

THE TAXONOMIST

Alaska's Infinite Regress

By Robert S. McIntyre

As they're hardly shy about telling us (over and over again), most Republican politicians these days define themselves by their anti-tax fervor. But they're much less fond of admitting how horribly regressive most of their tax proposals actually are.

In fact, recognizing that an informed public generally likes progressive taxes, Republicans typically lie about the impact of their tax ideas. Take, for example, Sen. Jon Kyl (R-Ariz.), who recently claimed on the Senate floor that the federal estate tax on the largest two percent of estates isn't paid by rich "fat cats," it's paid by "schoolteachers, . . . airline pilots . . . and mechanics." Or President George Bush, who insisted that his tax cuts for the rich will mainly reduce taxes for single mothers making \$22,000 a year. Or House Majority Leader Dick Armey (R-Tex.), who boldly asserts that his proposal for a flat-rate wage tax, exempting all capital income, is "fair" and "progressive."

In a notable exception to this typical lack of candor, here's the story of how the Republican-dominated Alaska legislature almost adopted an explicitly regressive state income tax.

Alaska is one of only two states that lack both a state-wide sales tax and a personal income tax (the other is New Hampshire). Instead, courtesy of levies on Prudhoe Bay oil, Alaskans are actually paid by their government to live there, through an annual oil-funded "dividend," equal to \$1,850 per resident last year.

But this year, with declining oil revenues, Alaska found itself with an \$826 million shortfall in its general fund for the current fiscal year and an expected \$963 million for the fiscal year that starts in July. That confronted Alaska taxophobic lawmakers with some ugly choices. What to do?

Since cutting the hugely popular oil dividend was a political non-starter, there seemed to be only two options: a statewide sales tax or a personal income tax—the latter having last been seen in Alaska prior to 1979 when it was repealed as the flood of oil money began.

Given the typical GOP aversion to progressive taxes, the sales tax alternative at first looked the least unattractive. In fact, a 3-percent sales tax—which featured taxes on groceries and in an added bow to regressivity, would have applied only to the first \$2,000 of any purchase—was reported out of the House tax-writing committee. But it soon ran into trouble because many of Alaska's cities and towns already impose their own local sales taxes, with rates as high as 7 percent. The prospect of a total sales tax rate of 10 percent in some areas caused many local businesses, along with the Alaska Municipal League, to oppose the sales tax plan, and

ultimately it never came to a floor vote.

Of course, the idea of restoring a state income tax caused even more heartburn for Republican legislators. Lame-duck Democratic Governor Tony Knowles suggested an income tax based on the federal system, with generous exemptions and marginal rates on taxable income ranging from 2 percent up to as high as 7.7 percent on very large earnings. That was quickly rejected on anti-fairness grounds. Even a flat-rate tax on federal adjusted gross income was deemed far too progressive.

To break the stalemate, John Davies, a liberal Democrat House member from Fairbanks, put forward an unusual "compromise" plan specifically designed to gain Republican support. Davies's plan, based on federal AGI with no exemptions, included slightly graduated rates over the low- and middle-income ranges—starting at 1.35 percent on the first \$10,000 in income and rising to a peak of 2.7 percent between \$20,000 and \$50,000. To satisfy Republicans' zeal to protect the wealthy, however, marginal rates sharply declined thereafter, eventually falling to only 0.05 percent for incomes above \$1 million.

Davies touted his upside-down income tax to Republicans as mimicking the distributional effects of a sales tax, at least for the GOP's most-favored constituents. The pitch was successful, as 13 of the 28 Republicans joined with all but one of the 12 Democrats (who reasoned that the plan was better than an actual sales tax) to pass the Davies bill in the House by a 24-15 margin.

Alas for the annals of tax humor, when the bill reached the Alaska Senate (14 Republicans, six Democrats), Republicans came up with an even more congenial—and typical—answer to the state's budget problem. The Senate GOP plan, which was ultimately enacted, included only a token tax component, a dime-a-drink alcohol tax expected to raise \$20 million next year. The rest of the shortfall was covered by borrowing against the future, slashing the state's budget reserve by almost half compared to the start of fiscal 2001-02.

The *Anchorage Daily News* summarized public opinion about the budget agreement this way: " 'That sucks,' said Jason Borland, holding a six-pack of Coors outside the Kmart liquor store at Northway Mall." Imagine the reaction, however, if Alaskans had ever actually seen state income tax forms with anti-graduated rates.

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