Postage Stamps, WIC				x		x			x						
Food at Schools				x		x			x						x
Bus Rentals				x											x
Utilities						x									
Child Care															x
Dockage & wharfage									x						
Insurance				x											x
Printing Services				x					x						x
Manufacturing															
Retail Sales															x
Lease of Real Property															
Real Estate Fees				x		x									
Construction									x						
Household Items									x						
Wholesale Items															x
Services															
Arts & Crafts															
Amusement															
Hotel Tabs															
Beer				x		x			x						x

Municipal Sales Taxes And Exemptions (Compiled in 1999)

Municipalities	Ketchikan Borough	City of Ketchikan	City of Saxman	Kodiak Borough	Kodiak	Ouzinkie	North Slope Borough	Wainwright	C/R of Sitka	Northwest Arctic Borough	Kotzebue	Haines Borough	City of Haines	Aleutians East Boro.	Sand Point
Population	14,231	8,460	379	13,848	6,589	252	9,389	543	8,779	6,844	2,964	2,476	1,463	2,199	830
Special Sales Taxes:															
Bed Tax	4%	6%	4%	5%	5%				4%		6%				
Raw Fish														2%	2%
Liquor											6%				
Tobacco															
Other				.925 sever.		0.93%			x						
General Sales Tax	2%	3.5%	3.5%		6%	3%		3%	5%		6%	1.50%	4.00%		3%
Exemptions:															
Seniors (age)	65	65	65		65	65			65		65				
Sales Tax Cap (amt)		\$1,000			\$500							\$5,000	\$5,000		
Casual Sales	x	x			x	x			x		x	x	x		x
Dues & Fees	x	x			x				x		x	x	x		
Gov't Prohibitions	x	x	x		x				x		x	x	x		x
Gov't Agencies	x	x	x		x	x			x		x	x	x		x
Funeral	x	x			x				x		x	x	x		x
Medical	x	x			x				x		x	x	x		x
Newspapers & Pubs.	x				x				x		x				
Nonprofits	x	x	x		x				x		x	x	x		x
Student Trans.	x	x							x			x	x		
Food Stamps	x	x							x		x	x	x		x
Food at Schools	x	x			x				x		x	x	x		
Res. Rentals		x										x			x
Utilities					x	x						x	x		
Child Care		x			x				x			x	x		x
Freight & wharfage									x						
Insurance		x			x							x	x		x
Banking Services					x							x	x		x
Manufacturing									x						
Catalog Sales												x	x		x
Sale of Real Property											x	x	x		x
Real Estate Fees															
Construction									x		x	x	x		
Resale Items															
Wholesale Items															
Fuels															
Arts & Crafts															
Bingo		x	x		x										
Pull Tabs		x	x		x										
Other	x	x		x	x							x	x		

Municipal Sales Taxes And Exemptions (Compiled in 1999)

Municipalities	King Cove	False Pass	Lake & Pen Borough	Chignik	Denali Borough	Bristol Bay Borough	Yakutat Borough	Bethel	Unalaska	Nome	Petersburg	Wrangell	Dillingham
Population	703	58	1,867	121	1,864	1,297	810	5,463	4,285	3,706	3,398	2,589	2,332
Special Sales Taxes:													
Bed Tax			6%		7%	6%	4%		5%			\$4. per night	
Raw Fish	2%	2%	2%	1%		3%			2%				
Liquor								5%					
Tobacco													
Other				x									
General Sales Tax	3%	2%					4%	5%	3%	4%	6%	7%	
Exemptions:													
Seniors (age)											65	65	
Sales Tax Cap (amt)								>\$3,000		\$1,500	\$1,000	>\$1,000	>\$2,000
Casual Sales		x					x	x	x		x	x	x
Fees & Fees							x	x	x	x		x	x
Gov't Prohibitions							x	x	x	x		x	x
Gov't Agencies		x					x	x	x	x		x	x
Funeral		x					x				x	x	x
Medical		x					x	x	x	x	x	x	x
Newspapers & Pubs.		x					x		x	x		x	x
Nonprofits		x					x		x	x	x	x	x
Student Trans.							x	x				x	x
Food Stamps							x	x		x	x	x	x
Food at Schools							x	x	x				x
Res. Rentals		x					x	x		x	x		
Utilities									x		x		
Child Care							x				x	x	
Wharfage							x	x	x		x	x	x
Insurance		x						x	x		x		x
Banking Services								x		x			
Manufacturing									x			x	
Catalog Sales								x			x		
Sale of Real Property		x								x			x
Real Estate Fees													
Construction							x	x	x	x			
Retail Items									x		x		
Wholesale Items													x
Services													
Arts & Crafts													
Income												x	
Utility Tabs												x	
Other		x			x		x	x	x	x	x		x

Municipal Sales Taxes And Exemptions (Compiled in 1999)

Municipalities	Craig	Cordova	Hoonah	Emmonak	Togiak	Unalakleet	Saint Paul	Chevak	Alakanuk	Gambell	Klawock	Thorne Bay	Pilot Station	Fort Yukon	Kotlik	Scammon Bay	Nenana	
Population	2,145	1,909	896	838	801	784	761	741	671	670	659	597	558	553	552	450	435	4
Special Sales Taxes:																		
Bed Tax						10%												
Raw Fish					2%													
Liquor					5%													
Tobacco																		
Other																		
General Sales Tax	5%	6%	5%	3%	2%	5%	3%	3%	4%	3%	5.50%	3%	2%	3%	3%	2%	3%	2
Exemptions:																		
Seniors (age)	60	65	65	65		65		65	65		60	60		55		65		
Sales Tax Cap (amt)	<\$150.00		<\$125.00	\$1,000	\$1,000						\$4,000	\$10,000		<\$125				
Casual Sales	x	x	x	x		x	x	x	x	x	x		x	x	x	x	x	
Dues & Fees	x	x	x	x				x	x	x	x	x		x			x	
Gov't Prohibitions	x	x	x	x		x	x	x	x	x	x	x		x	x	x	x	
Gov't Agencies	x	x	x	x		x	x	x		x	x	x		x	x		x	
Funeral	x		x	x		x				x	x	x		x			x	
Medical	x		x	x		x		x	x	x		x			x		x	
Newspapers & Pubs.	x		x			x		x	x		x	x		x	x		x	
Nonprofits	x	x		x		x		x	x	x	x	x	x	x		x	x	
Student Trans.	x		x					x	x		x			x			x	
Food Stamps	x	x				x												
Food at Schools	x	x	x	x		x	x	x	x	x		x		x	x	x	x	
Res. Rentals								x	x	x							x	
Utilities				x				x	x	x	x	x	x			x		
Child Care	x	x	x	x								x						
Freight & wharfage	x	x					x	x	x			x						
Insurance		x	x	x				x		x	x			x			x	
Banking Services			x															
Manufacturing	x							x	x									
Catalog Sales			x	x				x	x	x	x		x			x		
Sale of Real Property						x						x		x			x	
Real Estate Fees																		
Construction	x	x	x			x				x						x		
Resale Items	x	x							x			x						
Wholesale Items				x			x		x		x	x					x	
Fuels								x	x									
Arts & Crafts				x		x		x	x									
Bingo																		
Pull Tabs																		
Other	x	x	x				x	x	x	x	x	x	x	x		x	x	

Municipal Sales Taxes And Exemptions (Compiled in 1999)

Municipalities	Saint Michael	Tanana	Ambler	Elim	Marshall	Aleknagik	Newhalen	White Mountain	Pelican	Egegik	Port Alexander
Population	362	317	315	306	300	259	191	188	149	132	90
Special Sales Taxes:											
Bed Tax						5%			6%		6%
Raw Fish							2%			3%	
Liquor											
Tobacco											
Other											
General Sales Tax	4%	2%	3%	2%	4%	5%	2%	1%	4%	1%	2%
Exemptions:											
Seniors (age)											
Sales Tax Cap (amt)											
Casual Sales	x	x				x	x	x		x	x
Dues & Fees		x	x	x				x			
Gov't Prohibitions		x		x	x	x		x		x	x
Gov't Agencies	x	x		x		x	x	x		x	
Funeral		x		x		x	x				
Medical	x	x		x			x	x			
Newspapers & Pubs.	x	x		x		x	x				
Nonprofits	x	x	x	x	x	x	x	x		x	x
Student Trans.		x									
Food Stamps							x		x		
Food at Schools	x	x		x			x	x	x		
Res. Rentals			x	x	x		x	x		x	
Utilities				x		x	x	x			
Child Care		x									
Freight & wharfage											x
Insurance		x		x		x	x	x			
Banking Services			x		x			x			
Manufacturing		x						x			
Catalog Sales				x				x			
Sale of Real Property		x	x		x	x	x				
Real Estate Fees											
Construction				x							
Retail Items									x		
Wholesale Items	x	x	x		x			x			x
Fuels							x				
Arts & Crafts											
Fishing											
Cellular											
Other	x	x	x		x		x			x	x

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."

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Bill History/Action Display



BILL: HB 320

BILL VERSION:

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THEN EDT, L&C, FIN

SPONSOR(s): REPRESENTATIVE(s) SEATON

SHORT TITLE: APPORTIONMENT OF BUSINESS
INCOME

STATUS DATE: 05/14/03

TITLE: "An Act relating to apportionment of business income; and providing for an effective date."

Bill Root: [Display Bill Root](#)[Next Bill](#)[Full Text](#)[Committee Action with Bill History](#)

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HOUSE BILL NO. 320

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY REPRESENTATIVE SEATON

Introduced: 5/14/03

Referred: House Special Committee on Ways and Means, House Special Committee on Economic Development, International Trade, and Tourism, Labor and Commerce, Finance

A BILL**FOR AN ACT ENTITLED**

1 "An Act relating to apportionment of business income; and providing for an effective
2 date."

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

4 * **Section 1.** AS 43.20.021(a) is amended to read:

5 (a) Sections 26 U.S.C. 1 - 1399 and 6001 - 7872 (Internal Revenue Code), as
6 amended, are adopted by reference as a part of this chapter. These portions of the
7 Internal Revenue Code have full force and effect under this chapter unless excepted to
8 or modified by other provisions of this chapter. [HOWEVER, NOTHING IN THIS
9 CHAPTER OR IN AS 43.19 (MULTISTATE TAX COMPACT) MAY BE
10 CONSTRUED AS AN EXCEPTION TO OR MODIFICATION OF 26 U.S.C. 833.]

11 * **Sec. 2.** This Act takes effect immediately under AS 01.10.070(c).

ALASKA BUSINESS TAXATION:



S

CORPORATION

PROJECT REPORT

July - August 1997

Olga Y. Paluba
Graduate Intern
Income and Excise Audit Division
Alaska Department of Revenue

Acknowledgment Letter

This S Corporation project report would not have been possible to complete without assistance of many Income and Excise Audit Division (IEAD) employees. Although not a big report, in doing it I have accumulated large debts. One set of these is to Brett Fried who introduced me to IEAD, was always there to help with the project, supplied me with ideas to explore, motivated me, and edited the multiple drafts.

A second set of debts is to Bob Bartholomew and Larry Meyers who initiated this project and did much to sharpen the focus of the report during our weekly meetings.

Third, I would like to thank Paul Dick, Bob LaTour, and Cliff Doherty for taking time to answer my questions, contribute to the project, and edit the drafts; Carl Meyer for legal advice; Brenda Vaughn for administrative support and her kindness; John Johnson and Rex Richardson for opening to me several important secrets of my computer. I appreciate the efforts and assistance of many others for making it easier for me to adjust to the new environment and gain practical knowledge about taxation and state revenue issues.

Every intern should be so lucky as to have such generous and self-sacrificing backup support and an opportunity to be part of a very disciplined, dynamic, and devoted team.

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Executive Summary

In 1997, the Alaska Department of Revenue conducted a research project exploring the structure of business taxation. The focus of the discussion was S corporation election and its effect on state revenue. The purpose of this project was to provide policy and decision makers with facts pertinent to the status and treatment of S corporations in Alaska. The major findings of this research are outlined below:

- Out of approximately 70,000 businesses in Alaska only 10% are subject to Alaska income tax.
- Since FY 92, the growth of Alaska tax returns filed by S corporations has been 38%, while returns by C corporations has grown by only 2%.
- \$17 million is the estimated amount of revenue loss in FY 97 due to the nontaxable status of S corporations in Alaska.
- Among the states there are no uniform rules governing the taxation of an S corporation and its shareholders. Some states tax S corporations in the same manner as they tax other corporations.
- Alaska recognizes S corporations but imposes no corporate or personal income tax.
- S corporation election in Alaska is not industry-specific, but is spread throughout all major industries.
- Half of foreign S corporations that have nexus with Alaska are based in Washington; 40% of these are fishing businesses.

Introduction

Alaska has for a long time tried to come to terms with its dependence on oil revenues. Recommendations made by the Long Range Financial Planning Commission in 1995 include increasing excise taxes and user fees. One strategy that has not been widely explored is revisiting the structure of the Alaska business income tax.

Alaska has approximately 70,525 businesses (see table 1 and chart 1) of which 12,045 are corporations. Surprisingly, only 23% of these corporations pay any tax. Of these taxpaying businesses, 82% of the total corporate tax is paid by the top 10 corporations, six of which are oil and gas companies (see Appendix A).

One of the reasons for the small percentage of companies that pay business tax is the popularity of business structures that are not taxed on their net income, such as S corporations.

The FY 97 projected revenue loss from S corporation election was \$17 million.

This report addresses the following topics:

- different types of business structures in Alaska,
- how S corporations fit into this general framework,
- composition and tax treatment of S corporations, and
- revenue effects of S corporation election in Alaska.

Besides sole proprietorships, partnerships, limited partnerships, and corporations, businesses can now choose the following

**TABLE 1: ALASKA BUSINESS STRUCTURES
(FY 97)**

Sole proprietorships ¹	44,589
General partnerships ¹	12,821
C corporations ²	
Domestic ³	4,342
Foreign	2,854
Total C corporations	7,196
S corporations ² :	
Domestic	4,011
Foreign	838
Total S corporations	4,849
Limited partnerships (LPs) ⁴ :	
Domestic	211
Foreign	74
Total limited partnerships	285
Limited liability companies (LLCs) ⁴ :	
Domestic	642
Foreign	129
Total limited liability companies	771
Limited liability partnerships (LLPs) ⁴ :	
Domestic	2
Foreign	12
Total limited liability partnerships	14
Total Businesses	70,525

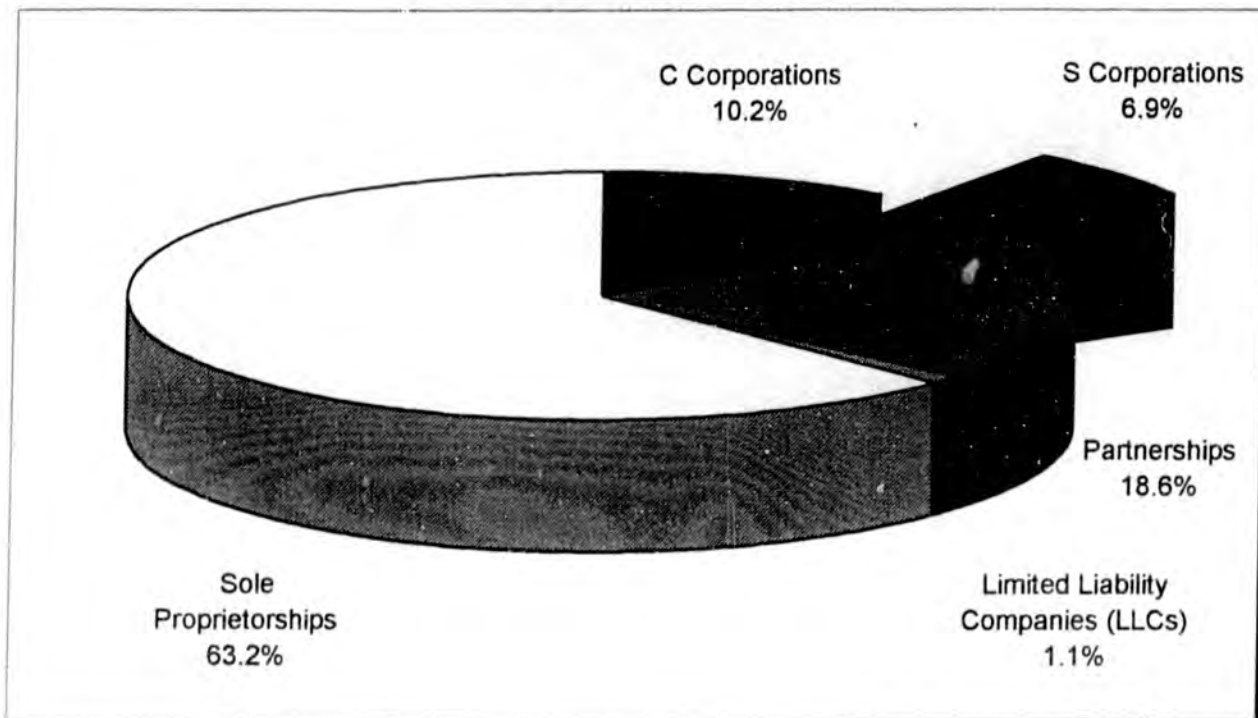
¹ Source: Alaska Department of Commerce and Economic Development (DCED). The data is based on the number of current active Alaska business licenses as of July 8, 1997.

² Source: Alaska Department of Revenue. The numbers represent the filing activity of businesses during FY 97.

³ Source: Alaska Department of Revenue. The numbers represent the filing activity of businesses during FY 97.

⁴ Source: DCED. The information reflects the number of businesses (as of July 1997) that have registered with DCED either since the time the entity type was created, as is the case with LLPs and LLCs, or since the time they started filing with DCED, as is the case with LPs.

CHART 1: FY 97 DISTRIBUTION OF BUSINESS STRUCTURES IN ALASKA⁵



business types: limited liability partnerships, limited liability companies, and S corporations. The most popular forms of business in Alaska are sole proprietorships (63.2%) and partnerships (18.6%).

Alaska Businesses

In the last decade several business structures types emerged and have become popular with businesses in Alaska and nationwide.

Approximately 90% of all Alaska businesses pay little (if any) tax on their net income.

The C corporation is the only business structure where profits are subject to corporate income taxes. C corporations make up approximately 10% of all 70,525 Alaska businesses.

Although all of the differences between business structures will not be addressed, a general discussion is included of how each of them regards limited liability, participation in management, and tax treatment by the Internal Revenue Service (IRS) and by the State of Alaska.

⁵ Sources: DCED and Alaska Department of Revenue. Partnerships include general partnerships, limited partnerships, and limited liability partnerships. The numbers of limited (285) and limited liability (14) partnerships are so small that they were combined into a single category.

S Corporation

An S corporation is a corporation that elects S status under Subchapter S of the Internal Revenue Code⁶. By making this election the corporation chooses to be taxed as a pass-through entity, similar to a partnership or a sole proprietor.

The potential tax benefit of electing S corporation status is that income is not subject to a corporate level tax and instead "passes through" to the individual shareholders. The amount that passes through to each shareholder is in direct proportion to the size of their ownership interest in the entity.

C Corporation

Generally, corporations that do not or cannot elect S corporation status are considered C corporations. The federal government and the State of Alaska levy a tax on the earnings at the corporate level⁷. Additionally, when income is distributed to a shareholder, it is subject to tax as part of the shareholder's individual income. In Alaska, this is only true at the federal level because the state does not have a personal income tax.

Corporations compute their tax liability based on their federal taxable income with Alaska adjustments. Alaska uses an apportionment method to determine the share of income that is taxable in the state. Corporations, other than oil and gas corporations, apportion their income to Alaska by using a three-factor formula based on sales, property, and payroll. Oil and gas corporations use a modified apportionment formula.

The applied tax rate is measured in \$10,000 increments and ranges from 1% to 9.4%. Corporate income over \$90,000 is taxed at the 9.4% rate.

Other Pass-through Entities

Pass-through entities are not subject to the Alaska corporate income tax. These entities include the following: general partnerships, limited partnerships, limited liability partnerships, and limited liability companies. A brief discussion of these entity types is found below. (See Appendix B for a more detailed comparison of all business structures.)

General partnership

This is the traditional form of partnership. General partners are liable for all debts and obligations of the business including liability for malpractice or other torts of partners and employees. In terms of liability, general partnership (GP) offers no protection.

Limited partnership

Limited partnership (LP) is a form of partnership that consists of at least one general partner who accepts unlimited liability and other members, known as limited partners. The latter are personally liable only for their capital contributions and future contributions to which they are committed.

Limited liability partnership

Limited liability partnership (LLP) is new to Alaska. The amendment to the Uniform Partnership Act⁸ became effective on January 1, 1997.

It creates a form of partnership which uses a different approach to:

- liability and
- participation in management.

⁶ IRC 1361-79

⁷ AS 43.20

⁸ AS 32.05.405.—32.05.760

The legislation offers protection from the wrongful acts of other partners or third-parties and provides equal opportunities for all partners to participate in management.

The limits on vicarious liability have resulted in LLPs being mostly used by private lawyers and accountants. Under the newly-established LLP statute a partner is not, directly or indirectly, liable for the debts, obligations, and liabilities that arise from misconduct, negligence, malpractice or any wrongful acts committed by a partner or an employee. However, the personal liability for the partner's own actions remains the same. A partner is not relieved of liability for the partner's own negligence, wrongful acts, wrongful omissions, malpractice or misconduct.

Unlike in a limited partnership, where a general partner manages the enterprise himself and limited partners do not participate directly in management, in an LLP every partner takes part in all business operations and still retains limited liability for the wrongful acts, malpractice, and torts of other individuals.

Limited liability company

Limited liability companies (LLCs) are fast proving to be a popular form of doing business. Most states (48 states and the District of Columbia) have legalized the status of LLCs and allow the formation of such business structures.

The LLC is seen as a hybrid between a corporation and a partnership. It enjoys the advantage of giving members full protection from the liabilities of the entity, while at the same time being taxed as a partnership for federal income tax purposes.

This type of business structure ensures that all members are free from personal liability for

the debts of the enterprise. There is no set limit on participation in management and members of an LLC can deduct business losses on their personal tax returns. In Alaska the LLC was approved in 1995⁹. The statute was amended in January 1997 to allow sole proprietors to form an LLC which before had to consist of at least two members. The expected effect of this amendment is an increase in the number of LLCs.

Additionally, the new "check-the-box" regulations¹⁰ give an LLC owner(s) the right to decide if the business should be taxed as a partnership or a corporation. Since partnerships do not pay corporate taxes, most LLCs choose to be taxed as partnerships. In this case, their tax treatment is similar to S corporations.

New Treasury regulations eliminate the need for unincorporated businesses to guard against corporate characteristics (free transferability of interest, limited liability, continuity of life, and centralization of management) which previously could limit the ability of the business to be classified as a partnership for federal income tax purposes.

Despite the growth in the number of LLCs, many questions and issues relating to their taxation and the taxation of their members have yet to be resolved. This is a possible reason why many businesses are still cautious about choosing this type of business structure.

Business Fees in Alaska

Currently, the Alaska Department of Commerce and Economic Development collects three types of mandatory fees: organizational filing fees, biennial fees, and business license fee. The latter is submitted

⁹ AS 10.50 et seq.

¹⁰ Treas. reg. section 301.7701