

ALASKA

LEGISLATURE

COMMITTEE

FILES

1991-1992

8672

7275

HOUSE

STATE

AFFAIRS

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

Bill Version: HB154

REQUEST _____

Publish Date: _____

Revision Date: 3/13/87

Agency Affected: Revenue

Title: State Individual Income Tax

BRU: Administrative Services

Sponsor: _____

Components: _____

Requestor: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
OPERATING						
PERSONAL SERVICES	-	529.0	1097.1	1171.0	1171.0	1171.0
TRAVEL	-	10.0	8.0	8.0	8.0	8.0
CONTRACTUAL	-	402.9	1028.1	1068.6	1068.6	1068.6
SUPPLIES	-	5.5	18.0	18.0	18.0	18.0
EQUIPMENT	-	163.2	158.2	-0-	-0-	-0-
LANDS & STRUCTURES	-	-	-	-	-	-
GRANTS, CLAIMS	-	-	-	-	-	-
MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	1110.6	2309.4	2265.6	2265.6	2265.6
CAPITAL	-	-	-	-	-	-
REVENUE	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	1110.6	2309.4	2265.6	2265.6	2265.6
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	1110.6	2309.4	2265.6	2265.6	2265.6

POSITIONS:

FULL-TIME	-	19	28	27	27	27
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	27	27	27	27

ANALYSIS: Attach a separate page if necessary

(See attached)

Prepared By: Ervin E. Jones

Phone: 465-2313

Division: Administrative Services

Date: 3/13/87

Approved by Commissioner: J. Malone

Date: 3/16/87

Agency: Revenue

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)
- Senate Secretary

Department of Revenue
Administrative Services Division
Fiscal Note Analysis
Individual Income Tax Bill
3/13/97

Assumptions:

1. The Administrative Services Division will be responsible for the following functions relative to the Alaska Individual Income Tax Withholding System and the Alaska Individual Income Tax Return Processing System.
 - a) Design, purchase and distribute all necessary tax returns and related forms.
 - b) Process all tax returns, including mail handling, microfilming, document review, data capture and filing.
 - c) Process all remittances of tax due which is received with tax returns.
 - d) Design, program, test, document, and maintain the automated Alaska Individual Income Tax Withholding System and Alaska Individual Income Tax Return Processing System.
 - e) Process and account for all individual income tax refunds to individuals.
 - f) Establish an automated billing subsystem for routine tax deficiencies, penalty and interest.
 - g) Acquire and maintain computer capacity to accommodate the two systems and the access required by the department's users.
2. The Department of Revenue will contract with a bank to provide a "lock-box" function, with employees depositing all individual income taxes withheld on a monthly basis.
3. The Department of Administration's data processing chargeback system will require that the Department of Revenue budget for the cost of data processing resources used by the withholding system and returns processing system. The total chargeback is budgeted in Administrative Services.
4. The Permanent Fund Dividend program will stay intact through FY92, in its current form.
5. The processing of Withholding and Individual Income Tax returns will be automated as much as possible.
6. The Alaska Individual Income Tax Withholding System must be in place before January 1, 1988.
7. The Alaska Individual Income Tax Return Processing System must be in place before January 1, 1989.
8. The fiscal note includes the incremental cost of providing space for the employees and equipment required by the department.

9. After reviewing the fiscal analyses of all divisions, an estimate of the additional computer resources needed has been made. This cost assumes:
 - a) The withholding and income tax processing systems will reside on DOA's mainframe computer and will be programmed in command-level CICS.
 - b) To gain the tremendous advantages in programming development offered by the Wang VS, Revenue will purchase a software package which allows an analyst/programmer to write programs on the Wang VS and have them translated to command level CICS to run on the mainframe, which offers economical storage and processing for large files.
10. Given the existing federal tax law, this bill requires all persons receiving a permanent fund dividend to file an Alaska Individual Income Tax return. However, for purposes of this fiscal analysis, it is assumed that the final version would not require filing by a person whose only source of income is the Alaska Permanent Fund Dividend. Thus, most of Alaska's children would not have to file. If this proves not to be the case, there will be an incremental cost of processing the additional 180,000 tax returns.

Program Summary:

The Alaska Individual Income Tax will require the creation of two major processing systems:

- 1) Alaska Individual Income Tax Withholding System.
- 2) Alaska Individual Income Tax Return Processing System.

In addition to designing, programming and maintaining the two above mentioned automated systems, the Administrative Services Division will process, review, microfilm, and data capture approximately 70,000 withholding forms and 275,000 Alaska Individual Income Tax returns annually. Refund warrants will be issued on approximately 213,750 of the returns filed. In addition, approximately 25,000 individual letters will be prepared, mailed, and controlled in response to persons who file incomplete tax returns or whose tax returns result in a mathematical adjustment.

Finally, the addition of such a major program to the Department of Revenue will definitely impact the ability of the Administrative Services Division to provide general administrative support services with the existing staff.

The Administrative Services Division will require staffing as early as FY88 in order to design and establish the computerized processing systems envisioned, and to produce the forms required. In late FY88, staffing will come on board to process the Withholding reports and returns. In FY89, additional staff will be needed to support the Alaska Individual Income Tax Return Processing System. The analysis below shows the estimated expenditures for FY88 - FY92.

FY88

1. Positions:

A. Data Processing:

1 PFT Analyst/Programmer V, R21,
 @ \$4,856/Mo including salary and
 benefits for 12 months ' = \$58,272

2 PFT Analyst/Programmer IV, R19,
@ \$4,281/Mo each including salary
and benefits for 12 months = 102,744

2 PFT Analyst/Programmer III, R17,
@ \$3,730/Mo each including salary
and benefits for 6 months = 44,760

The above analyst programmer team will design, program, and maintain the two major systems mentioned above, including all subsystems and interfaces with the existing Revenue systems and the Alaska State Accounting System.

These systems will provide for a minimum of the following:

Alaska Individual Income Tax Withholding System

- * Online system comparable to the federal system with monthly deposits, quarterly returns, and an annual reconciliation.
- * Direct deposit system at a "lock-box" bank by employers.
- * Automatic generation of:
 - quarterly packets of:
 - * monthly deposit coupons
 - * quarterly tax returns
 - notices of tax deficiencies, penalty and interest
 - standard correspondence
 - management reporting data.
- * Interface with accounts receivable system and Alaska Individual Income Tax Return Processing System.

Alaska Individual Income Tax Return Processing System

- * document locator number system
- * return data capture
- * online systems
 - access/inquiry
 - address changes
 - status change system
 - generation of out cards
 - use of microfilm vs hard copy for review
 - automated calculation checks
 - generation of reduced refund notices with appeal rights
 - generation of automated billings for deficiencies, penalty and interest with appeal rights
- * interface with accounts receivable system (A/R)
- * interface with AIITWHS to verify claimed withholding
- * history file
- * possibility of multi-year file for easy access to information on prior year activity, etc.
- * check writing for refunds
- * management reporting data

B. Document Processing:

1. Mailroom

1 PFT Clerk IV, R9, @ \$2,343/Mo
including salary and benefits for
3 months = \$7,029

This position will augment the existing mailroom staff to perform the task of receiving, opening, sorting, and distributing an additional:

- * approximately 70,000 pieces of mail due to the Alaska Individual Income Tax Withholding System (17,500 employers times four quarterly returns.
- * handling, sorting and posting of additional outgoing/incoming mail as follows:
 - approximately 7,000 missing information letters, billing notices, and correspondence with employers.

2. Manual Review

1 PFT Tax Examiner III, R14, @
\$3,124/Mo including salary and
benefits for 5 months = \$15,620

2 PFT Document Processor I, R7, @
\$2,118/Mo including salary and
benefits for 3 months = 12,708

These positions will manually review all Withholding Tax returns filed based on a predetermined criterion.

- * identify incomplete returns
- * send out automatically generated missing information letters and billing notices

3. Microfilming

1 PFT Document Processor I, R7 @
\$2,118/Mo including salary and
benefits for 3 months = \$6,354

These positions will augment the existing microfilm staff to microfilm, assign document locator numbers, and date stamp 100% of Withholding Tax returns filed.

4. Data Capture

2 PFT Data Processing Clerk I, R8,
@ \$2,222/Mo including salary and
benefits for 3 months = \$13,332

These positions will augment the existing Data Entry staff to data capture and verify captured data of 100% of returns filed.

C. General Departmental Support Services

1 PFT Chief, Income Tax Operations, R23, @ \$5,558/Mo including salary and benefits for 12 months	=	\$66,696
1 PFT Personnel Assistant II, R14, @ \$3,115/Mo including salary and benefits for 12 months	=	37,380
1 PFT Clerk Typist III, R8, @ \$2,222/Mo including salary and benefits for 12 months	=	26,664
1 PFT Supply Officer II, R16 @ \$3,515/Mo including salary and benefits for 12 months	=	43,180
2 PFT Accounting Clerk III, R10, @ \$2,468/Mo including salary and benefits for 12 months	=	59,232
1 PFT Publications Specialist I, R13, @ \$2,915/Mo including salary and benefits for 12 months		34,980

These positions will augment the existing general administration support staff for the additional programs and related 100+ new employees.

- * Personnel:
 - classification of positions and respond to reclassification requests
 - maintain payroll and leave records
 - process registers, and arrange interviews
 - handle grievances, information requests, typing tests, etc.

- * Fiscal:
 - increase in travel requests
 - general distributions
 - handling increase in cancelled warrants

- * Supply and purchasing:
 - increase in supply orders for paper intensive organization
 - Purchases increase:
 - * general equipment
 - * computer terminals, printers
 - * maintenance contracts
 - * general office supplies
 - Property Control (terminals, furniture, calculators, etc. will increase

* Forms management:

- preparation of Individual Income Tax booklet each year (considerably more complex than PFD booklet)
- preparation of employment withholding forms
- miscellaneous support forms:
 - * missing information letter
 - * denial forms
 - * check stock (refunds)

* General:

- general supervision and management of major additional line program in division, in addition to:
 - * permanent fund dividend program
 - * shared taxes
 - * administrative services to the department

TOTAL PERSONAL SERVICES

\$529.0

2. Other Expenditures:

a) Travel:

un-site review of selected tax return processing systems in other states \$4.0

training for analyst/programmers in command level CICS and Wang VS Cobol. \$6.0

TOTAL TRAVEL

\$10.0

b) Contractual:

Terminals

1. 3 Wang 4250 workstations	\$18,216
2. 3 Wang emulator boards	2,415
3. 2 Wang 4230 key-punch terminals, 2 months	1,800
4. Microfilmer, with maintenance, 3 months	3,792
5. 4 phones, centrex costs, local and long distance	5,390
6. printing: Withholding Returns, Deposit Coupons, envelopes, calendars, W-4's, etc.	42,000
7. postage	22,000
8. chargeback for computer time from DOA	91,600
9. Wang/IBM development package (NETRON-CAP) with maintenance	123,500
10. Wang/IBM remote access software with maintenance	5,240
11. Wang Disk Pack cleaning	700
12. IBM Control Unit maintenance	600

13. Wang VS-100 I.O.P. maintenance	360
14. Wang VS-100 Memory maintenance	720
15. Wang VS-100 Disk Drive maintenance	2,256
16. DOR's additional office space requirements	<u>102,354</u>

TOTAL CONTRACTUAL \$402.9

c) Supplies:

Computer, microfilming, duplicating, general consumption \$5.5

d) Equipment:

1) Kodak film cabinet	\$1,025
2) Kodak film carousel	225
3) Wang VS-100 IOP (2)	7,200
4) Wang VS-100 Memory (6 MB)	32,400
5) Wang VS-100 disk drive (628 MB)	27,000
6) Wang Disk Packs (8)	4,800
7) IBM Control Unit	8,000
8) Additional systems furniture	72,827
9) Operational seating	4,750
10) File cabinets, calculators, etc.	<u>5,000</u>

TOTAL Equipment \$163.2

TOTAL EXPENDITURES \$1,110.6

3. Funding - General funds

4. Section Cost Analysis - N/A

Computations - N/A

Economic Impact - N/A

Impact on Local Government - N/A

FY89

1. Positions:

A. Data Processing:

1 PFT Analyst/Programmer V, R21,
@ \$4,856/Mo including salary and
benefits for 12 months = \$58,272

2 PFT Analyst/Programmer IV, R19,
@ \$4,281/Mo each including salary
and benefits for 12 months = 102,744

2 PFT Analyst/Programmer III, R17,
@ \$3,730/Mo each including salary
and benefits for 12 months = 89,520

The above analyst programmer team will design, program, and maintain the two major systems mentioned above, including all subsystems and interfaces with the existing Revenue systems and the Alaska State Accounting System.

These systems will provide for a minimum of the following:

Alaska Individual Income Tax Withholding System

- * Online system comparable to the federal system with monthly deposits, quarterly returns, and an annual reconciliation.
- * Direct deposit system at a "lock-box" bank by employers.
- * Automatic generation of:
 - quarterly packets of:
 - * monthly deposit coupons
 - * quarterly tax returns
 - notices of tax deficiencies, penalty and interest
 - standard correspondence
 - management reporting data.
- * Interface with accounts receivable system and Alaska Individual Income Tax Return Processing System.

Alaska Individual Income Tax Return Processing System

- * document locator number system
- * return data capture
- * online systems
 - access/inquiry
 - address changes
 - status change system
 - generation of out cards
 - use of microfilm vs hard copy for review
 - automated calculation checks
 - generation of reduced refund notices with appeal rights
 - generation of automated billings for deficiencies, penalty and interest with appeal rights

- * interface with accounts receivable system (A/R)
- * interface with AIITWHS to verify claimed withholding history file
- * possibility of multi-year file for easy access to information on prior year activity, etc.
- * check writing for refunds
- * management reporting data

B. Document Processing:

1. Mailroom

1 PFT Clerk IV, R9, @ \$2,343/Mo
including salary and benefits for
12 months = \$28,116

1 PFT Clerk II, R7, @ \$2,118/Mo
including salary and benefits
for 6 months = 12,708

These positions will augment the existing mailroom staff to perform the task of handling, opening, sorting, and distributing an additional:

- * approximately 275,000 Individual Income tax returns filed per year.
- * approximately 70,000 pieces of mail due to the Individual Income Tax Withholding System.
- * posting, handling and sorting of additional outgoing mail as follows:
 - approximately 7,000 missing information letters, billing notices, etc.

2. Validation

1 PFT Data Processing Clerk I,
R8, @ \$2,222/Mo including
salary and benefits for 6 months = \$13,332

This position will manually validate all the Alaska Withholding and Individual Income Tax Returns accompanied with a payment.

- * separate checks and returns
- * validate checks and returns
- * forward checks to Treasury
- * forward returns to microfilming

3. Manual Review

1 PFT Tax Examiner III, R14, @
\$3,124/Mo including salary and
benefits for 12 months = \$37,488

2 PFT Document Processor I, R7, @
\$2,118/Mo each including salary and
benefits for 12 months = 50,832

4 PFT Document Processor I, R7, @
\$2,118/Mo each including salary
and benefits for 6 months = 50,832

20 TEMP Document Processor I, R7, @
\$1,569/Mo each including salary and
benefits for 6 months = 188,280

These positions will manually review all Withholding and Individual Income Tax returns filed based on a predetermined criterion.

- * identify incomplete returns
- * send out automatically generated missing information letters
- * identify returns for desk examination

4. Microfilming

1 PFT Document Processor I, R7 @
\$2,118/Mo including salary and
benefits for 6 months = \$12,708

This position will augment the existing microfilm staff to microfilm, assign document locator numbers, and date stamp 100% of Withholding and Individual Income Tax returns filed.

5. Data Capture

1 PFT Data Processing Clerk III, R11
@ \$2,613/Mo including salary and
benefits for 6 months = \$15,678

2 PFT Data Processing Clerk I, R8,
@ \$2,222/Mo each including salary
and benefits for 12 months = 53,328

1 PFT Data Processing Clerk I, R8
@ \$2,222/Mo including salary and
benefits for 6 months = 13,332

7 TEMP Data Processing Clerk I,
R8 @ \$1,657/Mo each including
salary and benefits for 6 months = 69,594

These positions will augment the existing Data Capturing staff to data capture and verify captured data of 100% of Withholding and Individual Income Tax returns filed.

C. General Departmental Support Services

1 PFT Chief, Income Tax Operations,
R23, @ \$5,558/Mo including salary
and benefits for 12 months = \$66,696

1 PFT Personnel Assistant II, R14,
@ \$3,115/Mo including salary and
benefits for 12 months = 37,380

1 PFT Personnel Assistant I, R12,
@ \$2,773/Mo including salary and
benefits for 12 months = 33,270

2 PFT Accounting Clerk III, R10,
@ \$2,468/Mo each including salary
and benefits for 12 months = 59,232

1 PFT Clerk Typist III, R8, @
\$2,222/Mo including salary and
benefits for 12 months = 26,664

1 PFT Publications Specialist I,
R13, @ \$2,915/Mo including salary
and benefits for 12 months = 34,980

1 PFT Supply Officer II, R16,
@ \$3,515/Mo including salary and
benefits for 12 months = 42,180

These positions will augment the existing general administration support staff for the additional programs and related 100+ new employees.

* Personnel:

- classification of positions and respond to reclassification requests
- maintain payroll and leave records
- process registers, and arrange interviews
- handle grievances, information requests, typing tests, etc.

* Fiscal:

- increase in travel requests
- general distributions
- handling increase in cancelled warrants

* Supply and purchasing:

- increase in supply orders for paper intensive organization
- Purchases increase:
 - * general equipment
 - * computer terminals, printers
 - * maintenance contracts
 - * general office supplies
- Property Control (terminals, furniture, calculators, etc. will increase.

* Forms management:

- preparation of Individual Income Tax booklet each year (considerably more complex than PFD booklet)

- preparation of employment withholding forms
- miscellaneous support forms:
 - * missing information letter
 - * denial forms
 - * check stock (refunds)

* General:

- general supervision and management of major additional line program in division, in addition to:
 - * permanent fund dividend program
 - * shared taxes
 - * administrative services to the department

TOTAL PERSONAL SERVICES

\$1,097.1

2. Other Expenditures:

a) Travel:

training, increased EEO travel, data processing coordination

\$8.0

b) Contractual:

1. 11 Wang 4250 workstations	\$66,792
2. 11 Wang emulator boards	8,855
3. 9 Wang 4230 workstations	48,600
4. 1 Wang DWS 55 printer	3,636
5. Printing - tax booklets, "L" letters, W/H forms, check stock, envelopes, etc.	202,000
6. Postage - booklets, letters, W/H forms, etc.	95,475
7. 2 Kodak Microfilmers with maintenance	30,336
8. 2 Kodak Reader/Printers	13,704
9. IBM Copier with maintenance	10,308
10. 20 phones, centrex costs, local and long distance	26,960
11. Risk management	600
12. Pitney Bowes 6500 System with maintenance	7,284
13. Chargeback for computer time from DOA	286,000
14. Wang Disk Pack cleaning	700
15. IBM Control Unit maintenance	600
16. Wang VS-100 I.O.P maintenance	360
17. Wang VS-100 Memory maintenance	720
18. Wang VS-100 Disk Drive maintenance	2,256
19. Wang/IBM remote access maintenance	240
20. Wang/IBM development package (NCTRON-CAP) with maintenance	15,000

21. 2 Borroughs EP 301 with maintenance	3,000	
22. DOR's additional office space requirements	<u>204,708</u>	

TOTAL CONTRACTUAL		\$1,028.1
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c) Supplies:

Computer, microfilm, duplicating, general consumption		\$18.0
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d) Equipment:

1. Kodak film carrousel	\$ 225	
2. Additional systems furniture	137,988	
3. Operational seating	9,000	
4. File cabinets, calculators, etc.	<u>11,000</u>	

TOTAL Equipment		\$158.2
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TOTAL EXPENDITURES		<u>\$2,309.4</u>
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3. Funding - General funds

4. Section Cost Analysis - N/A

Computations - N/A

Economic Impact - N/A

Impact on Local Government - N/A

FY90 - FY92

1. Positions:

A. Data Processing:

1 PFT Analyst/Programmer V, R21,
@ \$4,856/Mo including salary and
benefits for 12 months = \$58,272

2 PFT Analyst/Programmer IV, R19,
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- * Automatic generation of:
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 - notices of tax deficiencies, penalty and interest
 - standard correspondence.
 - management reporting data.
- * Interface with accounts receivable system and Alaska Individual Income Tax Return Processing System.

Alaska Individual Income Tax Return Processing System

- * document locator number system
- * return data capture
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 - access/inquiry
 - address changes
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 - generation of out cards
 - use of microfilm vs hard copy for review
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 - generation of reduced refund notices with appeal rights
 - generation of automated billings for deficiencies, penalty and interest with appeal rights

- * interface with accounts receivable system (A/R)
- * interface with AIITWHS to verify claimed withholding history file
- * possibility of multi-year file for easy access to information on prior year activity, etc.
- * check writing for refunds
- * management reporting data

B. Document Processing:

1. Mailroom

1 PFT Clerk IV, R9, @ \$2,343/Mo
including salary and benefits for
12 months = \$28,116

1 PFT Clerk II, R7, @ \$2,118/Mo
including salary and benefits
for 12 months = 25,416

These positions will augment the existing mailroom staff to perform the task of handling, opening, sorting, and distributing an additional:

- * approximately 275,000 Individual Income tax returns filed per year.
- * approximately 70,000 pieces of mail due to the Individual Income Tax Withholding System.
- * posting, handling and sorting of additional outgoing mail as follows:
 - approximately 7,000 missing information letters, billing notices, etc.

2. Validation

1 PFT Data Processing Clerk I,
@ \$2,222/Mo including salary
and benefits for 12 months = \$26,664

This position will manually validate all the Alaska Withholding and Individual Income Tax Returns accompanied with a payment.

- * separate checks and returns
- * validate checks and returns
- * forward checks to Treasury
- * forward returns to microfilming

3. Manual Review

1 PFT Tax Examiner III, R14, @
\$3,124/Mo including salary and
benefits for 12 months = \$37,488

6 PFT Document Processor I, R7, @
\$2,118/Mo each including salary and
benefits for 12 months = 152,496

20 TEMP Document Processor I, R7, @
\$1,569/Mo each including salary and
benefits for 6 months = 188,280

These positions will manually review all Withholding and Individual Income Tax returns filed based on a predetermined criterion.

- * identify incomplete returns
- * send out automatically generated missing information letters
- * identify returns for desk examination

4. Microfilming

1 PFT Document Processor I, R7 @
\$2,118/Mo including salary and
benefits for 12 months = \$25,416

This position will augment the existing microfilm staff to microfilm, assign document locator numbers, and date stamp 100% of Withholding and Individual Income Tax returns filed.

5. Data Capture

1 PFT Data Processing Clerk III, R11
@ \$2,613/Mo including salary and
benefits for 12 months = \$31,356

3 PFT Data Processing Clerk I, R8,
@ \$2,222/Mo each including salary
and benefits for 12 months = 79,992

7 TEMP Data Processing Clerk I,
R8 @ \$1,657/Mo each including
salary and benefits for 6 months = 69,594

These positions will augment the existing Data Capturing staff to data capture and verify captured data of 100% of Withholding and Individual Income Tax returns filed.

C. General Departmental Support Services

1 PFT Chief, Income Tax Operations,
R23, @ \$5,558/Mo including salary
and benefits for 12 months = \$66,696

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@ \$2,773/Mo including salary and
benefits for 12 months = 33,270

2 PFT Accounting Clerk III, R10,
@ \$2,468/Mo each including salary
and benefits for 12 months = 59,232

1 PFT Clerk Typist III, R8, @
\$2,222/Mo including salary and
benefits for 12 months = 26,664

1 PFT Publications Specialist I,
R13, @ \$2,915/Mo including salary
and benefits for 12 months = 34,980

1 PFT Supply Officer II, R16,
@ \$3,515/Mo including salary and
benefits for 12 months = 42,180

These positions will augment the existing general administration support staff for the additional programs and related 100+ new employees.

* Personnel:

- classification of positions and respond to reclassification requests
- maintain payroll and leave records
- process registers, and arrange interviews
- handle grievances, information requests, typing tests, etc.

* Fiscal:

- increase in travel requests
- general distributions
- handling increase in cancelled warrants

* Supply and purchasing:

- increase in supply orders for paper intensive organization
- Purchases increase:
 - * general equipment
 - * computer terminals, printers
 - * maintenance contracts
 - * general office supplies
- Property Control (terminals, furniture, calculators, etc. will increase.

* Forms management:

- preparation of Individual Income Tax booklet each year (considerably more complex than PFD booklet)
- preparation of employment withholding forms
- miscellaneous support forms:
 - * missing information letters
 - * denial forms
 - * check stock (refunds)

* General:

- general supervision and management of major additional line program in division, in addition to:

- * permanent fund dividend program
- * shared taxes
- * administrative services to the department

TOTAL PERSONAL SERVICES \$1,171.0

2. Other Expenditures:

a) Travel:

training, increased EEO travel, data processing coordination \$8.0

b) Contractual:

1. 11 Wang 4250 workstations	\$66,792
2. 11 Wang emulator boards	8,855
3. 9 Wang 4230 workstations	48,600
4. 1 Wang DWS 55 printer	3,636
5. Printing - tax booklets, "L" letters, W/H forms, check stock, envelopes, etc.	186,000
6. Postage - booklets, letters, W/H forms, etc.	80,475
7. 2 Kodak Microfilmers with maintenance	30,336
8. 2 Kodak Reader/Printers	13,704
9. IBM Copier with maintenance	10,308
10. 20 phones, centrex costs, local and long distance	26,960
11. Risk management	600
12. Pitney Bowes 6500 system with maintenance	7,284
13. Chargeback for computer time from DOA	357,500
14. Wang Disk Pack cleaning	700
15. IBM Control Unit maintenance	600
16. Wang VS-100 I.O.P maintenance	360
17. Wang VS-100 Memory maintenance	720
18. Wang VS-100 Disk Drive maintenance	2,256
19. Wang/IBM development package (NETRON-CAP) with maintenance	15,000
20. Wang/IBM remote access maintenance	240
21. 2 Borroughs EP 301 with maintenance	3,000
22. DOR's additional office space requirements	<u>204,708</u>

TOTAL CONTRACTUAL \$1,068.6

c) Supplies:

Computer, microfilm, duplicating,
general consumption

\$18.0

d) Equipment: None.

TOTAL EXPENDITURES

\$2,265.6

3. Funding - General funds

4. Section Cost Analysis - N/A

Computations - N/A

Economic Impact - N/A

Impact on Local Government - N/A

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

REQUEST _____

Bill Version: _____
Publish Date: _____

Revision Date: _____
Title: Individual Income Tax

Agency Affected: Revenue
ERU: Commissioner's Office (Research)

Sponsor: _____
Requestor: _____

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
OPERATING						
PERSONAL SERVICES	-	54.6	54.6	54.6	54.6	54.6
TRAVEL	-	1.5	1.5	1.5	1.5	1.5
CONTRACTUAL	-	39.9	28.6	28.6	26.6	28.6
SUPPLIES	-	.9	.9	.9	.9	.9
EQUIPMENT	-	6.8	-	-	-	-
LANDS & STRUCTURES	-	-	-	-	-	-
GRANTS, CLAIMS	-	-	-	-	-	-
MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	103.7	85.6	85.6	85.6	85.6
CAPITAL	-	-	-	-	-	-
REVENUE	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	103.7	85.6	85.6	85.6	85.6
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-	-	-	-	-

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: Attach a separate page if necessary

See Attached.

Prepared By: David Tonkovich
Division: Revenue/Research

Phone: 465-2173
Date: 2/20/87

Approved by Commissioner: Hugh Malone
Agency: Department of Revenue

Date: 7/26/87
3/16/87

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)
- Senate Secretary

Continuation of Fiscal Note/Bill Analysis

Individual Income Tax

Assumptions:

1. The Research Section will be responsible for economic and statistical reports on the Individual Income Tax.
2. The Research Section will forecast tax revenues and respond to requests from the Governor's Office, the Legislature and the Public for current and historical statistical information.
3. The Research Section will prepare fiscal notes on revenue impacts of any proposed changes to income tax law.
4. Assumes that duties begin at the start of FY88. Items with a asterisk (*) are costs for the first year only.

1. Positions

Research

1 PFT Economist II, R 20 at \$4,550/mo.
including salary and benefits for
12 months

Total Personal Services \$54.6

The above position will do all analysis, program development and coordination of research on the individual income tax. These duties include forecasting economic conditions and tax revenues. Other duties will include development and maintenance of data bases to support the research and forecasting efforts, the preparation of fiscal notes, policy analyses, and coordination of research needs with those of tax administrators.

This work will provide the following information:

1. Income and tax information by income class.
2. The ability to estimate revenue impacts of any significant change in tax structure - rates, income classes, exemptions and deductions.
3. If zip code information is available it should be possible to present such data on a geographic basis.

2. Other Expenditures

- a. Travel
Assume 3 trips in-state per year for
coordination, public information, testimony \$1.5
- b. Contractual
 - 1. Economic Consulting during model development
15 days at \$750/day 11.3*
 - 2. Phone, centrex, local and long
distance charges .6
 - 3. Chargeback for computer time from DOA 28.0
- c. Supplies
 - Duplication, general consumption, mailing .7
 - Books, technical journals .2
- d. Equipment
 - 1. Wang APC, VS Communication Board and
30mb Hard Disk 6.5*
 - 2. Desk Calculator .3*

Total Expenditure First Year \$103.7

Total Expenditure Subsequent Years \$85.6

3. Funding - General Funds

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

Bill Version: _____
Publish Date: _____

REQUEST: _____

Revision Date: _____
Title: State Income Tax

Agency Affected: Department of Revenue
BRU: Treasury

Sponsor: _____
Requestor: _____

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
OPERATING						
PERSONAL SERVICES	-	32.8	46.4	46.4	46.4	46.4
TRAVEL	-	-	-	-	-	-
CONTRACTUAL	-	44.6	89.1	89.1	89.1	89.1
SUPPLIES	-	-	-	-	-	-
EQUIPMENT	-	-	-	-	-	-
LANDS & STRUCTURES	-	-	-	-	-	-
GRANTS, CLAIMS	-	-	-	-	-	-
MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	77.4	135.5	135.5	135.5	135.5
CAPITAL	-	-	-	-	-	-
REVENUE	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	77.4	135.5	135.5	135.5	135.5
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	77.4	135.5	135.5	135.5	135.5

POSITIONS:

FULL-TIME	-	1	1	1	1	1
PART-TIME	-	1	1	1	1	1
TEMPORARY	-	-	-	-	-	-

ANALYSIS: see attached analysis.

Prepared By: Milt Barker MB

Division: Treasury

Phone: 465-2350

Date: February 25, 1987

Approved by Commissioner: [Signature] For

Agency: Department of Revenue

Date: 2/26/87

3/16/87

Distribution (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)
- Senate Secretary

DEPARTMENT OF REVENUE
TREASURY DIVISION

FISCAL NOTE ANALYSIS

ASSUMPTIONS:

1. Cash Management Section will develop the RFP and the contract to lockbox the monthly employers' withholding tax deposits. 17,500 payments per month.
2. Cash Management Section will perform the depository functions of the remittances attached to individual tax returns. 100,000 per year.
3. Cash Management Section will process all returned items (NSF checks, etc.). 1,500 per year.
4. Processing and deposit of penalty and interest payments.
5. Cash Management Section will provide the accounting to AKSAS and reconciliation between the bank, AKSAS, and the Department of Revenue's system for the tax payments on a consolidated basis.

COSTS:

<u>Personal Services</u>	<u>FY 1988</u>	<u>FY 1989</u>
Accounting Technician I \$2,718 X 12 mo	19.0*	32.6
Accounting Clerk II \$2,310 X 6 mo	13.8	13.8
Lockbox contract	<u>44.6</u>	<u>89.1</u>
 TOTAL	 <u>\$77.4</u>	 <u>\$135.5</u>

* 7 months in FY 1988

DEVELOPMENT TIME:

		<u>Completion Date</u>
Technical Analysis of the required system	4 months	10/87
Lockbox Contract	3 months	12/87
In-house training of depository procedures	2 weeks	12/87
In-house training of accounting procedures	2 weeks	12/87

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION
POUCH WF-STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 485-3795

MEMORANDUM

DATE: April 21, 1987

TO: Rep. Al Adams, Chairman
Louann Cutler, Professional Assistant
House Finance Committee

FROM: Cameron Kashani, Revenue Analyst ^{CK}
Legislative Finance Division

SUBJ: Fiscal Note for HB 154

At your request, I have reviewed and evaluated the fiscal note on Individual Income Tax which was prepared by the Department of Revenue (DOR). The following represents my recommendations on the proposed fiscal note dated March 23, 1987.

At the present time it seems more appropriate to address FY88 implementation costs of the Individual Income Tax, since any future expectation would reflect speculation rather than having any logical foundation. Therefore, I have prepared a fiscal note for the House Finance Committee which only includes FY88 implementation cost figures.

In the review of the Department's fiscal note, I took the liberty of speaking with various authorities of the Department of Revenue, the National Conference of State Legislatures, The National Association of Tax Administrators, the Department of Administration, and the Data Processing Coordinator of the State of North Dakota.

According to the National Association of Tax Administrators, the States of Vermont and North Dakota could be used as examples because of their comparability to the State of Alaska with respect to population size and the number of expected returns,

From the historical standpoint, in FY82, Legislative Audit Division had conducted a special audit on the Department of Revenue in order to determine the positions associated with the repealed individual income tax. Findings of this study revealed the following individual income tax positions:

	Audit	Admin. Services	Enforcement
PFT	27	17	12
OTHER	7	10	0

It should be noted that the Governor's Proposed Individual Income Tax calls for a flat rate which is closely akin to the Federal Tax Law. Therefore, the need for extensive auditing and, to some extent, enforcement would be considerably reduced.

The attached fiscal note prepared by the Legislative Finance Division differs from the Department's fiscal note dated 3/13/87. The following changes are noteworthy:

Audit

- a) Reclassify 1 PFT Revenue Auditor IV to Revenue Auditor III
- b) Reclassify 1 PFT Clerk IV to Clerk III
- c) Delete 1 PFT Clerk Typist II
- d) Reduce funding for contractual and equipment

Enforcement

The main difference between DOR's fiscal note and the one prepared by Legislative Finance Division is the forwarding of the hiring time which would eliminate the need for any enforcement activities till FY89. Assuming a filing deadline of April 15, 1988 with 60 days appeal period, any enforcement and collection effort during FY88 would seem unnecessary and could be postponed to the following year. Moreover, the existing manpower within the Division of Enforcement deems to suffice any temporary need.

Administrative Services

- a) Delete 1 PFT Chief Income Tax Operations
- b) Delete 1 PFT Publication Specialist I
- c) Delete 1 PFT Accounting Clerk III
- d) Reclassify 1 PFT Personnel Assistant II from PFT to PPT
- e) Reclassify 1 PFT Supply Officer II from PFT to PPT
- f) Reduce funding for contractual, supplies, and equipment to reflect the cost associated with the deleted positions.

I had asked Jan Daniel of the Department of Administration's Data Processing Section to speak with the authorities in the States of North Dakota and Vermont in order to obtain a more realistic scenario with respect to design, development and implementation of a computer system for the State Individual Income Tax. Enclosed is a copy of his memorandum regarding this subject.

There may be some problems with respect to finding qualified programmers who can accomplish the aforementioned tasks in a timely fashion. The Legislature may want to give the Department the authority and the freedom to hire qualified programmers who can meet the qualification criteria set forth by the Department. However, after the initial setup, the need for maintenance of the system would be less than what's indicated in the Department's fiscal note.

On the technical side of the issue, the Department is proposing to use Wang computer systems. This could be interpreted as user preference and would seem more appropriate if other systems are also taken into consideration. No doubt, further research is required prior to implementation which could alter the existing scenario.

Commissioner's Office

- a) Delete the Economist II position and its corresponding expenditure in all other line items.

It seems that the existing resource within the Research Section on the Commissioner's Office and the Governor's Office would provide adequate support with respect to tax issues.

Public Services

- a) Reduce the funding for 1 PFT Revenue Office Manager from 12 months to six months.

In brief, it would be more feasible if all the functions were consolidated into one single component called Individual Income Tax Division. One should bear in mind the problems that the Legislature has had with the PFD functions especially when determining PFD positions and their corresponding expenditures. Further, close monitoring of the implementation process by the State Legislature would be recommended.

(enclosure)

MEMORANDUM


State of Alaska

TO: Cameron Kashani
Revenue Analyst
Legislative Finance

DATE: April 17, 1987

FILE NO:

TELEPHONE NO: 465-2220

From: Jan Daniels, Director 
Data Network Services
Department of Administration

SUBJECT: Income tax
processing

I have investigated the fiscal note filed by the Department of Revenue dealing with the processing requirements of a state personal income tax. In order to understand the requirements of an income tax system I contacted two states which are currently processing this type of work. The information is as follows:

1. State of Vermont.

- a. Contact: Robert Barnet 802-828-2300.
- b. # of returns: 340,000
- c. Current year only- no amended.
- d. System developed in 1971.
- e. Cost of development in 1971: \$125,000.
- f. Time of development: 18 months.
- g. # of programmers during development: 5.
- h. # of maintenance programmers: 3.
- i. # of data entry personnel: 5 permanent + 7 temporary.
- j. DP cost for running system: \$80,000 year appx.
- k. Type of system: Batch.

1. State of North Dakota.

- a. Contact: Don Johnson 701-224-2048.
- b. # of returns: 300,000.
- c. Prior year processing - amended.
- d. System developed in 1986.
- e. Cost of development: Not known.
- f. Time of development: 7 months.
- g. # of programmers during development: 7.
- h. # of maintenance programmers: 3.
- i. # of data entry personnel: 6 permanent + 12 temporary.
- j. Employer information matching provided.
- k. DP cost for running system: \$120,000.
- l. Type of system. Online, Adabas, Natural.

The DP portion of the fiscal note appears to be well within the bounds of what other states have found to be true operational costs for income tax systems. The use of the Wang for data entry appears to make a great deal of sense in that the data entry system is available during the times Revenue needs to schedule it for peaks and they have demonstrated the effectiveness of this process in the Permanent Fund dividend system.

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

REQUEST: _____

Bill Version: HB 154
Publish Date: _____

Revision Date: _____

Title: Relating to the taxation of
income derived by individuals

Agency Affected: Revenue

BRU: Audit, Admin. Services, Public
Services, Treasury

Sponsor: _____

Requestor: _____

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES		550.8				
TRAVEL		33.0				
CONTRACTUAL		571.2				
SUPPLIES		9.4				
EQUIPMENT		171.6				
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		1345.0				
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND		1345.0				
FEDERAL FUNDS						
OTHER						
TOTAL		1345.0				

POSITIONS:

FULL-TIME		21				
PART-TIME		4				
TEMPORARY		0				

ANALYSIS : (Attach a separate page if necessary)

Prepared by: Cameron Kashani, Revenue Analyst Phone: 465-3795
Division: Legislative Finance Division Date: 4/20/87

Approved by Commissioner: _____ Date: _____
Agency: _____

- Distribution (by preparer):
- Legislative Finance
 - Legislative Sponsor
 - Requestor
 - Office of Management and Budget
 - Impacted Agency(ies)
 - Senate Secretary

**STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE**

REQUEST: _____ Bill Version: HB154
 Revision Date: _____ Publish Date: _____
 Title: State Individual Income Tax Agency Affected: Revenue
 BRU: Audit
 Sponsor: _____ Components: _____
 Requestor: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES		150.4				
TRAVEL		6.5				
CONTRACTUAL		34.5				
SUPPLIES		4.5				
EQUIPMENT		15.0				
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		210.9				

CAPITAL						
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REVENUE						
---------	--	--	--	--	--	--

FUNDING: (Thousands of Dollars)

GENERAL FUND		210.9				
FEDERAL FUNDS						
OTHER						
TOTAL		210.9				

POSITIONS:

FULL-TIME		6				
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

Prepared by: Cameron Kashani, Revenue Analyst Phone: 465-3795
 Division: Legislative Finance Division Date: 4/20/87

Approved by Commissioner: _____ Date: _____
 Agency: _____

Distribution (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)
- Senate Secretary

-1-
Division of Audit
Fiscal Note Analysis

Assumptions:

The Audit Division will administer the individual income tax laws to insure compliance with Alaska Statutes. Although calendar year tax returns will not be due until 1989, a withholding tax system must be in place and operative by January 1, 1988. Additional staff must be hired and fully trained to accomplish the following:

1. Compliance. This function will be accomplished by utilizing both tax examiner and auditor staff. Tax examiners, more typically, will handle desk review and less complex issues. Auditors will complete field audits and deal with more sophisticated and complex tax issues.
2. Appeals Coordination. These positions will be staffed by both tax examiners and auditors depending on the complexity and issues involved.
3. Payroll Withholding. This function will be accomplished by staffing of tax examiners to reconcile employers quarterly withholding, returns, monthly deposits and annual statements. They will maintain and reconcile the employees W-2's to the employers returns.
4. Return Examination and Processing. This function will be completed by clerks and tax examiners. The field returns will be checked for accuracy and completeness. Payments will be posted to the appropriate returns, and desk reviews will be completed to process the returns. Selected returns will be forwarded to an auditor for examination.
5. Public Education and Staff Training. This function will be performed by audit level staff members. Public education of the individual income tax laws and filing requirements will be accomplished through seminars conducted in various locations throughout the state and by training staff members dealing with the public. Staff training is necessary to maintain a competent level of employee and educate staff to the new and changing tax laws.

A schedual of estimated costs to operate the Audit Division programs are as follows:

Personal Services - FY 88

1 PFT Revenue Auditor III, R18, @ \$4,016/Mo including salary and benefits for 9 months	36.1
1 PFT Tax Examiner III, R14, @ \$3,115/Mo including salary and benefits for 9 months	28.0
1 PFT Tax Examiner II, R12, @ \$2,673/Mo including salary and benefits for 9 months	24.1
1 PFT Tax Examiner I, R10, @ \$2,468/Mo including salary and benefits for 9 months	22.2
1 PFT Clerk III, R8, @ \$2,222/Mo including salary and benefits for 9 months	20.0
1 PFT Clerk Typist III, R8, @ 2,222/Mo including salary and benefits for 9 months	20.0
	<u>150.4</u>

Travel - FY 88

6.5

This figure reflects a one time travel cost for employer training to be conducted in various locations throughout the State in conjunction with Public Services Division.

Contractual - FY 88

Wang terminals & software	<u>34.5</u>
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<u>Supplies - FY 88</u>	<u>4.5</u>
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Equipment - FY 88

Microfilm, printer, desks, chairs, etc.	<u>15.0</u>
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Total Expenditures	<u>210.9</u>
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STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

REQUEST: _____

Revision Date: _____

Tide: State Individual Income Tax

Sponsor: _____

Requestor: _____

Bill Version: HB154
Publish Date: _____

Agency Affected: Revenue
BRU: Administrative Services

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES		350.9				
TRAVEL		10.0				
CONTRACTUAL		394.1				
SUPPLIES		4.4				
EQUIPMENT		151.6				
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		907.1				

CAPITAL						
---------	--	--	--	--	--	--

REVENUE						
---------	--	--	--	--	--	--

FUNDING: (Thousands of Dollars)

GENERAL FUND		907.0				
FEDERAL FUNDS						
OTHER						
TOTAL		907.0				

POSITIONS:

FULL-TIME		14				
PART-TIME		2				
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

Prepared by: Cameron Kashani, Revenue Analyst Phone: 465-3795
Division: Legislative Finance Division Date: 4/20/87

Approved by Commissioner: _____ Date: _____
Agency: _____

- Distribution (by preparer):
- Legislative Finance
 - Legislative Sponsor
 - Requestor
 - Office of Management and Budget
 - Impacted Agency(ies)
 - Senate Secretary

Administrative Services
Fiscal Note Analysis

1. The Administrative Services Division will be responsible for the following functions relative to the Alaska Individual Income Tax Withholding system and the Alaska Individual Income Tax Return Processing system.

- a) Design, purchase and distribute all necessary tax returns and related forms.
- b) Process all tax returns, including mail handling, microfilming, document review, data capture and filing.
- c) Process all remittance of tax due which is received with tax returns.
- d) Design, program, test, document, and maintain the automated Alaska Individual Income Tax Withholding system and Alaska Individual Income Tax Processing system.
- e) Process and account for all individual income tax refunds to individuals.
- f) Establish an automated billing subsystem for routine tax deficiencies, penalty and interest.
- g) Acquire and maintain computer capacity to accommodate the two systems and the access required by the department's users.

2. The Department of Revenue will contract with a bank to provide a "lock-box" function, with employees depositing all individual income taxes on a monthly basis.

3. The Department of Administration's data processing chargeback system will require that the Department of Revenue budget for the cost of data processing resources used by withholding system and returns processing system. The total chargeback is budgeted in Administrative services.

4. The Permanent Fund Dividend program will stay intact in its current form.

5. The processing of Withholding and Individual Income Tax will be automated as much as possible.

6. The Alaska Individual Income Tax Withholding System must be in place before January 1, 1988.

7. The Alaska Individual Tax Return Processing System must be in place before January 1, 1989.

8. The fiscal note includes the incremental cost of providing space for the employees and equipment required by the department.

9. After reviewing the fiscal analyses of all divisions, an estimate of the additional computer resources needed has been made. This cost assumes:

a) The withholding and income tax processing systems will reside on DOA's mainframe computer and will be programmed in command-level CICS.

b) To gain the tremendous advantages in programming development offered by the Wang VS, Revenue will purchase a software package which allows an analyst/programmer to write programs on the Wang VS and have them translated to command level CICS to run on the mainframe, which offers economical storage and processing for large files.

10. Given the existing federal tax law, this bill requires all persons receiving a permanent fund dividend to file an Alaska Individual Income Tax Return. However, for purposes of this fiscal analysis, it is assumed that the final version would not require filing by a person whose only source of income is the Alaska Permanent Fund Dividend. Thus, most of Alaska's children would not have to file. If this proves not to be the case, there will be an incremental cost of processing the additional 180,000 tax returns.

Program Summary:

The Alaska Individual Income Tax will require the creation of two major processing systems:

- 1) Alaska Individual Income Tax Withholding System.
- 2) Alaska Individual Income Tax Return Processing System.

In addition to designing, programming and maintaining the two above mentioned automated systems, the Administrative Services Division will process, review, microfilm, and data capture approximately 70,000 withholding forms and 275,000 Alaska Individual Income Tax Returns annually. Refund warrants will be issued on approximately 213,750 of the returns filed. In addition, approximately 25,000 individual letters will be prepared, mailed, and controlled in response to persons who file incomplete tax returns or whose tax returns result in a mathematical adjustment.

Finally, the addition of such a major program to the Department of Revenue will definitely impact the ability of the Administrative Services Division to provide general administrative support services with the existing staff.

The Administrative Services Division will require staffing as early as FY 88 in order to design and establish the computerized processing systems envisioned, and to produce the forms required.

Personal Services - FY 88

1 PFT Analyst/Programmer V, R21, @ \$4,856/Mo including salary and benefit for 12 months	58.3
2 PFT Analyst/Programmer IV, R19, @ \$4,281/Mo including salary and benefits for 12 months	102.7
2 PFT Analyst/Programmer III, R17, @ \$3,730/Mo including salary and benefits for 6 months	44.8
1 PFT Clerk IV, R9, @ \$2,343/Mo including salary and benefits for 3 months	7.0
1 PFT Tax Examiner III, R14, @ \$3,115/Mo including salary and benefits for 5 months	15.6
3 PFT Document Processor I, R7, @ \$2,118/Mo including salary and benefits for 3 months	19.1
2 PFT Data Processing Clerk I, R8, @ \$2,222/Mo including salary and benefits for 3 months	13.3
1 PPT Personnel Assistant II, R14, @ \$1,557/Mo including salary and benefits for 12 months	18.7
1 PPT Supply Officer II, R16, @ \$1,757/Mo including salary and benefits for 12 months	21.1
1 PFT Clerk Typist III, R8, @ \$2,222/Mo including salary and benefits for 12 months	26.7
1 PFT Accounting Clerk III, R10, @ \$2,468/Mo including salary and benefits for 12 months	29.6
Total expenditures	<u>356.9</u>

The analyst programmer team will design, program, and maintain the two major systems mentioned earlier, including all subsystems and interfaces with the existing Revenue systems and the Alaska State Accounting System. All other positions will provide support in the following areas:

- a) Mailroom
- b) Microfilming
- c) Manual review of the tax returns
- d) Data capture
- e) Personnel, fiscal, supply and purchasing

Travel - FY 88

10.0

On-site review of selected tax return processing systems in other states and training for analyst/programmer in command level CICS and Wang VS Cobol.

Contractual - FY 88

1.	2 Wang 4250 workstations	12.2
2.	2 Wang emulator boards	1.6
3.	2 Wang 4230 key-punch terminals for 2 months	1.8
4.	Micfilmer, with maintenance, 3 months	3.8
5.	4 phones, centrex costs, local and long distance	5.4
6.	Printing: Withholding Returns, Deposit Coupons, /w-4's, etc.	42.0
7.	Postage	22.0
8.	Chargeback for computer time from DOA	91.6
9.	Wang/IBM development package (NETRON-CAP) with maintenance	123.5
10.	Wang/IBM remote access software with maintenance	5.2
11.	Wang Disk Pack cleaning	.7
12.	IBM Control Unit Maintenance	.6
13.	Wang VS-100 I.O.P., Memory, Disk	
14.	Drive maintenanc	3.3
15.	DOR's additional office space requirement	80.8

Total Contractual

394.1

Supplies - FY 88

4.4

Equipment - FY 88

1.	Kodak film cabinet and carresoul	1.2
2.	Wang VS-100 IOP (2)	7.2
3.	Wang VS-100 Memory (6 MB)	32.4
4.	Wang VS-100 Disk Drive (628 MB)	27.0
5.	Wang Disk Packs and IBM Control Unit	12.8
6.	Additional systems furniture	61.3
7.	Operational seating	4.7
8.	File cabinets, calculators, etc.	5.0
	Total Equipment	151.6

151.6

Total Expenditures

907.0

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

REQUEST: _____

Revision Date: _____

Title: State Individual Income Tax

Sponsor: _____

Requestor: _____

Bill Version: HB154
Publish Date: _____

Agency Affected: Revenue
BRU: Public Services

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES		10.7				
TRAVEL		10.3				
CONTRACTUAL		98.0				
SUPPLIES		.5				
EQUIPMENT		5.0				
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		139.7				

CAPITAL						
---------	--	--	--	--	--	--

REVENUE						
---------	--	--	--	--	--	--

FUNDING: (Thousands of Dollars)

GENERAL FUND		139.7				
FEDERAL FUNDS						
OTHER						
TOTAL		139.7				

POSITIONS:

FULL-TIME						
PART-TIME		1				
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

Prepared by: Cameron Kashani, Revenue Analyst Phone: 465-3795
 Division: Legislative Finance Division Date: 4/20/87

Approved by Commissioner: _____ Date: _____
 Agency: _____

- Distribution (by preparer):
- Legislative Finance
 - Legislative Sponsor
 - Requestor
 - Office of Management and Budget
 - Impacted Agency(ies)
 - Senate Secretary

-1-
Public Services
Fiscal Note Analysis

Assumptions:

1. Regulations will be promulgated requiring monthly or quarterly reporting of taxes withheld on wages.
2. Approximately 17,500 withholding reports and 275,000 annual individual income tax returns will need processing.
3. Public Services Division will provide individual income tax assistance to both businesses and individuals.
4. Public Services Division, in close association with the Audit Division, will develop employee training for the division and employer training for the public.

Personal Services - FY 88

1 PPT Revenue Office Manager, R15, @ 1646/Mo including salary and benefits for 12 months	19.7
--	------

Travel - FY 88

Employee training in conjunction with Audit Division and administrative travel	16.5
--	------

Contractual - FY 88

1. Advertising campaign, withholding requirements, income tax filing	45.0
2. Postage	30.0
3. Printing	5.0
4. Telephone charges	15.0
5. Messenger Services	2.0
6. Computer terminal maintenance	.5
7. Publications	.5
 Total Contractual	 98.0

<u>Supplies - FY 88</u>	<u>.5</u>
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<u>Equipment - FY 88</u>	<u>5.0</u>
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Total Expenditures	139.7
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STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

REQUEST: _____

Bill Version: HB154
Publish Date: _____

Revision Date: _____
Title: Individual Income Tax

Agency Affected: Revenue
BRU: Treasury

Sponsor: _____
Requestor: _____

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES		32.8				
TRAVEL						
CONTRACTUAL		44.0				
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		77.4				
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND		77.4				
FEDERAL FUNDS						
OTHER						
TOTAL		77.4				

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

Prepared by: Cameron Kashani, Revenue Analyst Phone: 465-3795
Division: Legislative Finance Division Date: 4/20/87

Approved by Commissioner: _____ Date: _____
Agency: _____

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)
Senate Secretary

Division of Treasury
Fiscal Note Analysis

Assumptions:

1. Cash Management Section will develop the RFP and the contract to lockbox the monthly employers' withholding tax deposits, 17,500 payments per month.
2. Cash Management Section will perform the depository functions of the remittances attached to individual tax returns. 100,000 per year.
3. Cash Management Section will process all returned items (NSF checks, etc.). 1,500 per year.
4. Processing and deposit of penalty and interest payments.
5. Cash Management Section will provide the accounting to AKSAS and reconciliation between the bank, AKSAS, and the Department of Revenue's system for the tax payments on a consolidated basis.

Personal Services - FY 88

1 PFT Accounting Tech I, RL2, @ \$2718/Mo including salary and benefits for 7 months	19.0
1 PPT Accounting Clerk II, R9, @ \$2310/Mo including salary and benefits for 6 months	13.8
Total Personal Services	<u>32.8</u>

Contractual - FY 88

Lockbox contract	<u>44.6</u>
Total Expenditures	<u>77.4</u>

INCOME TAX PROJECT REPORT
FEBRUARY 4, 1987

I. OVERVIEW

A taxing system can be devised to achieve whatever revenue goals one may specify. Reasoned answers by the policy makers to the main issues addressed in this report which take into consideration those goals and policy which forms the foundation for each of the answers will result in the identification of the appropriate tax system for the state.

A broad based tax system is the foundation underscoring all alternatives in the reimposition of the Alaska individual income tax. A discussion of a number of the issues and observations is presented in this report. For comparison purposes, four alternatives are discussed. Alternative One is the Alaska structure in effect prior to repeal effective in 1979 which includes the 86 tax law changes. Alternative Two mirrors Alternative One with the exception of a two rate tax bracket. Alternative Three is a flat tax. Alternative Four is termed a working draft which incorporates certain aspects of the other three alternatives. Each is more thoroughly described in Section III. Each alternative has been designed to generate approximately \$250 million in revenue.

II. INTRODUCTION

Designing the various tax structures to raise the same amount of revenue highlights the crucial issues. Each of the elements of a tax structure can be tailored to affect different taxpayers differently (or to try and affect them identically). The alternative tax structures we present will each be analyzed briefly on a number of general issues including how they affect taxpayer groups and how politically palatable they might be.

In general, the conceptual issues which should be considered with respect to measures designed to increase revenues are as follows.

A. Economic Efficiency

Individuals and businesses are making adjustments in light of the new federal tax and it is difficult to determine what additional adjustments would occur in response to a state income tax. One could possibly argue that this would be a good time to impose a state tax. Individuals and businesses are in the process of adjusting to new federal rules and could more readily modify their decisions than would be the case if the state waits several years to reimpose a tax.

Proponents argue that because a flat tax such as alternative 3 lowers marginal rates, this reduces the incentive to alter decisions based on tax considerations. Personal, business and investment decisions would be primarily based on economic as opposed to tax considerations. In addition,

the lower rates reduce the payoffs to time spent trying to avoid or in some cases evade taxes.

B. Income Elasticity

The income elasticity of individual income tax revenues, given progressive rates as in alternative 1, is greater than one which is to say a given percentage change in income will produce a larger percentage change in tax revenues. Thus, during periods of income growth, individual income tax revenues will increase more than in proportion to the growth and, during periods of income decline, they will fall more than in proportion to the decline. This makes the individual income tax relatively unstable in terms of yield.

The limited number of brackets of alternative 2 would probably cause this type of tax to be less revenue elastic than the first case. Under a system with narrower brackets and more numerous rates real or inflation driven increases in income can easily push returns into higher brackets with larger marginal rates. Conversely, with rates that apply to broader income ranges, bracket creep, while still present, would be less of a phenomenon.

Michigan, one state with a flat rate, no deduction tax such as alternative 3, has found that tax revenues have tended to grow more than in proportion to the growth of income because of the fixed dollar value of exemptions in that state. This responsiveness was found to decrease over time as income rose relative to the value of exemptions. Because the exemption is indexed in this presentation, this source of elasticity is probably not a factor.

C. Equity¹

In terms of equity the individual income tax is generally considered the "fairest" tax. The burden or incidence of the tax falls primarily on the individual taxpayer and there is less opportunity for shift of incidence compared with the corporate income or business type taxes.

1. Progressivity of the Tax Base- Distribution of Income Inclusions, Exclusions and Deductions

The individual income tax is based on source of income. As such, the distribution of income among households is very important in determining the vertical distribution of the tax incidence. Inclusion of various types of income in the tax base is important.

Special treatment or exclusions applied to some sources of income are going to affect households at different points on the income distribution differently. For example, capital gains, until recent tax reform, had special treatment. A portion of net capital gains could be excluded from income for tax purposes. Capital gains and investment income (such as corporate dividends and interest) are not major sources of income for lower income households. The complete inclusion in the tax base of these income sources

¹ see exhibit A

affects higher income households to a much greater degree than lower income households. Another issue discussed later is whether or not to make the PFD taxable.

The distribution of income exclusions and deductions differs among households also. Special exclusions and deductions will alter the distribution of the tax burden depending on which income sources or expenditure items are given favorable tax treatment. In some cases, special deductions have been given because they affect ability to pay taxes, eg. large medical expenses.

Changes in tax laws have implications for horizontal equity in that individuals make commitments based on existing tax laws which are difficult or impossible to reverse. When the law changes this can reduce welfare. An example is the reduced deduction for personal interest expenses under the new federal law. Persons who entered installment purchase agreements prior to the change are going to be adversely affected.

2. Progressivity of the Tax Rates¹

Given the progressive rate schedule of alternative 1, the tax burden is based on the "ability to pay" principle of taxation and the nominal incidence is progressive. That is, as income level of the taxpayer increases, the nominal tax rate also increases. It should be noted though that state income taxes are deductible when computing taxable income for federal income tax purposes if the individual itemizes deductions. This has the effect of reducing the burden on individuals with higher incomes who are subject to higher marginal rates at the federal level and are also more likely to be in a position to itemize. The effect is to reduce the progressivity of the tax burden at the state level. This effect will be reduced, however, in light of recent scheduled income tax rate reductions enacted at the federal level.

One possible disadvantage of a limited bracket structure such as alternative 2 is that those at the lower end of each bracket are taxed at the same nominal rate as those at the upper end. The tax is still progressive in nature across brackets. It is progressive to a lesser extent within brackets given that the personal exemption excludes a larger proportion of the lower income from the tax.

The key to vertical equity or adherence to ability to pay principles in alternative 3, the flat rate tax, is the size of the personal exemption. The exemption combined with the flat rate determine the progressivity of the system.

In general this type of tax takes the view that income from all sources is equivalent in defining the tax base. Problems of equity arise when certain income flows are excluded from the tax base or are taxed at preferential rates. In Michigan, for instance, there is no subtraction of itemized or standardized deductions. There is however some allowance for tax credits which represents a deviation from this ideal.

¹ see exhibit A

The main concerns with a flat rate tax involve its incidence. It may distribute burdens from upper to middle income taxpayers.

D. Intergovernmental Effects

All state income taxes are deductible from Federal income. This causes a leakage of tax from the federal government to the State. Alternatives 1 - 3 show that for every dollar of Alaska tax paid, the taxpayer effectively pays only 78¢ - 80¢ while the Federal government leaks 22¢ - 20¢ of it back to the State.

On the other hand, the deductibility of property taxes in alternatives 1 and 2 (generally levied at the local government level), erodes the tax base of the State. The estimated leakage of tax from the State to local government estimated under these alternatives is \$6 to \$7.5 million.

Since there are no deductions from alternative 3, the flat rate tax, leakage of tax from the State to local government under this alternative is zero. It has been argued that it undermines the ability of local government to levy taxes when they are not deductible from the taxes of higher level governments.

E. Inflation Effects

Inflation adjustments are present in the exemption, deduction and income limit amounts of all these tax alternative; however, the lack of inflation adjustment to the tax brackets in the rate structure will necessarily lead to bracket creep. What this means in practical terms, is that taxpayers may be no better off in any real sense (their income, after adjustment for inflation, is no greater) but may have to pay greater portions in tax. This can be mitigated with inflation indexed tax brackets.

The wider brackets of alternative 2 make bracket creep less likely, but without indexing of any amounts expressed in dollar terms, inflation remains a concern.

Inflation adjustment is present in the exemption amount of alternative 3. Because the exemption is indexed, this alternative is less distorted by inflation than the previous cases.

III. TAX MODEL ALTERNATIVES

A. ALTERNATIVE ONE: ADJUSTED 1978 ALASKA RATE STRUCTURE/ FEDERAL TA-
BASE

This alternative attempts to reinstate, largely, the tax structure effective in Alaska before it was repealed. That structure had its own set of progressive tax rates grouped by filing status, and was piggybacked to the federal law for most of its tax base elements.

1. Tax Base - New Federal Law adopted

2. Income Inclusions and Exclusions

Included as total income are wages, salaries, tips, interest income, dividends, income tax refunds, alimony received, business income, capital gains, pensions, IRA and annuity distributions, rents, royalties, partnership, estates, trusts, farm income, unemployment insurance (which we are unable to include in our model), social security benefits and other income. The new Federal law eliminates the \$100 - \$200 exclusion of dividend income and treats the full amount of capital gain as ordinary income. The Alaska Permanent Fund Dividend is included as income.

New restrictions are now included in the Federal law which define passive and active participation in ventures and set limits for higher income taxpayers on offsetting losses of any kind. Passive losses cannot be used to offset other income except for \$25,000 in participatory rental losses.

3. Income Adjustments

Under the new Federal law, only the Keogh plan contributions, savings withdrawal penalties and alimony paid adjustments from income remain. Eliminated is the Two Earner adjustment; while the IRA adjustment is phased out at higher income levels or eliminated if the employer covers the employee with a retirement plan. The moving expense and employee business expense adjustments are now deductions.

4. Treatment of the Alaska Permanent Fund Dividend

All of the alternatives exclude the PFD from state taxable income.

5. Nonresident Apportionment

As was done in the 1978 Alaska individual income tax law, nonresident workers apportion their income by source state in this proposal. The apportionment ratio is obtained by dividing Alaska adjusted gross income (income earned in this state or attributable to investments in this state) by total adjusted gross income. The ratio obtained is used to adjust exemptions and standard deduction. Itemized deductions are apportioned to Alaska based on the expenditure location, property site or source of income to pay the expenditure.

6. Standard Deduction

The following standard deductions are assumed to be adopted from the Federal Code and are indexed yearly for inflation.

INDIVIDUAL INCOME TAX REPORT

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<u>Filing Status</u>	<u>Standard Deduction</u>	<u>Add'nl for Blindness/ Age Exemption</u>
Single	\$3,000	\$750 per Exemption
Married Filing Joint	\$5,000	\$600 per Exemption
Married Filing Sep	\$2,000	\$600 per Exemption
Head of Household	\$4,400	\$750 per Exemption

7. Itemized Deductions

Those with greater than the standard deduction can itemize deductions on state returns as done on the Federal return. Alaska income taxes cannot be deducted for Alaska tax although they can for Federal income tax. Medical expenses in excess of 7.5 percent of adjusted gross income are deductible. Sales taxes are not deductible but property taxes are. Home mortgage interest (for primary and secondary residences) is still deductible, but consumer interest is phased out and other mortgage interest is no longer deductible. Union and professional dues, tax return preparation fees, employee business expenses are also deductible, but must total more than two percent of adjusted gross income. Moving expenses are deductible.

8. Personal Exemptions

Exemptions are available for the taxpayer, spouse, dependents and for certain debilitating conditions. They are worth \$1,950 each in 1988, \$2,000 in 1989 and are indexed for inflation thereafter. For higher income taxpayers, the value of these exemptions is reduced by five percent of taxable income if taxable income is greater than the threshold amount (which is indexed yearly for inflation).

<u>Filing Status</u>	<u>Income Threshold</u>
Single	\$ 89,560
Married Filing Joint	\$149,200
Married Filing Separately	\$113,300
Head of Household	\$123,790

9. Tax Credits

We have not included any tax credits in these alternatives.

10. Tax Rates

Tax rates effective for the 1978 and 1979 Alaska individual income tax are assumed to be re-adopted for this proposal.

B. ALTERNATIVE TWO: LIMITED BRACKETS/ FEDERAL TAX BASE

This alternative is piggybacked to the federal law for most of its tax base elements. The difference between this and Alternative #1 is a two bracket tax rate. This could be accomplished by following these three steps.

- Adopt new federal rules to derive the taxable income base;
- Divide taxable income into a small number (2 or 3) of brackets according to some objective criteria or adopt the Federal brackets.
- Specify state tax rates for each of the chosen brackets with income in the higher bracket(s) being taxed at a higher rate.

1. Tax Base - same as alternative #1
2. Income Inclusions and Exclusions - same as alternative #1
3. Income Adjustments - same as alternative #1
4. Treatment of the Alaska Permanent Fund Dividend - same as alternative #1
5. Nonresident Apportionment - same as alternative #1
6. Standard Deduction - same as alternative #1
7. Itemized Deductions - same as alternative #1
8. Personal Exemptions - same as alternative #1
9. Tax Credits - same as alternative #1

We have not included any tax credits in these alternative proposals.

10. Tax Rates

The rates and rate groups assumed to be in place for this proposal are presented below. These rates are a set that make the alternative revenue neutral compared to the first alternative and the last alternative, for the first year (1988) only. That is, all four proposals are constructed to raise approximately the same revenue.

TAXABLE INCOME LEVEL	
\$0 - \$25,000	3.7%
\$25,000 & more	7.7%

- C. ALTERNATIVE THREE: FLAT RATES/ FEDERAL TAX BASE, NO EXCLUSIONS OR DEDUCTIONS, HIGH PERSONAL EXEMPTION

A true flat tax has two attributes: (1) it applies the same rate of tax to everyone and to each component of the tax base; and (2) to arrive at the tax base there are no deductions from total income except personal exemptions and strictly defined business expenses.

To raise a certain amount of tax revenue it is necessary to make a trade-off between the size of the personal exemption and the marginal tax rate

"A high exemption may be desirable to secure relief for those at the bottom of the income schedule and to increase progressiveness (with respect to average tax rates). But a higher exemption means that a higher marginal tax rate must be applied to maintain revenues."

1. Tax Base

As with the previous alternatives, this tax system is tied to the Federal tax law. In this case, however, it is piggybacked to the federal law only for its income inclusion elements. It is not tied to the federal law for exemptions, deductions or income exclusions. The advantage in being tied to the federal system is largely administrative, as discussed previously. The disadvantage is that federal changes can automatically effect state law and revenues dramatically.

The federal law has changed since the Alaska individual income tax was in effect. This proposal assumes that the changes adopted by the federal government will be referenced in Alaska Statute much as they were in 1978-1979, but only for income inclusions. This will result in the expansion of the adjusted gross income; and therefore, the tax base. The provisions of the new law that we assume would be effective for this proposal are summarized below.

2. Income Inclusions and Exclusions

Included as total income are wages, salaries, tips, interest income, dividends, income tax refunds, alimony received, business income, capital gains, pensions, IRA and annuity distributions, rents, royalties, partnership, estates, trusts, farm income, unemployment insurance (which we were unable to include in our model), social security benefits and other income. The new Federal law eliminates the \$100 - \$200 exclusion of dividend income and treats the full amount of capital gain as ordinary income.

New restrictions are now included in the Federal law which define passive and active participation in ventures and set limits for higher income taxpayers on offsetting losses of any kind. Passive losses cannot be used to offset other income except for \$25,000 in participatory rental losses. (Passive losses occur particularly in some partnership and rental activities.)

3. Income Adjustments

Under the new Federal law, only the Keogh plan contributions, savings withdrawal penalties and alimony paid adjustments from income remain. Eliminated is the Two Earner adjustment; while the IRA adjustment is phased

out at higher income levels or eliminated if the employer covers the employee with a retirement plan. The moving expense and employee business expense adjustment are now deductions.

4. Treatment of the Alaska Permanent Fund Dividend

All of the alternatives presented exclude the Alaska Permanent Fund Dividend from taxable income.

5. Nonresident Apportionment

Nonresident workers apportion their income by source state in this proposal. The apportionment ratio is obtained by dividing the Alaska adjusted gross income (income earned in this state or attributable to investments in this state) by total adjusted gross income. The ratio obtained from Alaska to total income is used to adjust exemptions also.

6. Personal Exemption

The personal exemption in this alternative is set high both as a proxy for a subsistence amount and to respond to family size. The high personal exemption helps to make the effective rates of this proposal more progressive. The exemption value for taxpayer, spouse and dependents is \$3,000 each.

7. Tax Credits

We have not included any tax credits in these alternatives.

8. Tax Rates

The tax rate in this alternative was designed to provide a revenue neutral tax compared to alternative one. That is, total revenues are approximately the same as the previous two cases, \$250,000,000. A 3.9 percent tax rate was used for all income. Progressive rates could also be applied to this tax base but it would be difficult to develop a revenue neutral (compared to the other alternatives) case with these rates.

D. ALTERNATIVE FOUR: DISCUSSION/THE WORKING DRAFT

1. Filing Status

A decision will have to be made concerning the filing status of married persons. Under federal law, marrieds may file jointly or separately. It would be preferable to require that the same status be used for state purposes as utilized for federal purposes. Otherwise, income will have to be attributed to the spouse who earned the income and this would be important only at the state level. This would then present an audit question exclusively at the state level which would increase the state administrative requirements.

2. Exemptions

The next question concerns the setting of exemptions. For instance, extra exemptions may be desirable for those 65 and over and for the blind in addition to the normal exemptions for the spouses and dependents. Other exemptions could be cranked in as well to achieve other policy goals.

The amount of the exemption can also be set to achieve a certain desired result. For instance, if the exemption is set at \$3000 per person a family of four would pay no tax on the first \$12,000 of income AFTER certain limited deductions. The proposal merely uses a \$3000 exemption as a starting point. The fixing of this amount is a political decision which will take into consideration the minimum threshold level of taxation of lower income taxpayers, however changing this amount will be reflected in the rates.

3. Tax Base

a. Federal Total Income

The modified flat or graduated tax structure uses federal total income, with certain adjustments, as the tax base starting point. Federal total income is income from all sources, including all capital gains and permanent fund dividends, and corresponds to line 23 of the 1986 Form 1040. The adoption of the Internal Revenue Code provisions defining items of income may be preferable as these concepts are generally well settled through years of administrative rulings and court decisions. The administration of the tax will be facilitated by the adoption of the code provisions defining income. The processing and compliance efforts will also be enhanced since the federal return can be utilized for verification. Further, IRS audits will result in corresponding adjustments to the Alaska returns to the extent an income item is involved.

b. Additions To The Tax Base

Additions to the tax base would include interest on obligations from states other than Alaska. This tax free interest at the federal level is not included in income otherwise. Since lower income taxpayers do not generally receive tax free income, the impact will be absorbed by middle and upper income taxpayers. However, it may be desirable to maintain tax exempt status for interest on Alaska obligations, such as on AHFC bonds, to increase demand for those securities as well as to promote investment in Alaska rather than in other states. The inclusion of non-Alaska tax-exempt income in the tax base will require that the corporation income tax statutes be amended to achieve the same result at the corporate level.

The cost of living allowance that federal employees receive in the state must be added to the tax base to place these residents on a par with other state residents. Federal COLA is not subject to federal income tax and thus is not included in federal income.

c. Subtractions From The Tax Base

Deductions from the tax base might take a number of forms. One deduction, really an elimination, removes Alaska income tax refunds from the base. Income tax refunds, to the extent deducted on the federal return in a prior year, are income for federal purposes in the year of receipt. Since the state income tax is not a deduction for Alaska tax purposes, it should not form a part of the Alaska tax base and must therefore be subtracted.

Other subtractions from the tax base might include the penalty for early withdrawals from savings and alimony paid. These deductions are appropriate because interest income in full is included in total federal income without regard to the amount actually received or available. The deduction treats as total income only the amount actually received or available to a taxpayer. A deduction for alimony paid is necessary since alimony received is included in the tax base. The deduction is necessary to prevent the same amount from possibly being subject to tax twice.

The above mentioned additions and subtractions to the tax base would be made to arrive at an Alaska adjusted gross income figure. Adjusted gross income could instead be called taxable income and the tax computed on the amount so determined. However, there are other deductions that have merit in the tax system that may promote desirable public policy. Charitable contributions and home mortgage interest are just two examples. The experience we have with the federal tax reform efforts leading to the passage of the Tax Reform Act of 1986 illustrates that there are demands for certain deductions.

Thus, medical expenses in excess of 7% of Alaska adjusted gross income are allowed. So are contributions to Alaska charities and mortgage interest and property taxes on a principal Alaska residence. Only such expenditures (except for medical expenses) within Alaska are deductible in order to promote to the fullest the state economy and investment within the state. This treatment should prevent leakage of state tax dollars on out of state expenditures and correspondingly promote Alaska residency.

Interest on United States obligations must not be taxed by a state pursuant to federal law. Thus, a deduction is allowed. If the itemized deductions were not allowable under this alternative, the interest on U.S. obligations would be deducted in arriving at Alaska adjusted gross income. It is placed after AGI only because of the floor on medical expenses.

A standard deduction in lieu of itemized deductions is not provided. Standard deductions create leakage to the extent expenditures in the policy areas do not exceed the standard deduction. Requiring a full proof of those expenses should promote the public policy contemplated. Further, a heavy impact will fall on non-Alaska residents who may have little or no such expenses and will not be able to utilize the standard deduction. Renters may also be impacted although the current economic climate may make it preferable to encourage home ownership and commitment to Alaska and a particular Alaska community. That would be accomplished by allowing interest and taxes on principal residences. A failure to allow the deduction for home

Interest and taxes could have the reverse effect of promoting rental over home ownership in the state. (It is common knowledge that the delinquency rate on AHFC mortgage loans is becoming increasingly alarming. The situation should only worsen under the current ABE program which assumes yearly increases in the income of the debtor. State residents will fare well in the current economy if income remains constant. The ABE increases will impact state residents in the next year or two. Unfortunately, the ABE program is based on an assumption that is no longer valid. This exacerbates the already serious problem).

Taxable income would be derived from subtracting the deductions specified and the appropriate exemption amount from adjusted gross income. A tax would then be computed on the amount of the taxable income.

d. Credits

Credits against tax might be limited to that for child and dependent care in Alaska and for taxes paid by residents to other states. The credit for taxes paid by residents to other states is designed to prevent double taxation and promote Alaska residence. Those residents generate income from other states which they bring back into Alaska.

The tax liability for the tax year would be determined by subtracting the credits from the tax. Withholding and estimated tax payments would be required during the tax year. A withholding worksheet for state purposes would be required and penalties would be imposed for underpayments as computed in accordance with current federal law.

e. Non-Residents

A non-resident would compute his tax on only the income derived from sources within the state. A statute would be required to specify that income which is derived from sources within the state. The statute could be modeled after the law in effect prior to repeal with consideration given to further inclusion or clarification within constitutional limitations. Most non-residents would pay a higher effective tax rate than residents since non-residents would have few if any deductions from which to offset the Alaska source income. It may be possible to withhold the benefit of the lower rates to non-residents under a graduated rate system. Non-residents would pay tax at the higher rates determined in accordance with their income from all sources.

IV. ANALYSIS

The above scenario obviously represents a number of policy decisions that may or may not be politically feasible or acceptable by either the Administration or the Legislature. Each of the attributes of a tax involves a policy question and each must be resolved by the appropriate authorities during the discussion stage. The format of the example used herein is a judgment call of some of the members of the working group and does not

necessarily reflect the opinion of all members. It is intended to illustrate how one model can be built based on available alternatives.

Certain issues permeate the formulation of the tax system. First, will the system be capable of effective and efficient administration and achieve taxpayer compliance? Second, should the tax system promote state policy and economic goals, such as promoting residency and Alaska investment, or should state goals be primarily dealt with outside the tax system? Third, how should non-residents be treated in the system? Fourth, what is the desired distribution of the tax among the population? These issues are central to each of the alternatives.

A. Administrative Issues

Research alternatives One and Two differ only in that Research One uses the old Alaska tax rate schedules while Research Two uses new schedules patterned after those scheduled to go into effect for federal purposes in 1988. Both alternatives adopt federal provisions to arrive at taxable income figures, i.e. Income less adjustments to income less itemized deductions or standard deduction less exemptions equals taxable income.

Research alternative Three differs from Research One and Two in that it does not adopt federal provisions except for purposes of defining income items and then applies a flat percentage tax rate to that income, with some minor adjustments. Tax rate tables are not necessary with a flat tax.

The modified flat or graduated tax Working Draft alternative is similar in design to Research Three in that federal law is adopted for purposes of characterizing income items. It would also be similar to the extent the flat tax concept was used to establish tax liability as a fixed percentage of income. It differs from both Research One and Two in that it envisions a very limited number of adjustments and deductions from income and would either adopt selected federal provisions or specifically enact provisions into Alaska statutes. The utilization of a graduated tax rate system under this method would not effect the difference between it and the other alternatives.

The wholesale adoption of the federal code provisions in Research One and Two would mean that the state system will mirror the federal system. The caveat to remember is that the Internal Revenue Code has traditionally been aimed at federal, rather than state, policy concerns. What is good or appropriate behavior to encourage at the federal level is not necessarily important or cost-effective at the state level. The Alaska tax system should be made to reflect the concerns of the state rather than the federal government.

The adoption of federal law is problematic from the perspective that the income tax law changes on a yearly basis. The state system will also change due to the adoption of the federal code. This is more pronounced with deductions from income since those are the areas that change with the greatest frequency. The characterization of income items changes less frequently and the impact at the state level can be seen more readily. Thus, Research Three and the Working Draft present a advantage in this context over the other two

alternatives. The enactment into Alaska law of specific provisions addressing the subtractions from income would create a certainty of tax result and would remove the state tax law from the problems caused by changing federal law. This is feasible with the Working Draft and Research Three but not with Research One and Two because of the number of provisions involved. Of course, federal law will remain in effect for determining the profit or loss of sole proprietors, partnerships, estates, and trusts, as well as for rental property and royalty income. These business activities are separately accounted for and a net figure is reported as an income item.

Another problem to be considered is the discretionary nature of many of the deductions that arise in the code. There is virtually always going to be some difference of opinion as to what constitutes the proper amount of a deduction. The majority of disputes we have experienced in prior years concerned deductions rather than income items. The IRS generally relies on information returns to audit income items and focuses audit efforts on deductions and credits where the most abuse lies. There may be much to be said for a tax system that eliminates or sharply curtails the extent of deductions from income and the resultant abuse. A less cumbersome system should result in a fairer system for those taxpayers similarly situated. However, a system with no deductions may not reflect a taxpayer's true ability to pay and therefore be unfair. A compromise between the two could be the most logical solution.

Administratively, all the alternatives contemplate the drafting of statutes to accomplish the intended result. Further, the Department of Revenue will have to promulgate regulations and issue rulings covering many of the areas in the income tax law. A true flat tax without deductions from income, such as in Research Three, would be the simplest from a drafting perspective. However, any regulations and rulings pertaining to non-resident income will have the same level of complexity under any of the alternatives.

Withholding of tax at the source by employers will be required under all of the alternatives. Here, the least involved withholding system would be under Research Two because the state withholding could be set at a percentage of the federal withholding. The other alternatives differ from the federal and thus state withholding schedules will be required in order to determine the extent of withholding.

A withholding system means quarterly reports and year end reconciliation returns. It is estimated that there will be about 17,500 reporting entities which will generate 70,000 yearly withholding reports and 17,500 year end reconciliations. Taxes due are generally paid with the reports or returns although monthly payments are required for taxes withheld by an employer that exceeds \$500 in any month. Estimated tax payments and forms will also be required under all the alternatives to cover income not subject to withholding.

In addition to the withholding reports and returns, it is estimated that 275,000 returns will be filed each year. Other administrative concerns with all the withholding and tax filings would be virtually the same under all the alternatives. These administrative responsibilities would include, in part, the following.

1. Developing withholding and tax return form packages.
2. Taxpayer and employer education and assistance.
3. The receipt and processing of reports and returns.
4. Processing cash flow, including refunds.
5. Data capture of report and return information and cash flow.
6. Microfilming returns.
7. Filing (storage) of tax reports and returns.
8. Maintaining document retention schedules and periodically destroying documents.
9. Computer programming and increased computer capacity.
10. Computer editing of information.
11. Training of Department personnel in processing and review functions.
12. Office audit of each report and return and generation of billings.
13. Field audit activities, especially non-resident income area.
14. Collection activities.
15. Criminal investigations.
16. Appeal procedures for disputed taxes.
17. Coordination and processing of informational returns from banks reporting interest and taxes.
18. Coordination and usage of IRS-Alaska exchanges of information.
19. Yearly reporting to IRS of state tax refunds issued.

B. Policy and Economic Issues

The broadening of the tax base and reducing the tax rate lead to simplicity and fairness in a tax system. Base broadening strives to achieve the goal of treating similarly situated taxpayers in an equal manner. Thus, an all inclusive tax base, no subtractions from the base, and a flat tax rate have received support as being the less complex of the tax systems. However, a simple tax system may not be necessarily fair nor may it achieve state policy goals designed to encourage and promote the state economy.

An income tax system that is fair should be designed to include all, or virtually all, income received by an individual in the tax base and allow certain adjustments or deductions that clearly reduce the ability of one to pay the tax. Ability to pay is a threshold question in a tax system and the decision must be made early on whether the law should take this factor into consideration. If the answer is yes, then the decision maker must evaluate certain deductions and decide whether such are appropriate given the social and economic considerations currently existing at the time or reasonably foreseeable in the future. Certain deductions are justifiable since some expenditures reduce the ability to pay without increasing personal consumption and/or encourage socially desirable behavior.

A listing of some deductions will illustrate that selectivity will be required in deciding the extent to which deductions will be allowed.

Moving expenses
Employee business expenses
IRA deduction
Keogh and SEP retirement plan deductions
Alimony paid
Deduction for a married couple when both work
Capital gain deduction
Penalty on early time deposit withdrawals
Casualty and theft losses
Contributions
Mortgage and consumer interest
Medical and dental expenses
State and local income, sales, real and personal property taxes
Adoption expenses
Business entertainment expenses
Business gifts
Dues to professional societies
Educational expenses
Employment agency fees
Home office expenses
Production of Income expenses
Small tools and supplies expense
Special work clothes
Subscriptions to professional associations
Tax advice and preparation
Union dues and expenses

The Working Draft alternative allows as discretionary deductions only the penalty on early withdrawal of savings, alimony paid, medical expenses exceeding stated amounts, contributions to Alaska charities, real property taxes and mortgage interest on a principal Alaska residence, as well as a credit for Alaska child and dependent care. (Note: A credit is used in our alternative to provide a greater tax benefit since it applies equally to all taxpayers regardless of income levels and marginal tax brackets. A deduction might be just as appropriate and eliminate the need for a separate credit calculation). Discussion earlier in this report focused on the rationale supporting the suggestion that these items be deductible. The penalty on early withdrawal of savings, alimony paid and medical expenses do not involve consumption. The savings penalty is actually a recapture of interest that is included in income and the deduction backs that recapture amount out. A deduction for alimony is appropriate to prevent it from being taxed where the payor does not have the use of the money and, to the extent alimony is paid to another Alaska resident, from the same item being taxed twice. Medical expenses are subject to a floor based on income and may promote good health care but predominantly allow for catastrophic medical expenses which reduce one's ability to pay.

The other deductions in the Working Draft have been suggested since they not only meet all of our criteria, i.e. such do not increase personal consumption and they do encourage socially desirable behavior and they also reduce the ability of an individual to pay, but each also promotes Alaska residency and investment in the state and a concomitant commitment to

communities. What, if any, deductions that are to be ultimately allowed in the income tax system should be determined in relation to whether the state desires to promote policy and economic goals through the tax system. To some extent, any such deduction will be reflected in higher tax rates.

C. Non-Resident Issue

Under the prior tax system non-residents paid taxes at effective tax rates less than Alaska residents. This was due to the fact that Alaska residents had to include all income in the tax base while non-residents included only Alaska source income. While non-residents were allowed only a percentage of personal exemptions, standard deductions or itemized deductions in the ratio that Alaska income bore to total income which offset some of the advantage, nevertheless the failure to take all income into some account in the computation of the tax resulted in non-residents having their income taxed in the lowest rate brackets compared to residents in similar circumstances.

The decision makers must thus decide the extent to which non-residents deriving income from Alaska will contribute to the costs of providing state services. These state services benefit resident and non-resident alike. Thus, the Working Draft alternative would place non-residents on a par with state residents by taking total income into consideration in determining the appropriate tax brackets under which non-residents must compute their tax liability. All of the alternatives, except to the extent a flat tax might be imposed in which case it would make no difference, can be designed to attain this objective. The actual tax, however, is computed only on the income derived from Alaska sources. Constitutional limitations prohibit a state from levying its tax on income from other sources earned by non-residents.

The Working Draft differs from Research One and Two also in the treatment of deductions. Research One and Two incorporate federal provisions relating to deductions from income that are generic. That is, it makes no difference the state in which the expenditure is made. The Working Draft focuses upon only investment in Alaska as giving rise to allowable deductions. The effect of this will be, for example, to allow a resident to deduct mortgage interest on his Alaska residence while denying a deduction to a non-resident for interest paid on his out of state residence.

Income sourcing rules will be required to determine the extent of income derived in Alaska by non-residents. Prior law and the characterizations by other states can be drawn upon for guidance. There is a great deal of leeway in this area for abuse since it is not always a clear cut case of determining the income sourced within the state. For example, the customary structure in many Washington fishing businesses is to conduct fishing activities in corporate form through joint ventures with other corporations. Substantial sums are paid in the form of officers compensation for work alleged to be performed solely in the state of Washington. The corporation is allowed to deduct the compensation from its income and the individual who receives such asserts the compensation is not from an Alaska source. The compensation varies each year depending on the success of the business. It therefore becomes relatively easy to shift income to a non-taxable source. An audit is

required to make any adjustment and the audits are complex and very detailed. An audit presence will be necessary to achieve any real degree of compliance. A possible counter-measure, in part, would be to statutorily deny a corporation any deduction for officers compensation.

It is also particularly difficult to determine the Alaska source income for crew share, boat share, and captain share members on fishing vessels. In many cases the majority of time is spent just outside the state's territorial waters but the fish product is transferred or sold within the state and the taxpayers are largely dependent upon the state for providing benefits and services to the operations which make the activities profitable. If the Alaska source income is determined by reference to time spent in Alaska waters, very little tax will be generated. The same problem exists to some degree with all transportation carriers, i.e. air, marine and land. All these areas will need to be considered in determining the participation of non-residents in sharing the tax burden. Broad authority to the Department in promulgating statutory regulations could be a solution. Audit visibility will be a must if any serious effort is contemplated in ensuring that non-residents pay a fair share of the tax burden.

D. Distribution Of The Tax Burden

The distribution of the tax burden involves the question of what income groups will pay what part of the total tax required to be generated by the tax system. The income composition of the population must therefore be analyzed.

A pure flat tax system is less sensitive to income levels since all income is nominally taxed at the same rate. In contrast, a graduated tax rate system is sensitive to income levels since the more one earns the more tax one pays. If the design and intent of the tax system is to base it on the ability of the populace to pay the tax, then a graduated tax system like Research One and Two and the Working Draft graduated model must be preferred over Research Three.

Even in a graduated tax system, low income families are not necessarily removed from the tax roles. The setting of the minimum threshold levels of tax are thus important in achieving the overall distribution of the tax burden among the desired income levels. This is accomplished by the income level at which a tax liability arises as well as through the establishment of exemptions.

The distribution of the tax will also involve the determination of the number of tax brackets and rates that need to be employed in the system. This would likely be based on the ability of various income levels to pay progressively higher rates of tax.

In order to effectively measure and analyze the income levels, consideration must be given to the items defined in the tax system as income. The Research alternatives, and the Working Draft with certain additions, use federal law to define income. There are many advantages in doing so although there are persuasive reasons to reach beyond the federal characterizations.

For instance, all unemployment compensation benefits under federal law will be included in full in income in 1987. However, only half of social security benefits are included for those with other income of \$32,000 if married and \$25,000 if single. Interest on state or local obligations is excluded from federal income as is federal cost of living allowances. It might be fundamentally said that equal treatment of those with the same disposable incomes requires that all these items be treated as income, especially under a graduated tax system that provides for those with lower incomes through lower rates. The Working Draft attempts to strike a balance by including in income non-Alaska tax exempt interest and the federal cost of living payments while adopting federal law excluding social security payments and including unemployment compensation. The Research alternatives would continue to follow federal law in all pertinent respects.

Lastly, a decision will need to be made on the treatment of the Alaska Permanent Fund Dividend. The PFD is taxable under federal law. However, in contrast with the premise of levying a tax based on ability to pay, the alternatives exclude the PFD from the Alaska tax base. Inclusion of the PFD would raise \$8-12 million or otherwise allow lower tax rates.

It is possible, however, to incorporate the PFD payment into the income tax program in some fashion. That could be in the nature of a qualification filing with the income tax return or even as an offset against the tax. An offset could require a prior approval to a taxpayer of proper qualification. The tax return could also contain the names of dependents, i.e. children, who should receive direct payments where income tax returns are not required.

We also are aware of a proposal from the Division of Policy in the Governors Office that would apply the PFD to tax liability for most taxpayers and refund the PFD to other taxpayers whose liability was less than the amount of the PFD. The purpose is to cast the refundable PFD in the form of a "welfare" payment and remove it from federal income tax. Currently, there is substantial loss of the PFD revenue from the state to the federal level because of the tax.

We see problems in that approach because all taxpayers receive a credit or refund of a sum certain. The IRS will certainly attempt to apply constructive receipt or discharge of indebtedness rules to reach the income. A different approach might be to structure the PFD into a program like the earned income provision at the federal level.

The earned income credit at the federal level in 1988 applies to certain taxpayers with AGI of less than \$17,000 who receive earned income and have children. The credit is applied against tax liability or is refundable if no tax is owed. As an example, a head of household with AGI of \$12,000 would generate a credit of \$500 (14% of first \$5714 of earned income, or \$800, reduced by 10% of the amount exceeding \$9,000, or \$300). The concept might be applied at the state level in lieu of the PFD to distribute funds to those residents most in need of the payments. The remainder of the revenue that otherwise would have been paid to other residents could, for example, then be distributed to the municipalities based on population. The payments and distributions should not result in any tax liability to residents and there

INDIVIDUAL INCOME TAX REPORT

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would not be any leakage of state revenue as is the present situation under the PFD program. A major problem in any program of this nature would be in its application to non-residents.

The Working Draft and the Research alternatives do not attempt to address in detail these proposals because the ideas need more policy direction and the PFD could create an emotional response overshadowing the need to develop a viable tax system. The PFD question is probably best left to the Administration and the Legislature.

DRAFT BILL
TAX ALTERNATIVE TWO
FEBRUARY 13, 1987

A BILL

For an Act entitled: " An Act for the taxation of income derived by individuals, partnerships, and fiduciaries; and providing for an effective date."

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

*Section 1. AS 43.20.011 is amended by adding new subsections (g), (h), (i), (j) and (k) to read:

(g) There is imposed for each taxable year upon the taxable income of every resident, nonresident and part year resident individual and fiduciary of the state, except for those subject to the rates in (h), (i) or (j) of this section, a tax computed according to the following table.

If the taxable income is:	Then the tax is:
Over \$31 but less than \$30,000	3.2% of taxable income
\$30,000 or more	\$960 plus 5.7% of the excess over \$30,000

(h) There is imposed for each taxable year upon the taxable income of every resident, nonresident and part-year resident married individual who makes a single return jointly with his spouse (as provided in section 6013 of the Internal Revenue Code) and upon every resident, nonresident and part-year resident surviving spouse (as defined in section 2(a) of the Internal Revenue Code) a tax computed according to the following table.

If the taxable income is:	Then the tax is:
Over \$31 but less than \$50,000	3.2% of taxable income
\$50,000 or more	\$1600 plus 5.7% of the excess over \$50,000

(i) There is imposed for each taxable year upon the taxable income of every resident, nonresident and part-year resident head of a household (as defined in section 2(b) of the Internal Revenue Code) a tax computed according to the following table.

If the taxable income is:	Then the tax is:
Over \$31 but less than \$40,000	3.2% of taxable income
\$40,000 or more	\$1280 plus 5.7 of the excess over \$40,000

- (j) There is imposed for each taxable year upon the taxable income of every resident, nonresident and part-year resident married individual who does not make a single return jointly with his spouse a tax computed according to the following table.

If the taxable income is:	Then the tax is:
Over \$31 but less than \$25,000	3.2% of taxable income
\$25,000 or more	\$800 plus 5.7% of the excess over \$25,000

- (k) For purposes of (g), (h), (i) and (j) of this section, the tax on fiduciaries, nonresidents and part-year residents shall be the tax computed on taxable income from all sources multiplied by a fraction the numerator of which is adjusted gross income from sources within the state and the denominator of which is adjusted gross income from all sources. (DIFFERENCE BETWEEN THE TAX COMPUTED ON TOTAL TAXABLE INCOME FROM ALL SOURCES AND THE TAX COMPUTED ON TAXABLE INCOME ATTRIBUTABLE TO SOURCES OUTSIDE THE STATE.)
- (l) An individual shall determine the tax for purposes of this section by using the same filing status as reported on the federal return.

*Section 2. AS 43.20.030(a) and (d) are amended to read as follows:

- (a) Every individual, fiduciary, partnership and corporation required to make a return under the provisions of the Internal Revenue Code shall at the same time file with the Department a return setting out (1) the amount of tax due under this chapter, less allowable credits and payments claimed against the tax; and, (2) other information which the Department requires for the purpose of carrying out the provisions of this title.
- (d) A taxpayer shall file with the return a true copy of the tax return filed with the United States Internal Revenue Service. Every taxpayer shall file an amended return with the Department, and remit any additional tax and interest due, within 60 days of any final determination in the taxpayer's federal tax liability. For purposes of this section, a final determination means the time an amended federal return is filed or the date a federal assessment is made.

*Section 3. AS 43.20.031 is amended by adding new subdivisions (j), (k) and (l) to read:

- (j) The income of an individual and fiduciary is gross income as defined in Section 61 of the Internal Revenue Code, and includes those items specifically included in and specifically excluded from gross income under Subtitle A, Ch. 1B, Parts II and III, with the following modifications:
 - (1) a taxpayer who receives a cost of living allowance which is exempt from federal income tax shall determine and include that amount as part of his income as if the cost-of-living allowance were not exempt;
 - (2) a taxpayer who receives interest upon obligations of any state, or interest upon obligations of any political or municipal subdivision of any state, which is exempt from federal income tax, shall determine and include that amount as part of his income as if the interest were not exempt.

- (k) The following adjustments to the gross income of an individual and fiduciary are allowed as deductions in arriving at adjusted gross income under this section:
 - (1) The deductions allowable under Section 62(a)(1) of the Internal Revenue Code attributable to a trade or business carried on by a taxpayer.
 - (2) The deductions allowable under Section 62(a)(3) of the Internal Revenue Code from the sale or exchange of property.
 - (3) The deductions allowable under Section 62(a)(4) of the Internal Revenue Code which are attributable to property held for the production of rents or royalties.
 - (4) The deductions allowable under Section 62(a)(9) of the Internal Revenue Code for the premature withdrawal of funds from time savings accounts or deposits.
 - (5) The deductions allowable under Section 62(a)(10) of the Internal Revenue Code for alimony.
 - (6) Interest received on obligations of the United States.
 - (7) Refunds of state income taxes included in gross income.

- (l) In the case of an individual, the personal exemptions provided by Section 151 of the Internal Revenue Code shall be allowed as deductions from adjusted gross income in computing taxable income except the exemption amount shall be \$3,000.00 without regard to the inflation adjustment of Section 151(d)(3). (THE ALLOWABLE DEDUCTIONS FOR PERSONAL EXEMPTIONS IN THE CASE OF NONRESIDENT AND PART-YEAR RESIDENTS IS LIMITED TO AN AMOUNT IN THE RATIO THAT ADJUSTED GROSS INCOME FROM SOURCES IN THE STATE BEARS TO ADJUSTED GROSS INCOME FROM ALL SOURCES.)

*Section 4. A new AS 43.20.032 is added to read as follows:

The adjusted gross (TAXABLE) income of nonresidents, part-year residents, and fiduciaries is the adjusted gross (TAXABLE) income as determined under AS 43.20.031 of which a portion is attributable to sources in the state (WHEN ATTRIBUTABLE TO SOURCES IN THE STATE). Deductions are allowed against the portion attributable to sources in the state only to the extent connected with income which arises from sources in the state or property having a situs for taxation in the state.

*Section 5. AS 43.20.040 is amended by adding new subsections (b)(8) and (b)(9) and (d) to read:

- (8) working for salary or wages in the state;
- (9) an estate or trust deriving income from sources in the state.

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

*Section 6. A new AS 43.20.062 is added to read:

- (a) A resident is allowed as a credit against the tax otherwise due under this chapter the amount of income tax imposed on him for the taxable year by another state or territory of the United States on income derived from sources in the other state or territory which is also subject to tax under this chapter.
- (b) The credit allowed in (a) of this section is limited to that proportion of the tax computed under this chapter which the taxable income from the other state or territory bears to total taxable income. The credit shall not exceed the actual tax paid to the other state or territory.
- (c) The amounts deducted and withheld as taxes under this chapter during a calendar year are allowed as credits to the taxpayer against the tax imposed by this chapter.
- (d) A taxpayer meeting the qualification requirements for receipt of the Permanent Fund Dividend under AS 43.23.025 for the calendar year may instead apply the dividend as a credit against the tax imposed by this chapter for that calendar tax year under regulations promulgated by the department.

*Section 7. A new AS 43.20.171 is added to read:

- (a) Every employer making payment of wages or salaries shall deduct and withhold an amount of tax computed in a manner to approximate the amount of tax due on those wages under this chapter for that year. Remittance of taxes withheld shall be accompanied by returns or reports on forms prescribed by the department and at the time or times required by the department by regulation. The department shall publish the rate of withholding required by this section. Every employer making a deduction and a withholding shall furnish to the employee (UPON REQUEST) on or before January 31 of the succeeding year, or within 30 days of termination of employment if such 30 day period ends before January 31, a written statement on a form prescribed by the department showing (1) the name and taxpayer identification number of the employer; (2) the name and social security number of the employee; (3) the total amount of wages and other compensation; and, (4) the total amount deducted and withheld as tax. (OF THE AMOUNT OF TAX WITHHELD FROM THE EMPLOYEE ON A FORM PRESCRIBED BY THE DEPARTMENT).
- (b) Every employer making payments of wages or salaries earned in the state, regardless of the place where the payment is made,
 - (1) is liable for the payment of the tax required to be deducted and withheld under this section and is not liable to any individual for the amount of the payment; and,
 - (2) shall make return of and pay to the department quarterly or at other times as the department may require, the amount of tax levied which under the provisions of this chapter he is required to deduct and withhold
- (c) Any person required to collect, truthfully account for, and pay over any tax imposed by this chapter who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over, as provided in AS 43.05.220(d).
- (d) If the employer is the United States or the state or a political subdivision of the state, or an agency or instrumentality of one or more of the foregoing, the return of the amount deducted and withheld upon wages or salaries may be made by an officer of the employer having control of the payment of the wages or salaries or who is appropriately designated for that purpose.
- (e) In this section the terms wages, employee and employer have the meaning attributed to them under the Internal Revenue Code.

*Section 8. AS 43.20.340 is amended by adding new subsections (12), (13), (14), (15), (16), and (17) to read:

- (12) "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or a person acting in a fiduciary capacity for another or the estate of a deceased person'. The term fiduciary also means an estate or trust for purposes of this chapter.
- (13) "individual" means a natural person, married or unmarried, adult or minor, subject to payment of an income tax under the Internal Revenue Code;
- (14) "domicile" means the place where an individual has his true, fixed, permanent home and principal establishment and to which place he has the intention of returning whenever he is absent for a temporary or transitory purpose;
- (15) "nonresident" means an individual who is not a "resident" or "part-year resident";
- (16) "residence" means actual physical presence in the state and is determined without regard to a person's "domicile";
- (17) "resident" means an individual or natural person who during the taxable year has been domiciled in the state or has resided within the state for the entire taxable year; an individual does not lose his status as a resident simply by reason of attending an educational institution or by serving in the armed forces.

*Section 9. AS 43.20.012 and AS 43.20.013 are repealed.

*Section 10. This act takes effect on January 1, 1988.

Alaska Individual Income Tax

*Working Draft Proposal
and
Briefing Paper*

RECEIVED
FEB 12 1987
STATE OF ALASKA
DEPT. OF REVENUE
ENFORCEMENT DIV.

February 12, 1987

Joint Income Tax Working Group

Department of Revenue

Office of Management and Budget

Alaska Individual Income Tax

Summary

The tax proposal described here (the *Working Draft*) is simple to explain, simple to administer, and simple for the taxpayer. The structure of the Working Draft is illustrated in Figure 1. Calculations begin with "Total Federal Income," on line 23 of the federal form. "Adjustments To Income" are limited to those essential for legality or fairness. Deductions are eliminated entirely, a decision supported by strong theoretical and practical arguments. Despite a proposed personal exemption of \$3,000, the result is among the broadest bases for a state income tax. Other things equal, the breadth of the tax base should allow Alaska to have lower rates than most states, a desirable characteristic from economic and policy standpoints.

Federal Total Income

The arguments in favor of using federal total income as the starting point are simplicity (everyone has to calculate it anyhow), and a settled legal understanding of what total income means. Federal total income has been a stable concept, and changes that have occurred have tended to broaden the tax base.

- *Should the administration's proposal adopt federal total income as the starting point for its individual income tax calculation, as the Working Draft does?*

Adjustments to Income

Permanent Fund Dividends.

Permanent Fund Dividends (PFDs) are included in federal total income. The Working Draft proposes that PFD income be treated just like any other income.

- *Should the PFD should be treated the same as any other income for state tax purposes?*

Federal Cost-of-living Allowance (COLA).

Alaska has 18,000 civilian federal employees. Each receives a 22 percent cost of living allowance that is not taxed by the federal government. The Working Draft says the COLA should be part of the state tax base: to provide otherwise would be unfair to the remaining 204,000 Alaska workers who must pay state tax on their full income. This is consistent with Alaska's earlier income tax. The federal COLA adjustment adds over \$100 million to the state tax base.

- *Should COLA received by federal employees be taxed by the state?*

Tax Exempt Interest.

The Working Draft adds all tax exempt interest, and then deducts the interest on U.S. government obligations. The effect is to tax everything except that which federal law prohibits us from taxing. Economists generally believe that the subsidy paid (in lost taxes) is always larger than the subsidy received by the tax exempt borrowers (in lower interest costs). The part of the subsidy not collected by borrowers goes to high income taxpayers who hold exempt securities.

- *Should Alaska tax just the "exempt" interest from other states, tax none of the "exempt" interest, or (as proposed here) tax all "exempt" interest except that of the U.S.?*

Alimony.

Alimony paid is adjusted out (as it is in line 29 of the federal form) to avoid potential double taxation. Alimony is taxable income to those who receive it.

Early Withdrawal Penalties.

These penalties are deducted from interest earnings, all of which is already been included in income. Without an adjustment folks will be taxed on funds they never received. Of course, had they not chosen to get the money out early, they would not have suffered the penalty.

- *Should the early withdrawal penalty adjustment remain in the Working Draft?*

Federal Adjustments Not Included.

The 1986 federal form allows adjustments for miscellaneous items, some of which generated much popular support in the recent federal tax debate. A solid case can be made for leaving most items off the form, and not just for simplicity. Individual retirement accounts (IRAs), for example, are rarely purchased by low or lower-middle income households, but are almost always purchased by wealthy households. Employee "business" expense is another area that seems to invite petty chiseling. By 1988 it, along with moving expenses, will no longer be a permitted federal adjustment.

- *The Working Draft makes no adjustments for employee moving expense, employee "business" expense, IRA and Keogh plan deductions, or for married couples who work; is this approved?*

Personal Exemptions

The Working Draft allows a \$3,000 personal exemption. With the exemption a family of four pays no tax on the first \$12,000 of annual income. The exemption reduces the tax base by almost \$1.5 billion. The Working Group nevertheless included it to provide progressiveness within the lower income range, and to assure those with dependents face lower effective rates than those otherwise identically situated but without dependents. If there were no exemption, a person

making \$5,000 per year would pay the percentage tax rate as someone earning \$25,000. If deductions were allowed, the same lower income taxpayer would likely pay a *higher* effective percentage rate. Figure 4 shows the average effective tax rates in a two bracket tax system, with and without the personal exemption.

The personal exemption proposed in the Working Draft runs against the desire that "everyone with income should pay some taxes." Without a personal exemption, however, the costs of collecting the tax (including H.R. Block fees, taxpayer time and taxpayer aggravation) will exceed the amount collected for many taxpayers. If the social principle ("everyone with income should pay") overrides cost considerations, the Working Group suggests an additional bracket be added at the low end to provide a lighter tax burden on those with incomes below \$10,000 (couples with income below \$20,000).

- *Is the \$3,000 personal exemption approved? If not, is the addition of a third bracket approved for the low end of the income scale?*

Deductions

On the subject of deductions the Working Draft is simple: there are none, either itemized or "standard." It is this absence of deductions that provides the major simplification in the Working Draft. (The Working Draft still allows business deductions to be subtracted from non-incorporated business income.)

Each traditional deduction has its adherents. Usually they are among the well to do for it is they who benefit disproportionately from deductions. The big items are covered below in descending order of dollar importance. Allowing even a fiscally insignificant deduction might open the door for others.

Mortgage and Other Interest.

This is surely the biggie: the Dept. of Revenue estimates that Alaska taxable income in 1988 would be reduced by at least \$650 million if this deduction were allowed. Almost \$600 million of this is expected to be mortgage interest. The deduction is a subsidy to those who borrow money, especially those who borrow to buy a home (or homes). The subsidy is at the expense of those who rent, and all others who for one reason or another are not paying mortgage interest. Coupled with the inclusion of interest received in income, the deduction serves as a disincentive to saving. The subsidy is most important to those with high incomes. Figure 5 shows that the interest deduction reduces taxable incomes of persons in the \$50-60,000 bracket by 11.4 percent. Those in the \$10-20,000 bracket only get helped to the tune of 3.2 percent. On the other hand, the federal government and most states with income taxes continue to allow this popular deduction.

- *Is the administration comfortable with the elimination of the interest deduction from its tax proposal?*

Property Taxes.

The deduction for property taxes would reduce expected 1988 taxable income in Alaska by more than \$100 million, and cut tax revenues by roughly \$7

...to make up that amount, taxes of those who do not own property would have to be increased. The deduction of property taxes predominately helps high income taxpayers. Because the deduction allows local governments to "export" part of their taxes to the state level, elimination is likely to be opposed by municipal officials. It will certainly be opposed by real estate interests, who will note that the Working Draft runs counter to the federal approach and the approach of most other states with an income tax. The Working Group supports leaving it out.

- *Do property tax deductions remain out of the Working Draft?*

Miscellaneous Deductions.

This politically potent potpourri includes: union and professional dues and other employee expenses; certain legal, accounting and other professional fees; certain adoption costs; some appraisals; and finally, non-business tax preparation fees. These deductions would likely cost the Alaska tax base over \$100 million. This is a particularly difficult audit area, and one that seems to invite a certain amount chiseling.

- *Do miscellaneous deductions remain out of the Working Draft?*

Medical Deductions.

Federal law allows medical deductions if they exceed 7.5 percent of adjusted gross income. Few people have deductions this large, and thus the erosion of the tax base is not large -- only an expected \$20 million in Alaska in 1988. Some have argued that the deduction has encouraged the well-to-do to incur large "discretionary" medical expenses (such as major cosmetic teeth straightening). The estimates from DOR suggest, however, that the deduction would be broadly distributed among income groups. Figure 6 shows this, though it does not show the fact that 15 percent of deductions are taken by the 1 percent of filers who show losses in adjusted gross income.

- *Do medical deductions remain out of the Working Draft?*

Charitable Contributions.

Charity would not be deductible. That includes churches. There is little evidence that giving will be much affected at the marginal tax rates contemplated, however.

- *Do charitable deductions remain out of the Working Draft?*

Casualty and Theft Losses.

Non-business casualty losses from earthquakes, floods, car accidents, as well as losses from theft and other vicissitudes would not be deductible under the Working Draft.

- *Do casualty and theft loss deductions remain out of the Working Draft?*

Tax Rates and Brackets

The Working Draft would establish a two bracket tax with rates of 3.1 percent and 5.5 percent. The break between brackets, figured after subtracting the personal exemption, falls at \$25,000 for single filers and at \$50,000 for joint filers. Figure 7 shows the actual estimated effective tax rates for single and joint filing taxpayers. The relationship of the rates in the two brackets was chosen somewhat arbitrarily, so the progressiveness "tilt" should be reviewed. With this ratio between the higher and lower brackets (3.1%/5.5%), the tax will be slightly less progressive than the new federal system.

- *Are the tax rates and bracket breakpoints in the Working Draft approved?*

Indexing for Inflation and Deflation

The Working Draft does not yet provide for indexing (adjusting) the personal exemption and the bracket breakpoint for inflation or deflation. For example, if there was 10 percent inflation during a year, in the following year the \$3,000 personal exemption would automatically increase to \$3,300 under an indexing arrangement, and the \$25,000 bracket breakpoint would increase to \$27,500. If indexing is not provided, the yield of the tax will tend to increase during times of inflation, and decrease in times of deflation. This is called "bracket creep."

- *Should indexing for inflation and deflation be added?*

Combined PFD and Tax Forms

Mailing costs are expected to be reduced by 30 percent from combining the PFD and tax forms. Additional benefits may result from better compliance; if a non-resident return is received from a PFD recipient, a second look would likely be warranted. As currently planned, the recipient would be able to have the PFD applied to next year's tax liability by marking a box on the form.

- *Are combined PFD and tax forms approved?*

Non-resident and Part-year Apportionment

There are three possible ways to apportion for those who have income attributable to other states. The method that seems most appropriate may not pass constitutional scrutiny, however. The issue is still under legal review. The working group proposes use of whichever constitutionally appropriate method results in non-residents paying the largest part of their share of Alaska government costs. The decision will be briefed when a draft bill is presented for the governor's approval.

STATE OF ALASKA
INDIVIDUAL INCOME TAX
WORKING DRAFT

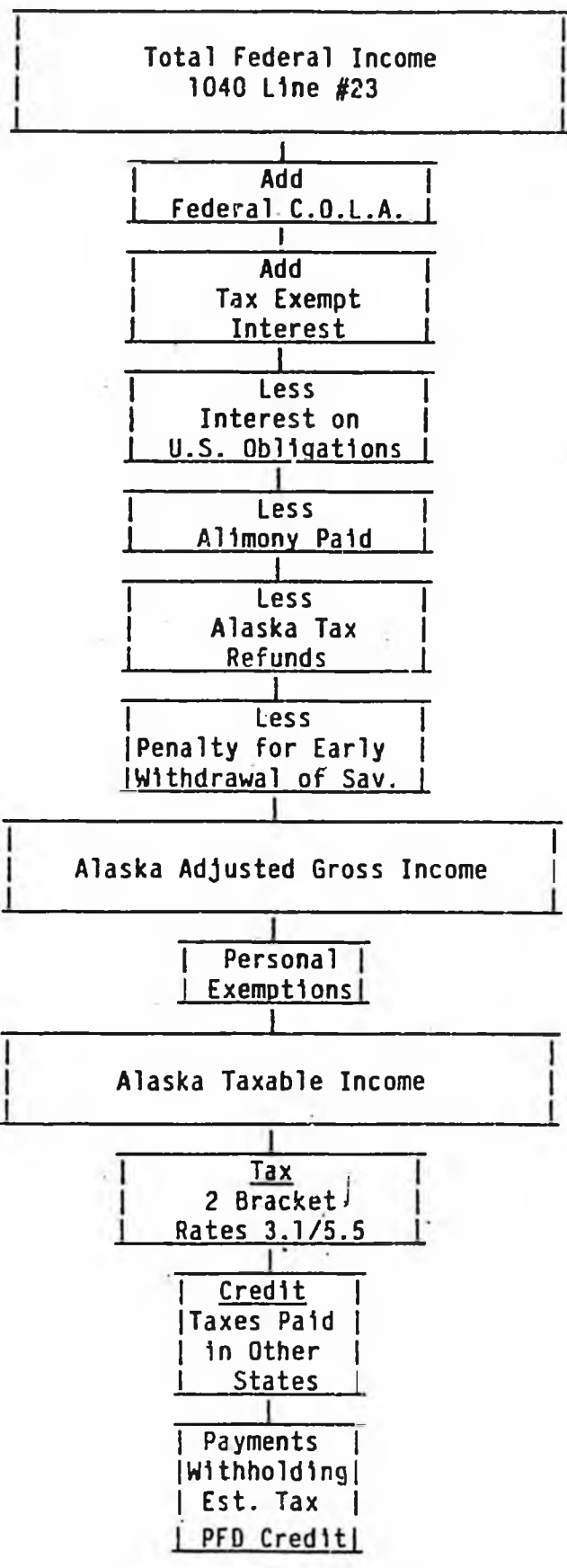
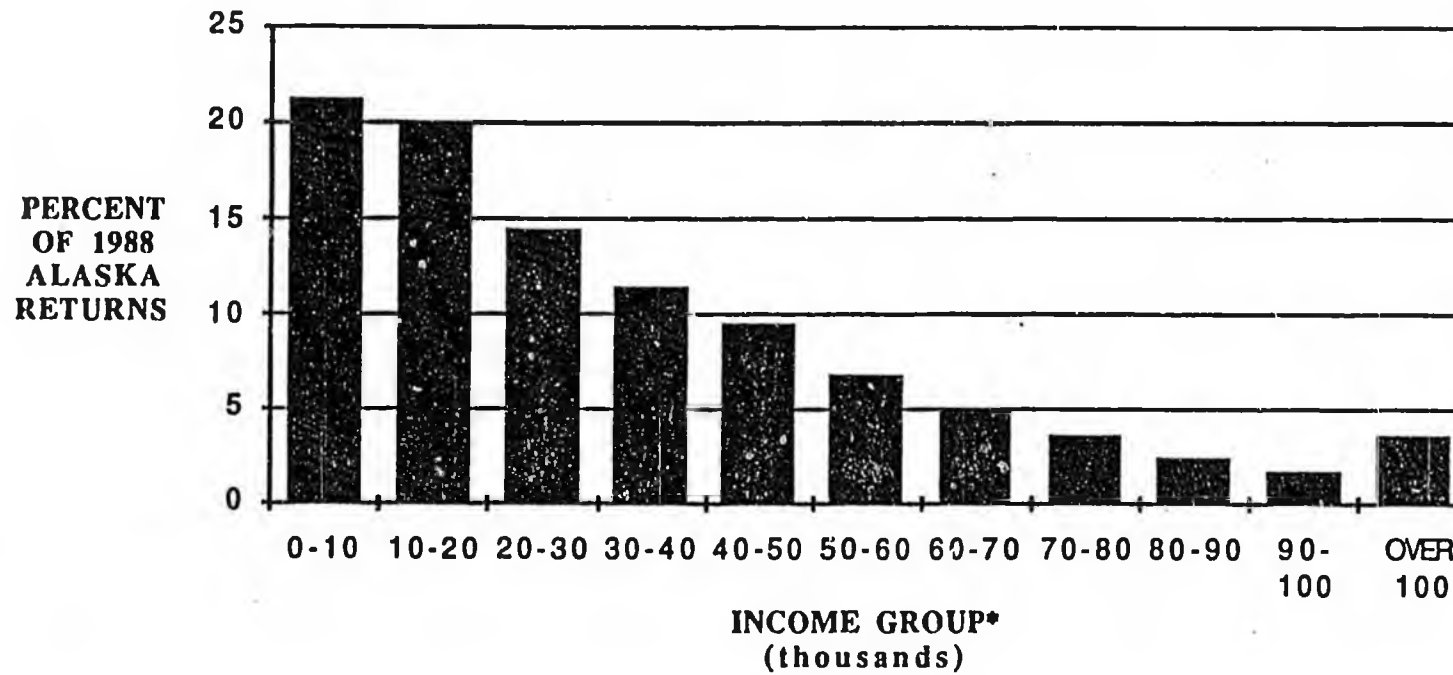


FIGURE 2

WHERE ARE THE TAXPAYERS?

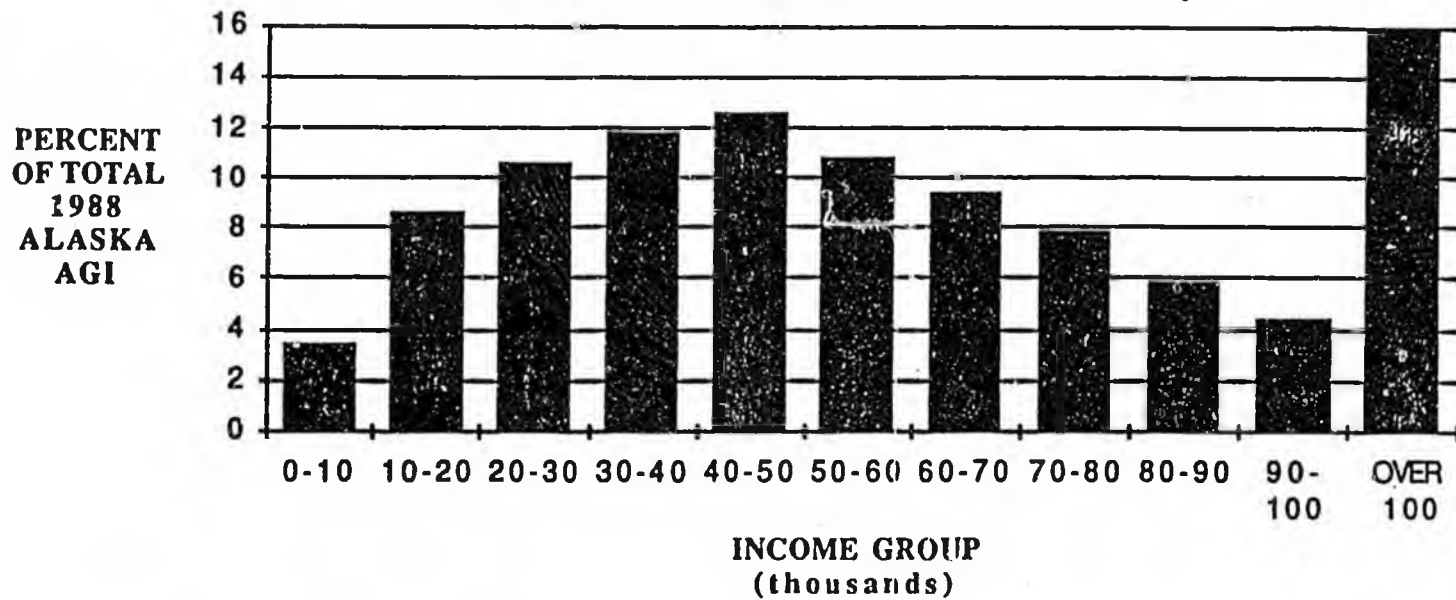


OMB from DOR data, 2/8/87.

*Adjusted Gross

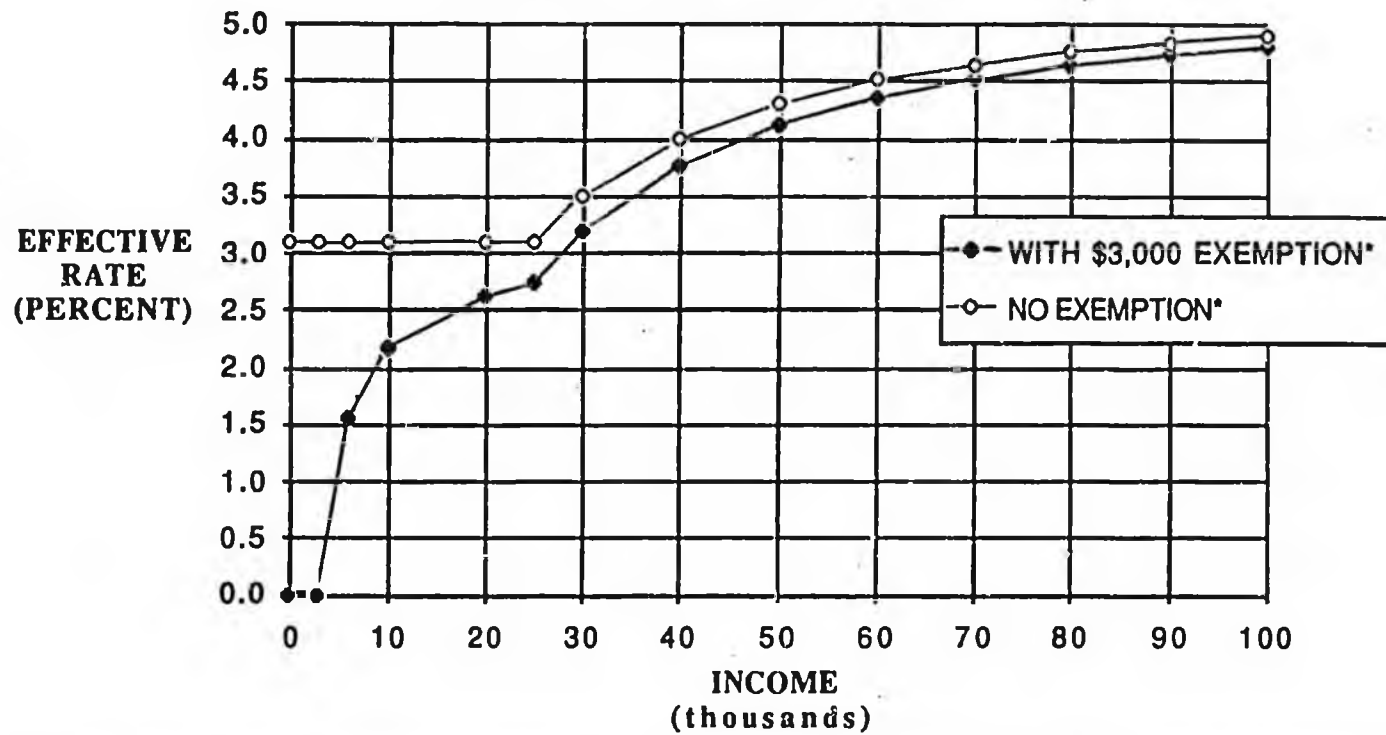
FIGURE 3

WHERE IS THE INCOME?



OMB From DOR estimates, 2/12/87

WHAT IF ALASKA ELIMINATES THE PERSONAL EXEMPTION?

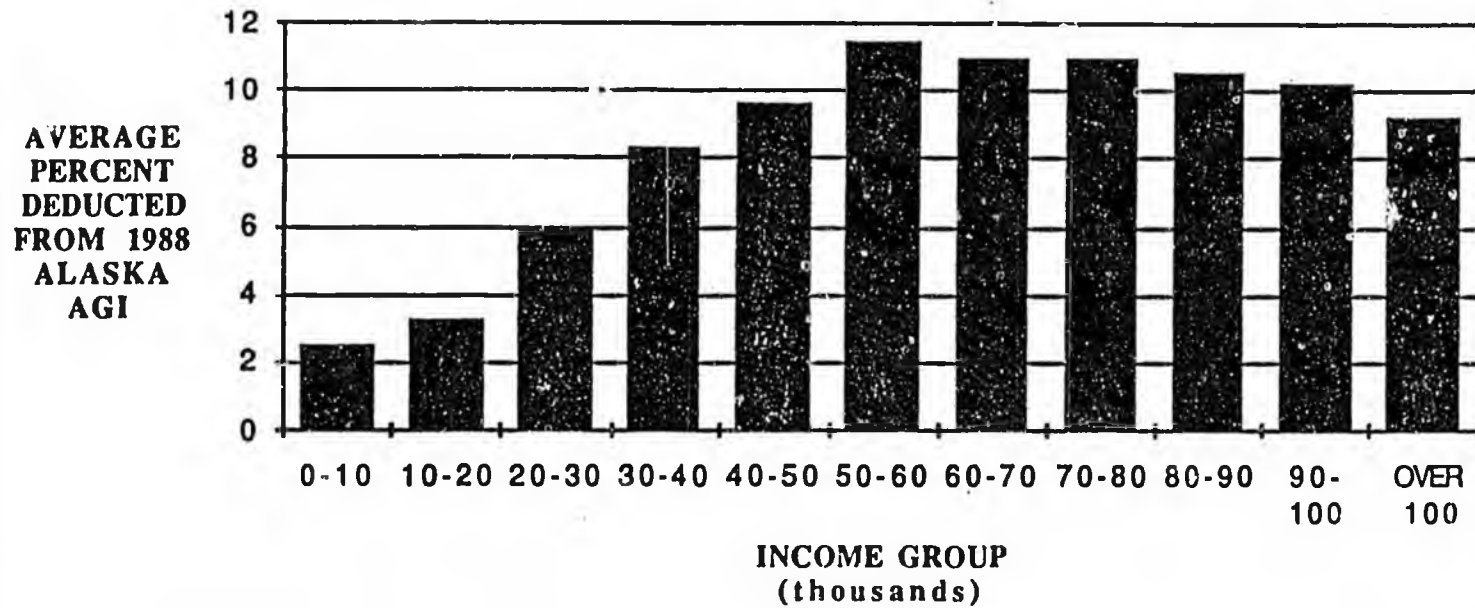


OMB, 2/10/87.

*No deductions. Brackets at 3.1 % below \$25,000 and 5.5% above (non-joint).

FIGURE 5

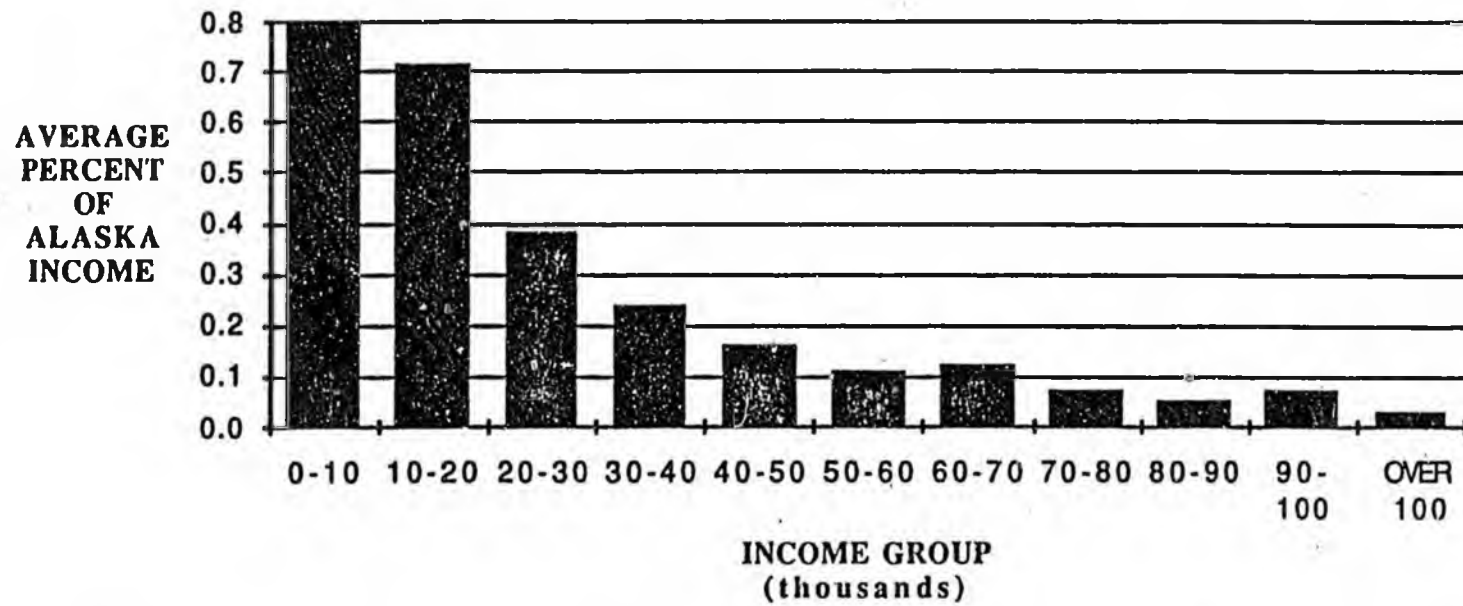
WHO BENEFITS FROM INTEREST DEDUCTIONS ?



G. Erickson from DOR data, 2/8/87.

FIGURE 6

WHO BENEFITS FROM MEDICAL* DEDUCTIONS?



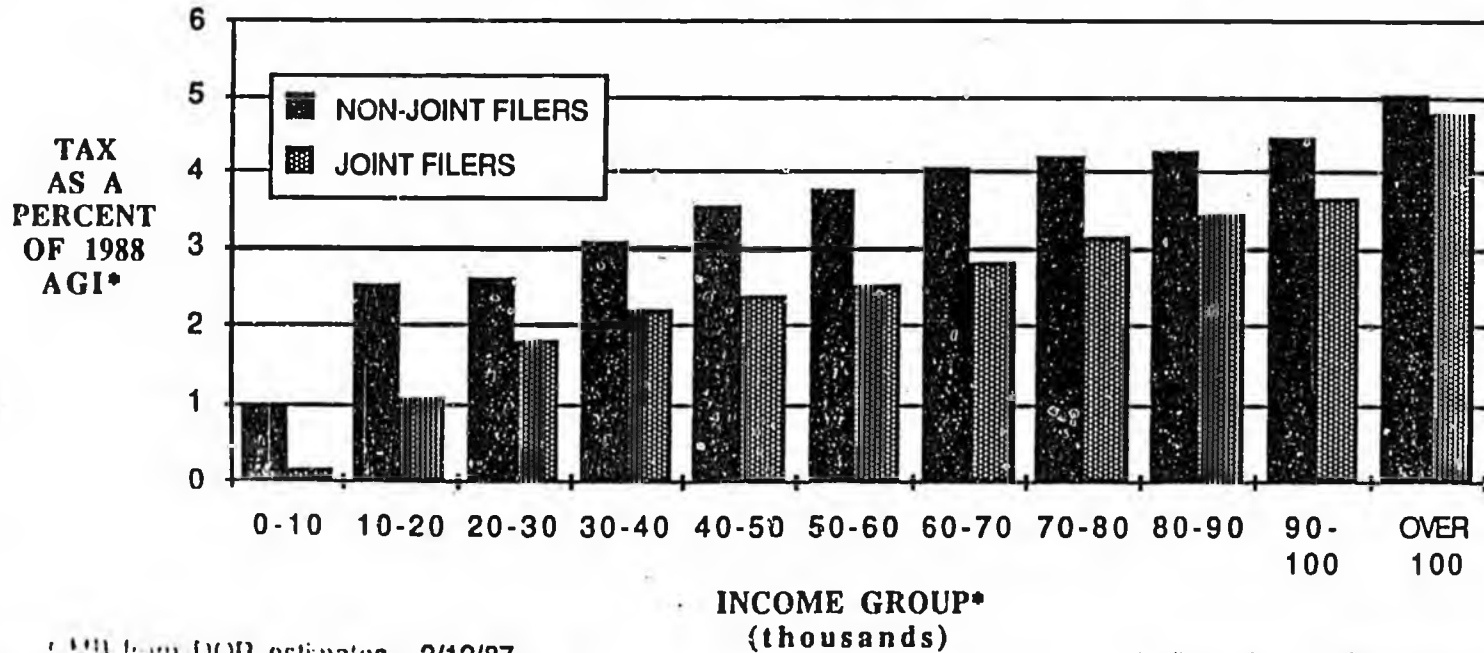
OMB from DOR data, 2/11/87.

*Only medical expenses exceeding 7.5 % of adjusted gross income.

FIGURE 7

WHAT ARE THE EFFECTIVE TAX RATES?

Personal exemption at \$3,000 with no deductions. Brackets at 3.1 % & 5.5%;
bracket breakpoint at \$25,000 (single) or \$50,000 (joint).



*data from DOR estimates, 2/12/87.

*adjusted gross income

Individual Income Tax Draft
 Designed Revenue Goal--\$250 million
 Effective tax rates
 1982

DRAFT*

AGI RANGE	ALL RETURNS	ALL RETURNS	ALL RETURNS	NON-JOINT RETURNS	JOINT RETURNS
	PERCENT OF RETURNS	PERCENT OF AGI	PERCENT OF RETURNS	EFFECTIVE TAX RATE	EFFECTIVE TAX RATE
LOSS	1.23%	-0.92%	0.00%	0.00%	0.00%
0 TO 10000	21.15%	3.35%	0.83%	0.95%	0.14%
10001 TO 20000	19.76%	8.61%	1.95%	2.50%	1.06%
20001 TO 30000	14.48%	10.58%	2.26%	2.59%	1.80%
30001 TO 40000	11.43%	11.78%	2.52%	3.06%	2.18%
40001 TO 50000	9.48%	12.55%	2.69%	3.52%	2.38%
50001 TO 60000	6.67%	10.82%	2.77%	3.76%	2.51%
60001 TO 70000	4.88%	9.34%	2.99%	4.03%	2.80%
70001 TO 80000	3.52%	7.78%	3.28%	4.18%	3.14%
80001 TO 90000	2.31%	5.80%	3.53%	4.26%	3.42%
90001 TO 100000	1.58%	4.42%	3.73%	4.44%	3.64%
100001 TO 150000	2.61%	9.11%	4.06%	4.66%	3.98%
150001 TO 200000	0.51%	2.54%	4.56%	4.91%	4.48%
200001 TO 300000	0.23%	1.59%	4.86%	5.06%	4.75%
300001 TO 400000	0.09%	0.92%	5.05%	5.12%	4.98%
OVER 400000	0.08%	1.73%	5.24%	5.33%	5.12%
TOTAL	100.00%	100.00%			

* Two brackets 3.2%-- 0 to 25000 (non-joint) & 0 to 50000 (joint)
 5.7%-- over 25000 (non-joint); over 50000 (joint)
 Apportions Non-residents tax method 1
 \$3000 personal exemption

MEMORANDUM

State of Alaska

TO: Vincent D. Wright
Chief of Research
Department of Revenue

DATE: December 31, 1986

FILE NO.:

THRU:

TELEPHONE NO.: 465-2173

SUBJECT: Individual Income Tax
Report

FROM: Mary Ellen Frank, Economist *MEF*
David Tonkovich, Economist *DT*
Al Zangri, Economist *AZ*

The enclosed report contains an analysis of three differently structured individual income taxes based on two possible economic scenarios that might occur in the State.

The first tax structure is based on the old state law, including tax rate tables, that existed in 1978-1979 but incorporates federal law changes that have occurred since that time. The state law was "piggybacked" to Federal law. The second tax structure is more closely akin to the Federal tax structure and adopts tax rate tables similar to the latest Federal law. The third tax structure is flat in nature and largely independent of the existing Federal system. The latter two approaches are constructed to generate roughly the same amount of revenue as the first, in the first year only, and are thus revenue neutral. For succeeding years beyond FY88 the taxes are not revenue neutral. The significant aspect of these three approaches and what one should focus on is the differing internal structures i.e. consideration of inclusions, exclusions, deductions, and exemptions.

The model that we designed can be modified to change these tax structures as well as apply different tax tables. We do not recommend any particular tax structure but simply lay out three possible alternatives that the decision makers may wish to consider.

MEF:DT:AZ:mkw

Enclosure

personal copy

REVENUE ALTERNATIVES

Individual Income Tax

Prepared by

Alaska Department of Revenue
Research Section
Vincent D. Wright

Mary Ellen Frank, Economist
Dave Tonkovich, Economist
Al. Zangri, Economist