HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

THIRTIETH LEGISLATURE - FOURTH SPECIAL SESSION

BY THE HOUSE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

Introduced:
Referred:

A BILL

FOR AN ACT ENTITLED

"An Act imposing a tax on wages and net earnings from self-employment; relating to the administration and enforcement of the wages and net earnings from self-employment tax; and providing for an effective date."

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

* Section 1. AS 43.05.045(a) is amended to read:

(a) Except as provided in AS 43.45.051(f), or unless [UNLESS] an exemption is granted under (b) of this section, a taxpayer required to submit a return or report for a tax levied under this title or for any other tax administered by the department shall submit the return or report electronically in a format prescribed by the department. Failure to comply with this section may result in a civil penalty under AS 43.05.220(f). If a law under this title requires a report or return or a portion of a report or return to be in writing, an electronically filed report or return satisfies this section. A taxpayer shall submit attachments to a report or return required under this title electronically.
Sec. 2. AS 43.45 is amended by adding new sections to read:

Chapter 45. Wages and Net Earnings Tax.

Sec. 43.45.011. Tax imposed. (a) A tax is imposed on an individual with
wages from a source in the state or net earnings from self-employment from a source
in the state. The tax is 1.5 percent of

(1) wages from a source in the state; and

(2) net earnings from self-employment from a source in the state.

(b) When calculating earnings from self-employment, a taxpayer may not
make the deduction for net operating losses provided under 26 U.S.C. 172(b)(1)(A)
(Internal Revenue Code).

(c) Notwithstanding any other provision of this section, for a taxable year, the
tax imposed on an individual may not exceed the greater of twice the value of the
permanent fund dividend determined under AS 43.23.025 for the calendar year
preceding a taxpayer's taxable year, or $2,200 multiplied by the percentage increase in
the Consumer Price Index for all urban consumers, all items, for the Anchorage
metropolitan area from July 1, 2017 using the base period 1982-84=100, compiled by
the Bureau of Labor Statistics, United States Department of Labor.

Sec. 43.45.021. Net earnings from self-employment and wages from a
source in the state. (a) Net earnings from self-employment from a source in the state
subject to tax under AS 43.45.011 include net earnings from self-employment that are

(1) a taxpayer's distributive share of an item of income, gain, loss, or
deduction of a partnership, as determined under AS 43.45.031;

(2) income or loss of a business conducted by a taxpayer, other than
income or loss from a partnership, as determined under AS 43.45.031;

(3) income derived from a business, trade, profession, occupation, or
employment carried on in the state, including income derived from a business, trade,
profession, occupation, or employment carried on in the state by an individual who
maintains or operates an office, shop, store, warehouse, boat, plane, factory, agency,
or other place where the individual's affairs are systematically and regularly carried
on, regardless of other transactions carried on outside the state; this paragraph does not
include income from an activity of an individual whose presence in the state is casual,
isolated, inconsequential, or ancillary to out-of-state activities, except that, if a
business, trade, profession, occupation, or employment is carried on partly in and
partly outside the state, other than for the rendering of purely personal services by the
individual, the taxable income derived from or connected with a source in the state is
determined under AS 43.19 (Multistate Tax Compact);

(4) income or a gain from the disposition of an asset if the acquisition,
management, or disposition of the asset constitutes an integral part of the taxpayer’s
regular trade or business operation;

(5) income from the transmission, broadcast, distribution, or
dissemination of a service directly or indirectly attributable to the performance in the
state of an athlete, entertainer, singer, musician, dancer, comedian, magician,
performing artist, actor, actress, or similar person, including syndication fees.

(b) A deduction included in a taxpayer’s net earnings from self-employment
must be based solely on income or a gain, loss, or deduction derived from or
connected with a source in the state. A taxpayer shall treat a deduction under this
subsection in the same manner as the corresponding federal deduction, unless the
department requires otherwise in regulation.

(c) Wages from a source in the state subject to tax under AS 43.45.011 include
wages that are earned while an individual is physically present in the state. The
department shall adopt regulations to implement and interpret this subsection.

Sec. 43.45.031. Business conducted by a taxpayer; income derived from or
connected with a source in the state. (a) The department shall adopt regulations
governing the amount of income or a gain, loss, or deduction from a business
conducted by a taxpayer that is derived from or connected with a source in the state
for purposes of determining a taxpayer’s net earnings from self-employment.
Regulations adopted under this subsection must be consistent with AS 43.19
(Multistate Tax Compact) and AS 43.45.021.

(b) The department shall adopt regulations governing the amount of income or
a gain, loss, or deduction that is derived from or connected with a source in the state
and is included in a taxpayer’s distributive share of a partnership for purposes of
taxation under this chapter.
(c) The department may by regulation require a taxpayer to allocate rather than apportion income or a gain, loss, or deduction under this section.

Sec. 43.45.041. Tax withholding on wages of individuals. Every employer making payment of wages

(1) 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 taxable year;

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

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

(4) shall furnish to the employee on or before January 31 of the succeeding year, or within 30 days after a request by the employee after the employee's or individual's termination if the 30-day period ends before January 31, a written statement on a form prescribed by the department showing

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

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

(C) the total amount of wages for the taxable year; and

(D) the total amount deducted and withheld as tax under this chapter for the taxable year.

Sec. 43.45.051. Returns and payment of taxes. (a) A person required to file a return under this chapter shall file the return on a form or in a format prescribed by the department. The return is due to the department at the same time and in the same manner, including extensions, as the taxpayer's federal income tax return to the United States Internal Revenue Service. A return filed under this chapter must be made under oath and on penalty of perjury.

(b) A self-employed taxpayer shall file with the department a return setting out

(1) the amount of tax due under this chapter; and
(2) other information necessary to carry out this chapter, as required by the department in regulation.

(c) The total amount of tax imposed under this chapter is due and payable to the department at the same time and in the same manner as the federal individual income tax payable to the United States Internal Revenue Service.

(d) A taxpayer, upon request by the department, shall furnish to the department a true and correct copy of a return that the taxpayer has filed with the United States Internal Revenue Service.

(e) A taxpayer shall notify the department in writing of an alteration in, or modification of, the taxpayer's federal income tax return and of a recomputation of tax or determination of deficiency, whether with or without assessment. A full statement of the facts must accompany the notice. A taxpayer shall file the notice not later than 60 days after the final determination of the alteration, modification, recomputation, or deficiency and shall pay any additional tax due under this chapter at that time. In this subsection, "final determination" means the time that an amended federal return is filed, a notice of deficiency or an assessment is mailed to the taxpayer by the Internal Revenue Service, and the taxpayer has exhausted rights of appeal under federal law.

(f) An individual is not required to file a return under this section electronically, but a person employed to prepare and file income tax returns shall file the returns for those individuals electronically.

(g) The department shall adopt regulations to allow a partnership to withhold a partner's income subject to tax under this chapter. A partnership that elects to withhold income under regulations adopted under this subsection may file a composite return.

**Sec. 43.45.061. Determination of taxable year and method of accounting.**

(a) For purposes of the tax imposed under this chapter, a taxpayer's

(1) taxable year is the same as the taxpayer's taxable year for federal income tax purposes; and

(2) method of accounting is the same as the taxpayer's method of accounting for federal income tax purposes.

(b) The department shall adopt regulations to determine the taxable income of a taxpayer whose method of accounting changes during a taxable year or between
taxable years.

Sec. 43.45.071. Refund of overpayments. (a) If an individual pays to the department, directly or through withholding by an employer, an amount exceeding the total tax imposed under this chapter during a calendar year and the individual applies for a refund in accordance with regulations adopted by the department, the department shall refund the overpayment to the individual.

(b) Interest on an overpayment may not be allowed under AS 43.05.280 if the department refunds the overpayment within 90 days after the date the individual correctly files the refund claim.

(c) The department may adopt regulations to coordinate refunds of overpayments under this section with refunds of employment security contributions under AS 23.20.165.

(d) An individual may apply for a refund under this section only during the calendar year immediately following the calendar year in which the excess was paid.

Sec. 43.45.081. Report of payments to self-employed individuals. A person required to report a payment to a self-employed individual to the federal government under 26 U.S.C. shall also report that payment to the department in accordance with regulations adopted by the department.

Sec. 43.45.091. Administration. (a) The department shall adopt regulations and forms necessary to implement and interpret this chapter, including regulations and forms for the electronic filing and payment of tax due under this chapter. Federal regulations issued under the Internal Revenue Code shall be considered persuasive authority in interpreting any provision of the Internal Revenue Code on which the tax imposed under this chapter relies, whether or not a federal regulation has been specifically incorporated into a department regulation, unless the federal regulation

(1) conflicts with a provision of this chapter;

(2) conflicts with a regulation adopted by the department; or

(3) is inconsistent with the purposes of this chapter.

(b) The tax collected by the department under this chapter shall be deposited into the general fund and accounted for separately. Nothing in this section creates a dedicated fund.
(c) The department shall, if it will result in cost savings for the state in the administration of the tax, for employers in the administration of the tax, or both, coordinate collection and reporting of the tax imposed under this chapter with the collection and reporting of employment security contributions by the Department of Labor and Workforce Development, including permitting the Department of Labor and Workforce Development to collect the tax payments and remit them to the department.

Sec. 43.45.101. References to Internal Revenue Code. (a) Unless the provision is inconsistent with this chapter or a regulation adopted under this chapter, the provisions of the Internal Revenue Code as now in effect or hereafter amended that are mentioned in this chapter are incorporated in this chapter by reference and have effect as though fully set out in this chapter.

(b) Sections 26 U.S.C. 6654, 6656, 6662, 6664, 6694, 6695, 6700 - 6702, 6707, 6713, 7201, 7202, 7206, 7207, 7216, 7407, and 7408 (Internal Revenue Code), as those sections read on January 1, 2017, are adopted by reference as a part of this chapter.

(c) When provisions of the Internal Revenue Code incorporated by reference as provided in (a) and (b) of this section refer to rules and regulations adopted by the United States Commissioner of Internal Revenue, or hereafter adopted, they are regarded as regulations adopted by the department under and in accordance with the provisions of this chapter, unless and until the department adopts specific regulations in their place conformable with this chapter.

Sec. 43.45.111. Information released to a banking institution. Notwithstanding AS 43.05.230, information on an individual tax return may be released to a banking institution to verify the direct deposit of a tax refund or correct an error in that deposit.

Sec. 43.45.151. Definitions. In this chapter,

(1) "employee" has the meaning given in 26 U.S.C. 3401;

(2) "employer" has the meaning given in 26 U.S.C. 3401;

(3) "Internal Revenue Code" means the Internal Revenue Code of 1986 (26 U.S.C. 1 et seq.), as amended, and regulations issued thereunder, if the regulations
are consistent with this chapter;

(4) "net earnings from self-employment" has the meaning given in 26 U.S.C. 1402;

(5) "partnership" means an entity as defined in 26 U.S.C. 7701(a) (Internal Revenue Code) and includes a limited liability company and a similar entity treated as a partnership for federal income tax purposes;

(6) "taxable year" means the calendar year or a fiscal year ending during the calendar year;

(7) "taxpayer" means an individual subject to the tax imposed under this chapter;

(8) "wages" has the meaning given in 26 U.S.C. 3401.

* Sec. 3. The uncodified law of the State of Alaska is amended by adding a new section to read:

REGULATIONS. The Department of Revenue may adopt regulations to implement sec. 2 of this Act. The regulations take effect under AS 44.62 (Administrative Procedure Act), but not before the effective date of sec. 2 of this Act.

* Sec. 4. Section 3 of this Act takes effect immediately under AS 01.10.070(c).

* Sec. 5. Except as provided in sec. 4 of this Act, this Act takes effect January 1, 2019.
September 22, 2017

The Honorable Bryce Edgmon
Speaker of the House
Alaska State Legislature
State Capitol, Room 208
Juneau, AK 99801-1182

Dear Speaker Edgmon:

Under the authority of art. III, sec. 18, Constitution of the State of Alaska, I am transmitting a bill relating to taxation of wages and earnings in the state.

The bill would impose a tax on wages and net self-employment income earned in Alaska by resident and nonresident individuals. The tax rate would be 1.5 percent annually, and would be capped at the greater of $2,200 (adjusted for inflation) or two times the amount of the permanent fund dividend distributed in the previous calendar year. The tax would take effect in calendar year 2019 and is expected to raise $300-325 million by FY2020.

Under this bill, employers would be required to pay to the Department of Revenue withholdings that approximate the amount of the tax. Through regulation, the withholding would stop when the statutory cap is reached. This protects individuals working multiple jobs and insulates vulnerable populations, such as single parents, by limiting each Alaskan’s tax burden, and keeps us the lowest-taxed state in the nation.

This tax is a simple and efficient measure to address our state’s budget shortfall. Over the past six years, state budgets have been reduced by 44 percent, but state revenues have fallen faster. To cover the gap, key state savings accounts have been drawn down by $14 billion, and are expected to be depleted by the end of FY 2019. It is vital that these savings accounts not go any lower and in accordance with the constitution must be replenished over time. New revenues are needed to support critical public services such as education, public safety, and reliable transportation.

We need a fiscal plan that includes prudent operating and capital budgets, the judicious use of investment earnings, and revenues necessary to balance the budget. This tax will get us closer to balancing the state’s budget and enable Alaska’s economy to grow.

Sincerely,

Bill Walker
Governor

Enclosure
Fiscal Note

State of Alaska
2017 Legislative Session

Identifier: DOR-TAX-09-21-17
Title: Head Tax
Sponsor: Rules by Request of the Governor
Requester: Governor

Department: Department of Revenue
Appropriation: Taxation and Treasury
Allocation: Tax Division
OMB Component Number: 2476

Expenses/Revenues
Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

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<th>OPERATING EXPENDITURES</th>
<th>FY2018 Appropriation Requested</th>
<th>Included in Governor's FY2018 Request</th>
<th>Out-Year Cost Estimates</th>
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<td>Grants &amp; Benefits</td>
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<tr>
<td>Total Operating</td>
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<td>2,700.0</td>
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</table>

Fund Source (Operating Only)

| 1004 Gen Fund (UGF)    | 1,000.0                         | 0.0                                  | 2,700.0                | 5,200.0                   |
| Total                  | 1,000.0                         | 0.0                                  | 2,700.0                | 5,200.0                   |

Positions

| Full-time | 5.0 |
| Part-time | 20.0 |
| Temporary | 40.0 |

Change in Revenues

| 1250 UGF Rev (UGF) | 160,000.0 | 320,000.0 | 320,000.0 | 320,000.0 | 320,000.0 |
| Total             | 0.0       | 0.0       | 160,000.0 | 320,000.0 | 320,000.0 |

Estimated SUPPLEMENTAL (FY2017) cost: 0.0 (separate supplemental appropriation required)
Estimated CAPITAL (FY2018) cost: 10,000.0 (separate capital appropriation required)

ASSOCIATED REGULATIONS
Does the bill direct, or will the bill result in, regulation changes adopted by your agency? Yes
If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/19

Why this fiscal note differs from previous version:
Not applicable; initial version.
The funds shown in the "FY18 Appropriation Requested" column will be a FY18 supplemental request.
The funds shown in the Estimated Capital cost row will be FY19 funds.

Prepared By: Ken Alper, Director
Division: Tax Division
Approved By: Commissioner Sheldon Fisher
Agency: Department of Revenue

Phone: (907)465-8221
Date: 09/21/2017 12:00 PM

Printed 9/22/2017
FISCAL NOTE ANALYSIS

STATE OF ALASKA
2017 LEGISLATIVE SESSION

BILL NO. 0

Analysis

Bill Analysis
The bill establishes a payroll tax on both wages and self-employment income earned in Alaska.

It applies equally to both residents and non-residents. The amount of tax is equal to one and one half percent (1 1/2%), with a maximum tax "cap" equal to two times the permanent fund dividend distributed in the previous calendar year. If the dividend is less than $1,100 as adjusted for inflation, the maximum cap is $2,200 instead.

The tax will be withheld by employers and remitted to the state. Employers of contract employees who are required to report this to the federal government, will be required to send comparable information to the state. Self-employed individuals shall report and pay directly to the state.

The Department of Revenue is given broad powers to administer the tax, including drafting regulations, determining what business income is from a source in the state and thus subject to the tax, collecting withholding taxes, and paying tax refunds. Portions of the internal Revenue Code are adopted by reference.

Revenue Impact
The Tax Division has modified their existing income tax revenue model to estimate the approximate number of taxpayers and their associated tax burden. The bill would take effect on January 1, 2019, meaning that the tax for calendar year 2019 would be due in early 2020.

At full implementation in FY2020, revenue will be about $320 million/year. Revenue in FY2019 will be half that number, $160 million, based on the tax taking effect in the middle of the fiscal year. Impact could be partially mitigated because this will likely qualify as a state income tax for federal tax purposes, meaning it would be deductible on Schedule A of form 1040. Therefore, Alaskans who itemize could be able to reduce their federal taxable income by the amount of their state tax.

Implementation Cost
Adding a broad based tax would be a significant challenge to the Tax Division. We have recently completed implementation of Tax Revenue Management System (TRMS), an integrated online tax application used by both taxpayers and administrators for the 25 tax programs currently overseen by the Division. We expect to engage FAST Enterprises, the TRMS contractor, to build a new module for this tax into TRMS.

Among the supplemental funds requested for FY2018, the Department intends to use about $300.0 to begin the implementation process. With this, we will engage a contractor with experience building a statewide tax structure impacting individual workers. An essential deliverable of the outside contract will be an implementation plan that includes staffing, infrastructure, and additional outreach needs. We will also contract for more advanced data services in order to more accurately forecast future revenues.

The $10,000.0 capital request reflects an estimate for our contract with FAST to add the new tax module as well as the Department's other short term implementation costs. This is a multi-year process and much of the actual spending will not occur until after we begin collecting revenues. In addition to the software development, this will require integration with national accounting and tax software vendors in order to update programs such as TurboTax and QuickBooks to incorporate Alaska. In addition to the tax return filing and examination modules, the contractor will have to provide for the associated databases, forms, communications, and integration with our existing imaging, accounting, and collections systems.
Analysis:

Currently, the Department of Labor administers the Employment Security Law, which establishes a relationship for data and tax collection with most employers in Alaska. It is possible that some efficiencies could be achieved by linking these databases. However, the proposed legislation adds at least three major functions that do not exist within the Employment Security Law. These are: receiving and processing individual (rather than employer aggregated) tax returns, receiving direct payment from self-employed individuals, and providing refunds in the event of overpayment.

The department envisions a gradual ramping up of the staff needed to collect and administer the tax. At full implementation, we will have about 40 additional staff. We expect the new staff to be roughly split between our Juneau and Anchorage offices. The staffing need is substantially less than what would be expected for a full income tax for two major reasons. First, the complex task of apportioning income among multiple states is greatly simplified by the bill structure. And second, the size of the tax cap reduces the expected need for complex audits of high income individuals.

Additional travel is largely for public education efforts, as well as the need to train new staff on the tax management system. Cost for Services reflects primarily internal "core services" paid to other state agencies, due to the substantial growth in the overall size of the tax division staff. Commodities are primarily subscription data services; the Tax Division anticipates needing to procure additional data to better forecast revenue from individual Alaskan and nonresident worker taxpayers.

The department anticipates that taxpayers will file online at approximately the rate currently achieved by the Permanent Fund Dividend Division. If a substantially larger portion choose to submit paper returns, the staffing needs would increase accordingly.

Throughout the six-year period covered by this fiscal note, we anticipate total implementation costs, operating plus capital, to be less than 2.5 percent of additional state revenue.

An initial analysis of the staff needs within the Tax Division to implement a personal income tax is as follows:

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<th>Title</th>
<th>FY18</th>
<th>FY19</th>
<th>FY20+</th>
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<td>Total FT</td>
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