

# **Taxation in Alaska: History, Theory, and Possible Futures**

**Presentation to Alaska Municipal Tax Conference**



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# Hello. Who am I?

- From NJ; first came to Alaska in 1991 as a grad student
- Long time legislative staff, since 2006
  - Specialist in Resource / Fiscal / Budget issues
- Tax Director during the Walker Administration, 2014-2018
  - Oil Tax Credit reform bills
  - Tax and Fiscal Policy, Permanent Fund Restructuring
  - 2017 Income Tax bill (Passed House)
- Consulting in recent years, including for AkML
  - Sales Tax system startup
  - Fiscal Policy Working Group

# Hello. Who am I?

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- Currently work at the Legislature, for Rep. Andy Josephson, House Finance Co-Chair
- These are controversial issues and some of what is in this presentation is my opinion

**I am not speaking for my boss, or for the House Majority**

# Contents: What I'm Talking About

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- Alaska's History as a Resource State
- Oil Tax History
- Reaction to Major Revenue Declines, 2014-2018
- Life with the POMV, 2019-2025
- Short- and medium-term expectations
- Contemplating broad-based taxes

# Alaska as a Resource State

# Alaska has always been a Resource State

## Since the first western contact in 1740, Alaska's economy has been driven by eras of large-scale resource development

- Furs 1740s (Aleutian/Pribilof)
  - Whaling 1840s (Gulf of AK, Arctic)
  - Salmon 1870s (Initially Southeast)
  - Gold 1880s (Juneau, Nome, Fairbanks)
  - Copper 1910s (Kennebecott)
  - Timber 1940s (Southeast)
  - Cook Inlet Oil 1950s
  - North Slope Oil 1970's
- **Development has always required large scale Outside capital, with inevitable tension between:**
    - **Needing to recruit that capital to Alaska with a reasonable expectation of a return on investment, while also**
    - **Sharing the resulting wealth with the state's permanent residents**

# The Debate over Statehood

**Statehood for Alaska was opposed by many who believed we would never be able to pay for our own government**

**Three things that moved the needle in Washington:**

- 1. Passage of a personal and corporate income tax by Gov. Ernest Gruening, in 1949**
- 2. A complex, intelligently run constitutional convention, in 1955**
- 3. Swanson River oil discovery in Cook Inlet, in 1956**

# The Debate over Statehood

**After statehood, Alaska was able to “select” 103 million acres of federal land**

**We had good geologists at DNR at the time, who selected Prudhoe Bay**

**For most of the oil on the North Slope, not only do we collect taxes (like any sovereign). We also collect royalty (like a landowner)**

**The Alaska Permanent Fund is entirely funded by royalties and other landowner rights, not by taxes**

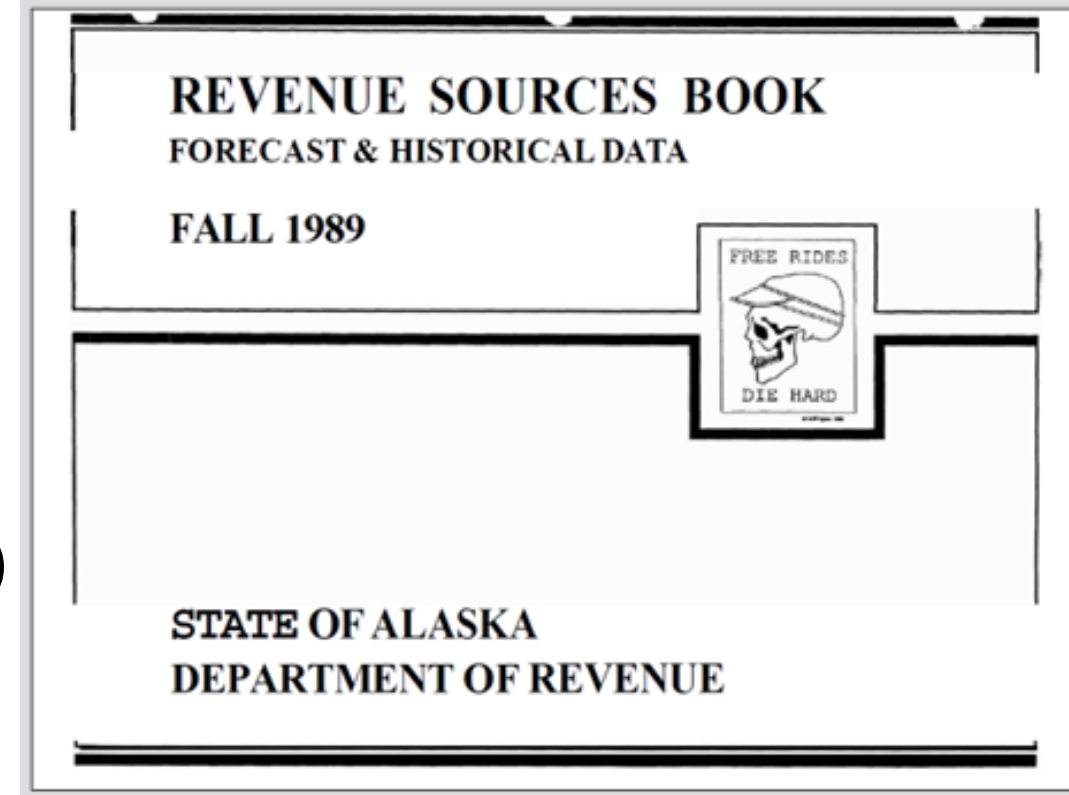
# Eras of Alaska's modern economic history

## **Since the first shipments through TAPS in 1977**

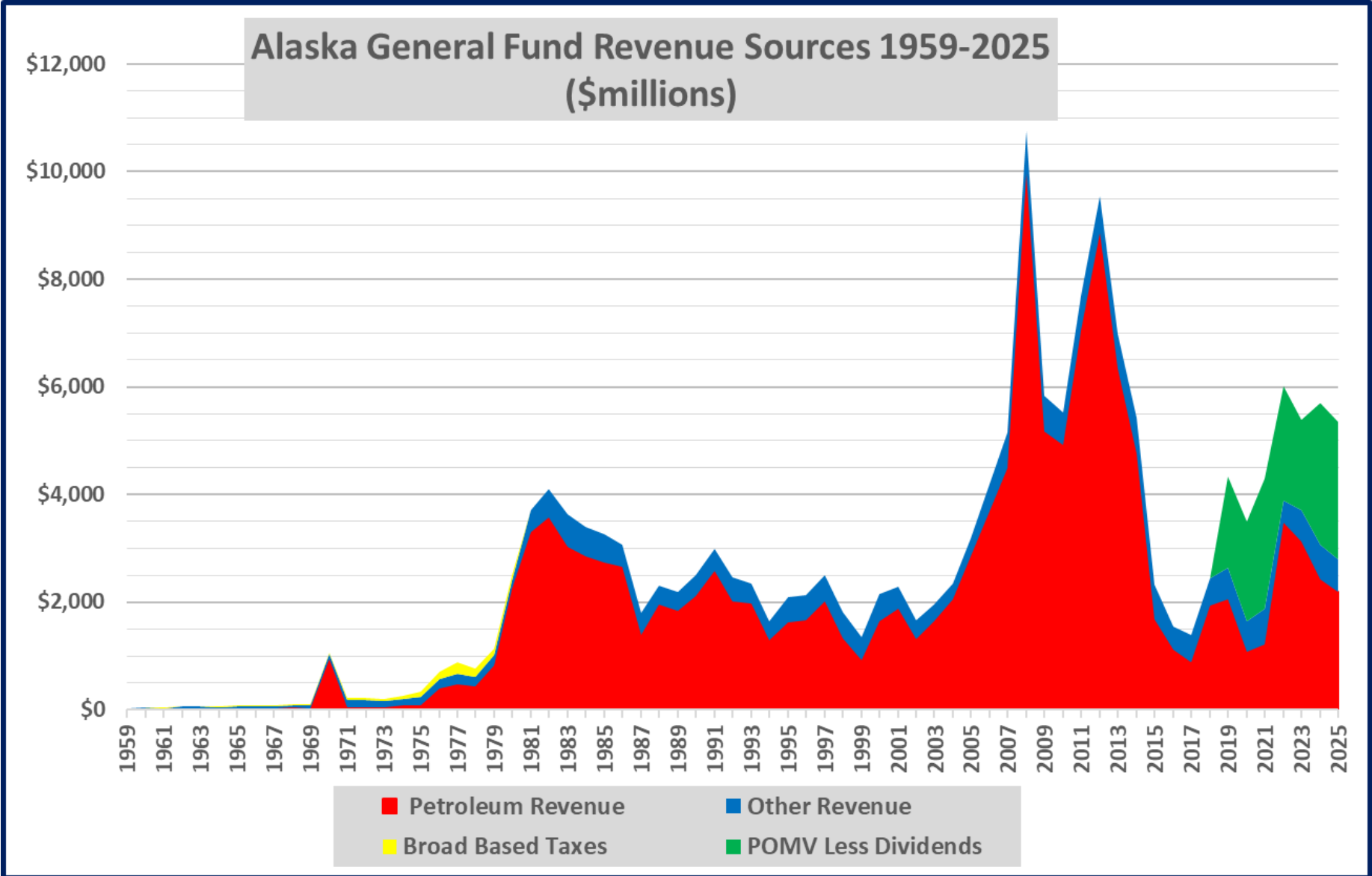
- 1977-1985 "Boom / Build / Spend"
- 1986-2000 "Bust / Retrench / Adapt"
- 2001-2005 "Panic / Plan / Posture"
- 2006-2014 "Surplus / Spend / Save"
- 2015-2018 "Crash / Cut / Draw down savings"
- 2019- "POMV / unfinished business"

# Alaska Ran on Oil Revenue, 1977-2018

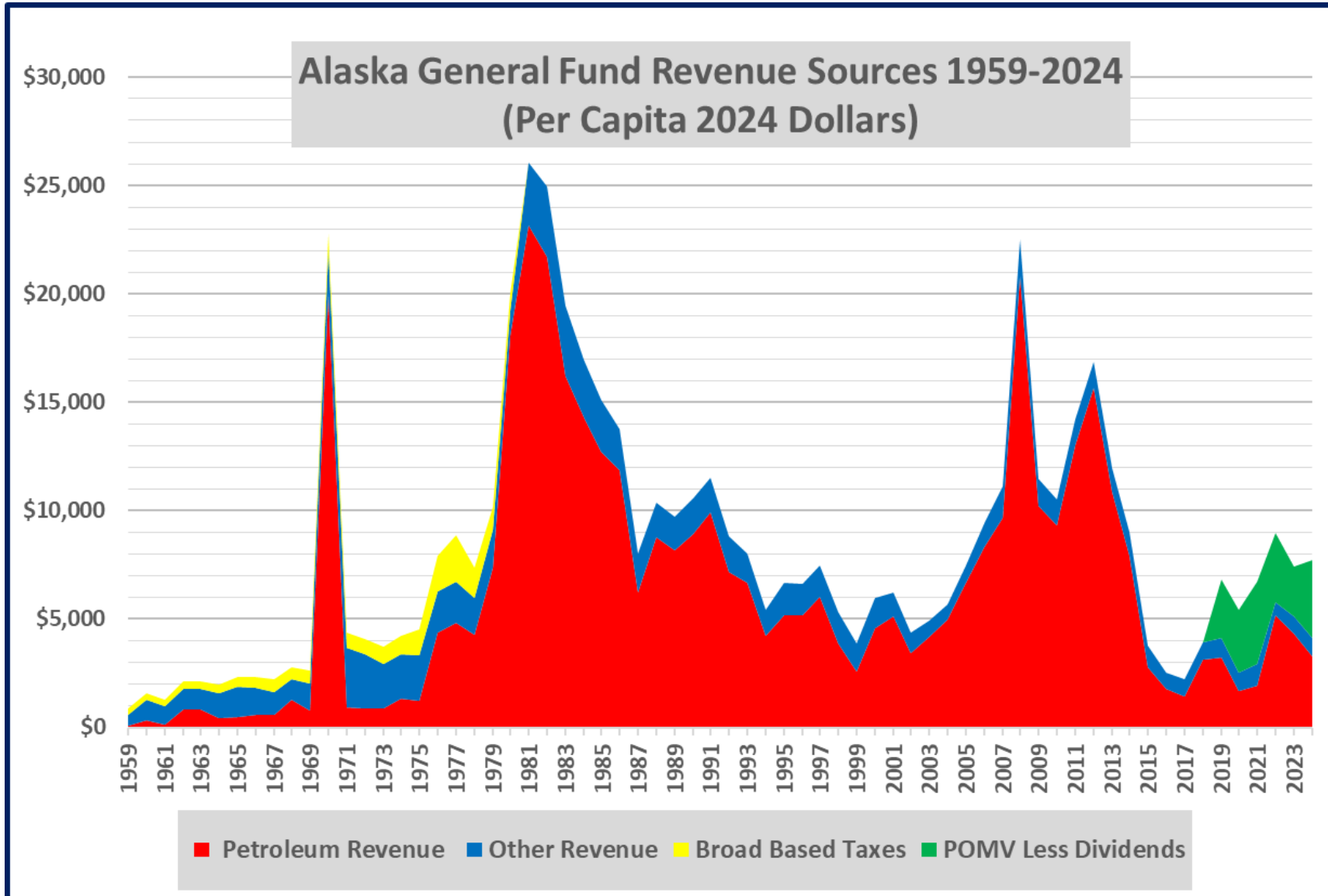
- Personal Income tax repealed 1980
- Early years; regional and partisan fights
- Price decline and tax formula issues in mid-late 1980s, big revenue declines
- 1990 royalty settlement funded the Constitutional Budget Reserve Fund (CBRF)
- CBRF used as a safety valve to routinely balance budgets ~1994-2005
- CBRF paid back 2008-2010 during high prices / big surpluses
- Savings again drawn down 2015-2020



# Alaska's Revenue has Changed Dramatically



... although it looks different depending on how you show it



# Quick History of Oil Taxes

# Four Major Oil and Gas Revenue Sources

## **Royalty**

Landowner's share. Most North Slope production is on State land. (Willow is not.) At least  $\frac{1}{4}$  of royalties go to the Permanent Fund

## **Property (ad valorem) Tax**

Pipeline, Equipment, Facilities.

About 80% credited back to local governments

## **Production (severance) Tax**

Based on net profits; most of the conflict in recent years is over this tax. North Slope tax is 35% less a "per-taxable-barrel" credit, with a gross minimum tax "floor."

## **Corporate Income Tax**

Taxes remaining profit after production tax, based on global apportionment. Rate is 9.4%, but effectively closer to 5%.

Only traditional "C" corporations pay this tax

**Since statehood, total state oil & gas revenue = \$164 billion**

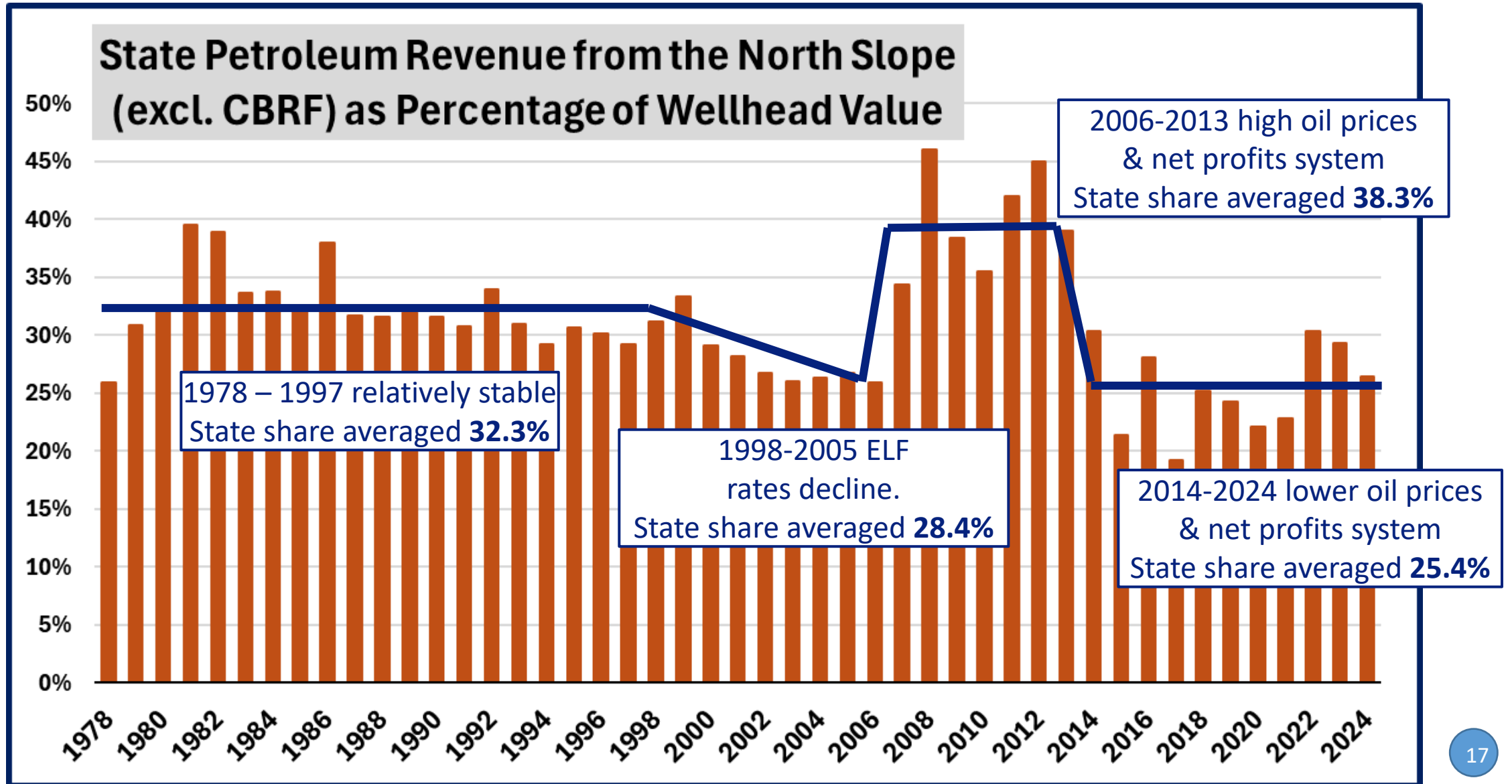
# Production Tax was relatively stable before 2005

- Gross tax 1% to 8% before 1977, with a minimum “cents per barrel”
- Economic Limit Factor (ELF), 1977, a base gross tax of 12.25% with a per-field multiplier based on well productivity
- ELF raised to 15% as part of 1981 deal to settle a corporate income tax lawsuit
- Formula tweaked in 1989 after Exxon Valdez spill to raise rates on largest fields
- Rates tended to get lower over time as more wells were drilled and field production naturally declined
- Early 2000s most fields including Kuparuk were paying less than a 1% tax
- 2000-05 Various legislative reform efforts for “fair share”

# More frequent production tax changes 2005-2017

1. 2005: Gov. Murkowski aggregates Prudhoe Bay satellite fields within ELF
2. 2006: Petroleum Production Tax "PPT" changed tax from gross value to net profits
3. 2007: Alaska's Clear and Equitable Share "ACES" corrects shortfalls due to bad cost estimates in PPT. Major tax increase
4. 2010: Cook Inlet Recovery Act "CIRA" provided additional tax credits outside North Slope targeted at Southcentral gas supply issues
5. 2013: SB21 was a major tax cut primarily at higher prices and providing "new oil" benefits
6. 2016: HB247 began tax credit reform, phasing out Cook Inlet credits and limiting "new oil" benefits
7. 2017: HB111 eliminated cash credits, replaced with carry-forward losses

# The State's share of oil value has varied over time



# Major Outstanding Issues

- Debate on “fair share” at different price points
- Misalignment between 35% offset for spending and a much lower effective tax rate on profits
- Equity between major producers and new explorers
- Large future tax offsets due to carry-forwards from new field development
- Increasing number of “S” corporations operating in Alaska, exempt from the corporate income tax
- Federal royalty sharing rules for growing NPRA development
- Dependence on gross minimum tax over wide price range and during new field cost recovery
- Limited “upside” to the state during price spikes
- Little transparency

# Reaction to Revenue Declines: 2014-2018

# Where We Are

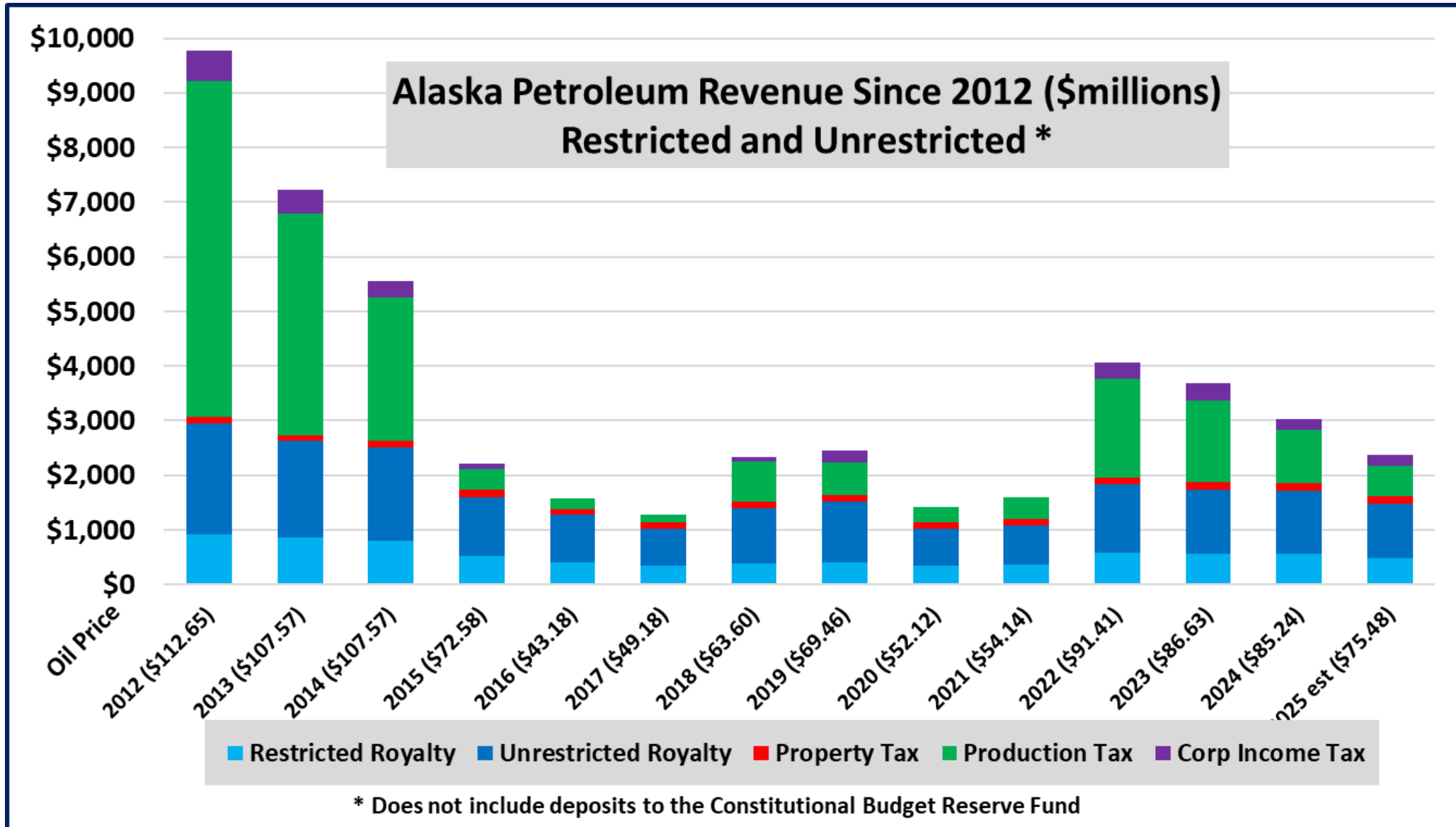
**After oil prices collapsed in late 2014, Alaska needed four things to establish a sustainable budget:**

1. Major budget cuts (implemented 2015-2018).
2. Structured use of Permanent Fund earnings (SB26 passed 2018).
3. Revised Dividend formula that works with new POMV and our fiscal reality
4. New revenues to fill any remaining gap.

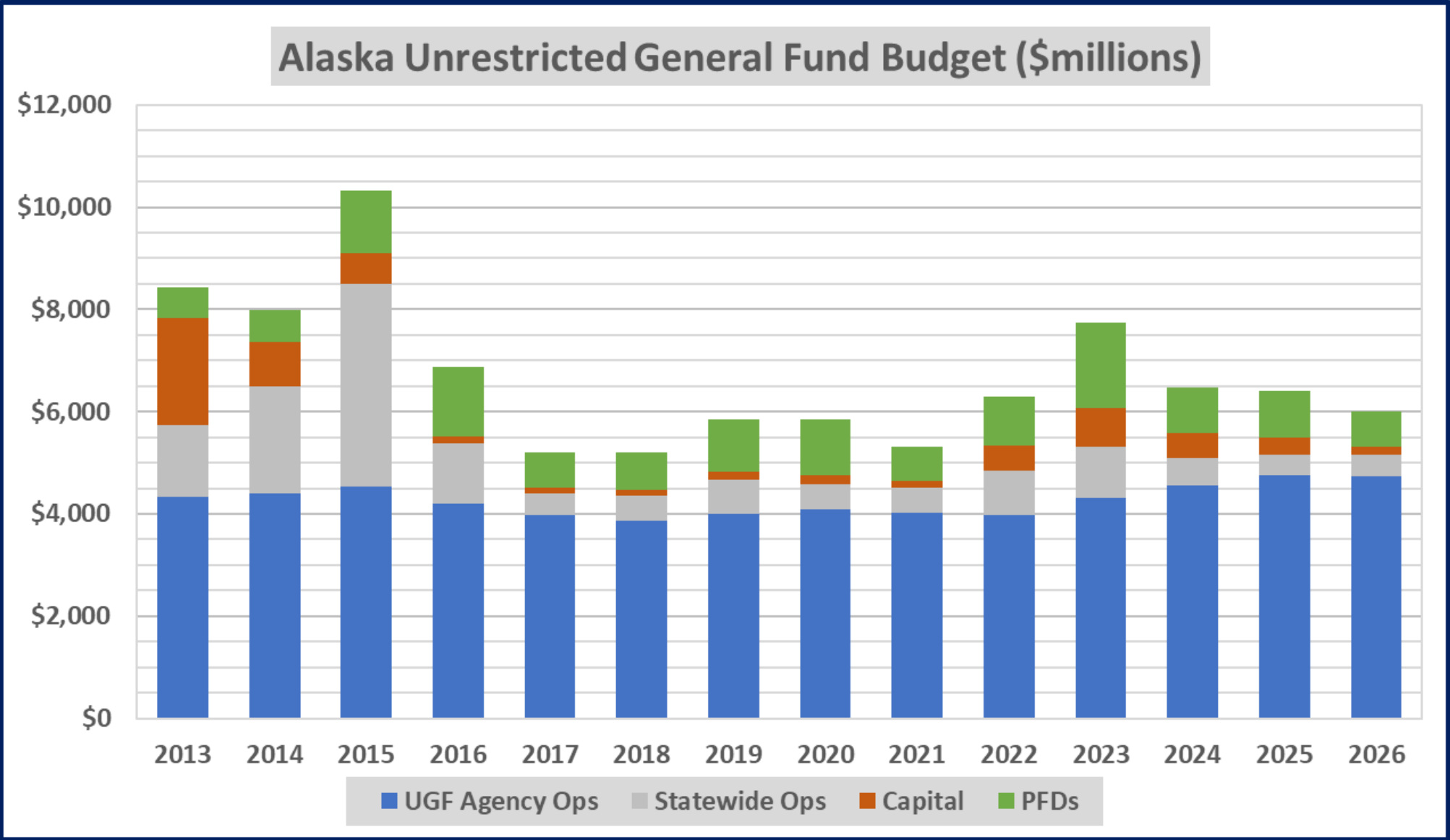
**Thus far, only #1 and #2 have been accomplished.**

**The others are necessary, eventually, but not likely in the 2026 session.**

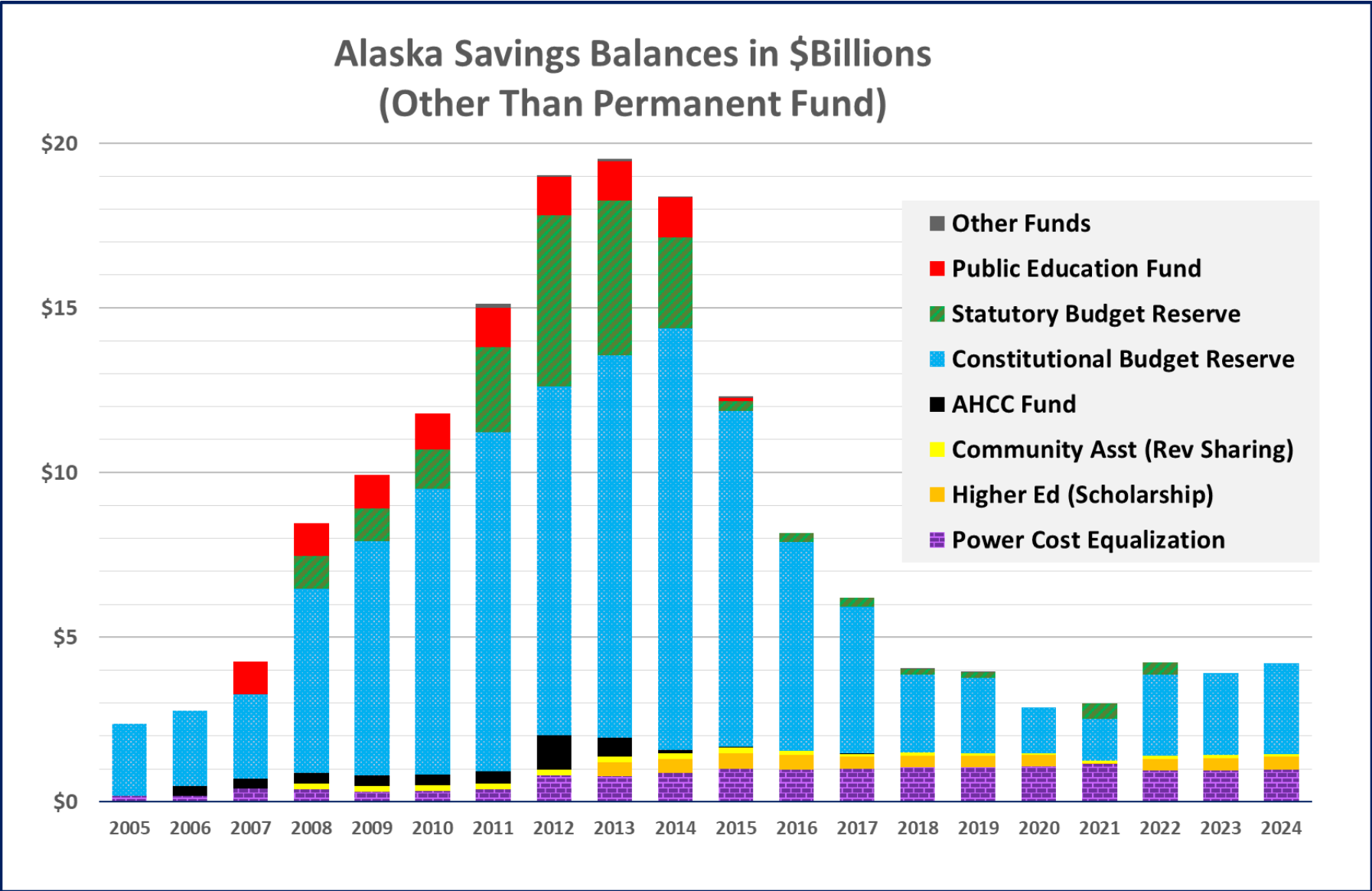
# Oil Prices Crashed in Summer 2014



# Budget cuts since FY2013, including PFDs



# Most of the savings that were drawn down since 2014 were set aside during the high oil price years 2007-2013



# New Paradigm: Life with the POMV 2019-2025

# What the POMV Does and Doesn't Do

## **SB26 was essential, historic legislation**

- 5% of the Fund's value (based on a five-year lookback average) can be drawn to operate state government
- The Fund earns 7-8% in an average year. If inflation is 2-3%, a 5% draw protects the "real" value of the fund
- New deposits made every year based on percentages of resource royalties (FY25 about \$450 million)
- With the steady growth of the Fund itself, the draw has increased from \$2.7 billion in FY2019 to \$3.8 billion in FY2026

# What the POMV Does and Doesn't Do

## **But the legislation was incomplete**

- Did not revise the dividend formula.  
(Formulas were passed by both the House and Senate, but neither version survived the conference committee)
- No hard protection against “overdrawing” the fund
- Maintains separate Principal / Earnings Reserve structure that could prevent the annual draw if the fund has a few consecutive bad market years
- No mechanism to reduce the draw during an oil price spike, potentially overheating the budget (as in 2022)
- Some consider the 5% rate to be too high

# Problems with the Unresolved Dividend

- Lack of stability.

If we don't know the dividend until the end of a legislative session, we don't know how much is left for state services

- The POMV was supposed to reduce the volatility of Alaska's revenues

- Political demagoguery

Many Alaskans' feel aggrieved for the loss / reduction of PFDs from the "historic" formula

- Governor Dunleavy ran in 2018 promising to pay Alaskans back for three years of reduced dividends, \$6,700

- It's been ten years since the statutory formula was used.

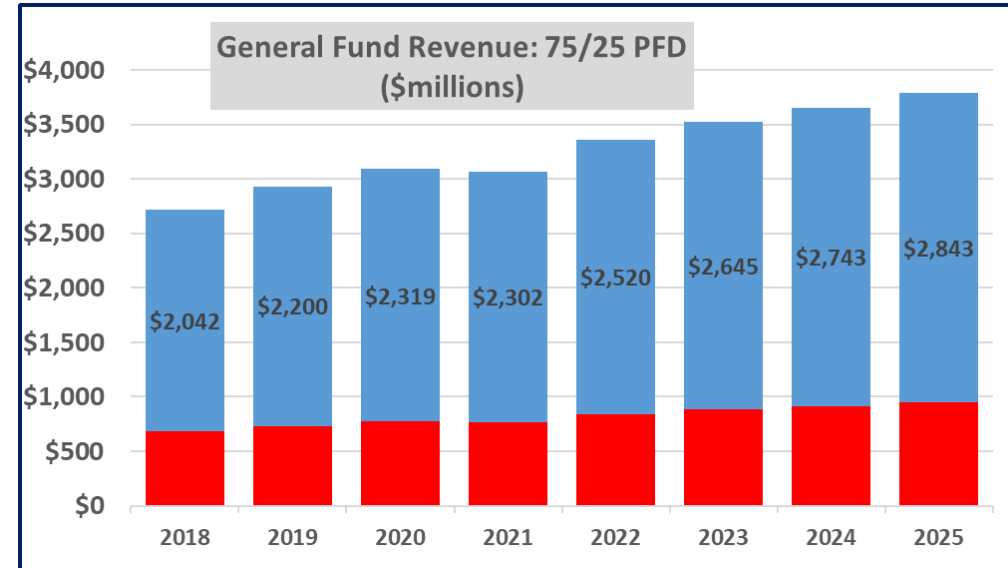
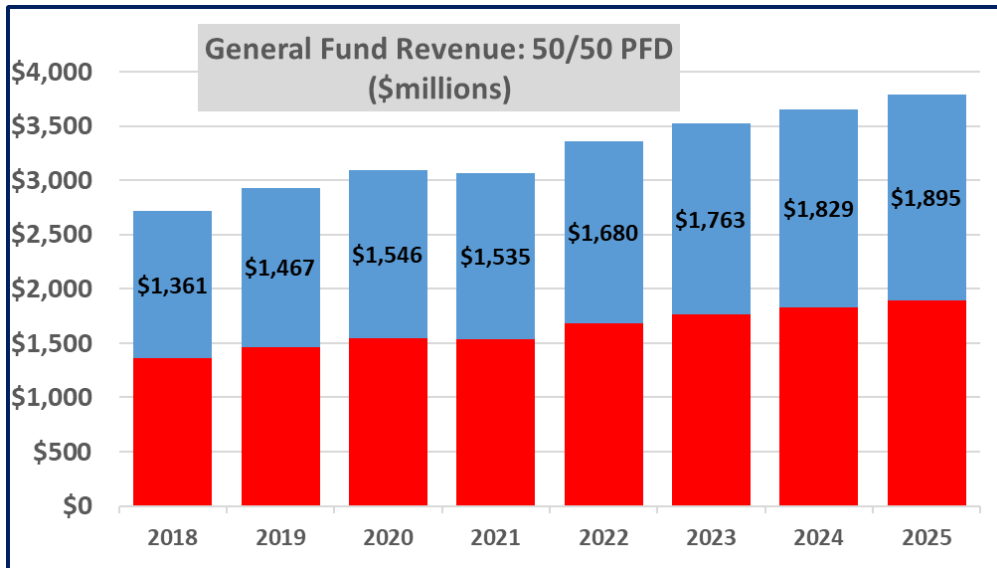
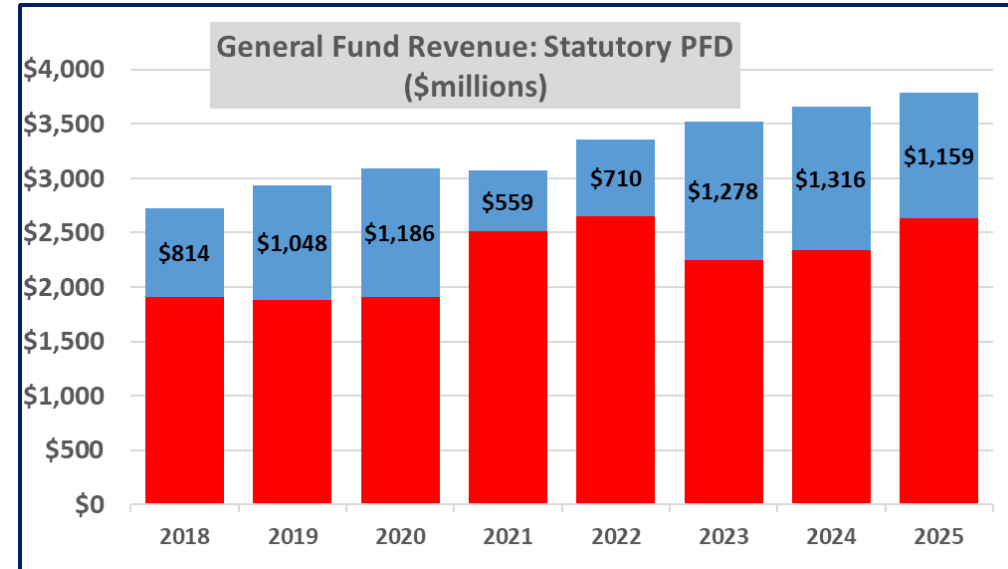
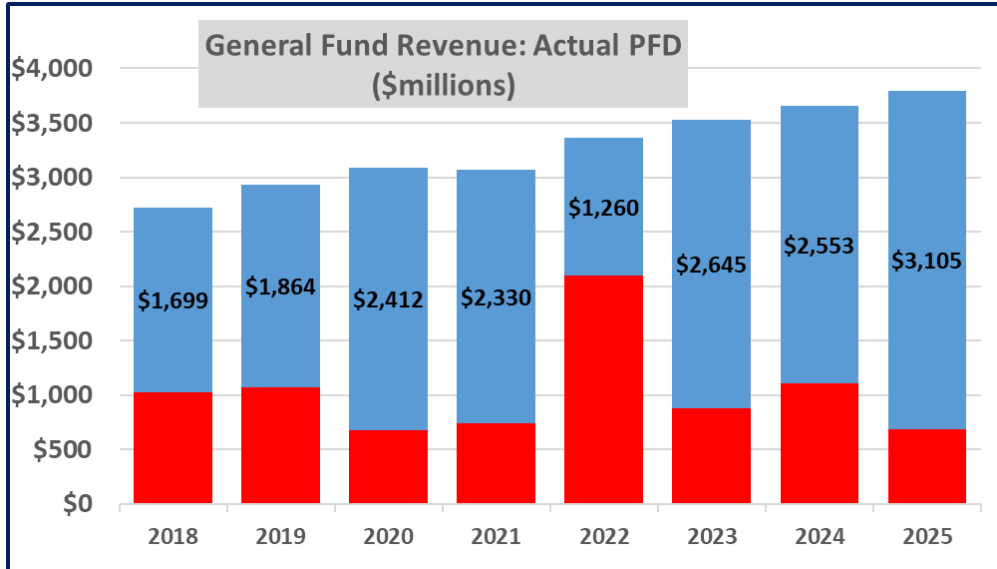
In total, \$11.3 billion, or \$17,300 per eligible Alaskan, has been reduced from the old formula

# And the logical solution

1. The Permanent Fund Corporation, since 2002, has supported a “single account” structure that would lock-in the 5% draw, prevent overdrafts, and eliminate the possibility of system failure due to short-term earnings
  - Ideally requires a constitutional amendment, although could be largely accomplished by statute
2. Consensus on a new dividend formula, ideally a percentage of the POMV
  - The historic “earnings-based” dividend formula does not work well with the “value-based” POMV. Earnings are much more volatile than value.

**When this settles out, we'll know if we need new revenue, and how much**

# General Fund vs Dividend: Four Scenarios



What Happens Next?

# Alaska Still Has a Structural Budget Deficit

## Enacted (post-veto) FY2026 UGF Budget (\$millions)

Agency Operating	\$4,739
Statewide Operating	\$410
Capital	\$159
<u>PFD (roughly 18% of POMV)</u>	<u>\$685</u>
<b>Total</b>	<b>\$5,993</b>

**Based on the spring forecast (\$68 oil), this will result in about a \$130 million surplus, before supplementals**

# Alaska Still Has a Structural Budget Deficit

**Revenue forecast for FY27 is about \$200 million above FY26**

## **Things that will need to increase for FY2027**

- Highway / Federal match (\$50-\$100 mil)
- Ferry / sunset of infrastructure money (\$60 mil)
- Public employee contracts already approved (\$35 mil)
- Fire and Disaster Funds (\$37 mil was vetoed)

## **Things many will want for FY2027**

- Restore Higher Education Fund used for FY25 Deficit (\$200 mil)
- Restore Community Assistance Fund (\$30 mil)
- Go back to 25% PFD (\$300 mil)
- Defined Benefit bill passes (\$40 mil)
- Deferred maintenance (\$2+ billion)

# What is Possible Next Session?

## Probably not very much

- House majority had done an amazing job on their core principles: education funding and pensions. But they only have 21 members, meaning very little flexibility if there are differences in approach.
- Few serious proposals for new or increased revenue
  - Governor has vetoed or threatened vetoes (SB113 Corporate Tax)
- Inability to achieve the  $\frac{3}{4}$  vote required to fund deficits from the Constitutional Budget Reserve
  - Senate has a strong desire to maximize savings to provide flexibility for the next administration
  - FY2025 budget passed without deficit, then oil prices declined. We liquidated half the Higher Education Fund to resolve this

# What About 2027 and After?

- There have been several “task forces” or similar groups looking at a comprehensive fiscal plan, which produced similar solutions
- From the 2021 Legislative “Fiscal Policy Working Group” co-led by Rep. Jonathan Kreiss-Tompkins and Sen. Lyman Hoffman”
  - Single Account Permanent Fund Structure
  - Resolve the Permanent Fund Dividend issue, with both a new POMV-based formula as well as a constitutional guarantee
    - (This group recommended “50/50”)
  - Healthy capital budget
  - New revenues (estimated need of \$500-\$775 million)
  - Budget cuts of \$25-200 million from FY2023 levels
  - Spending cap

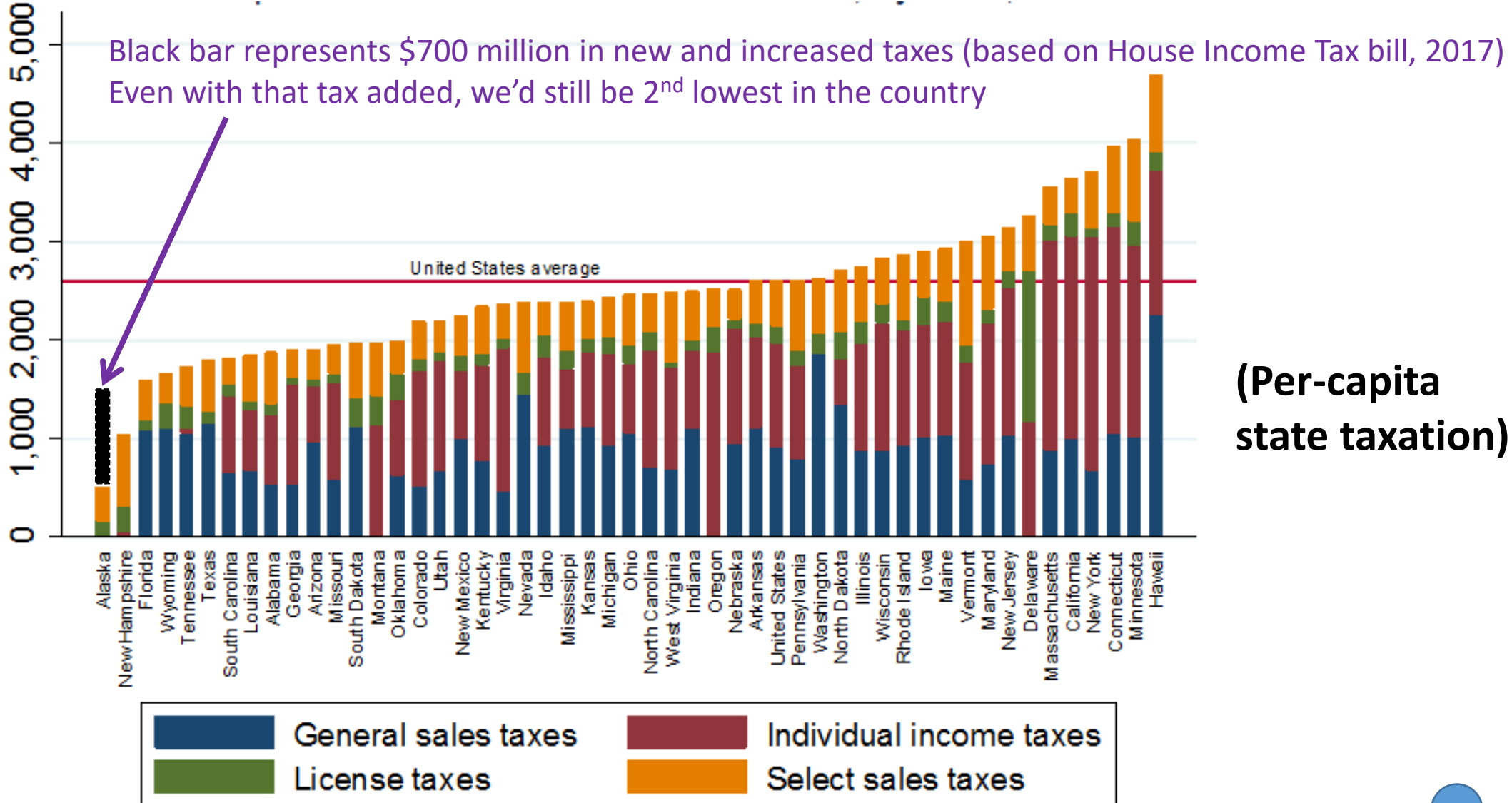
**Depending on who is governor and who leads the legislature, expect a renewed effort in 2027**

# Broad-Based Taxes

(Yeah, I said it)

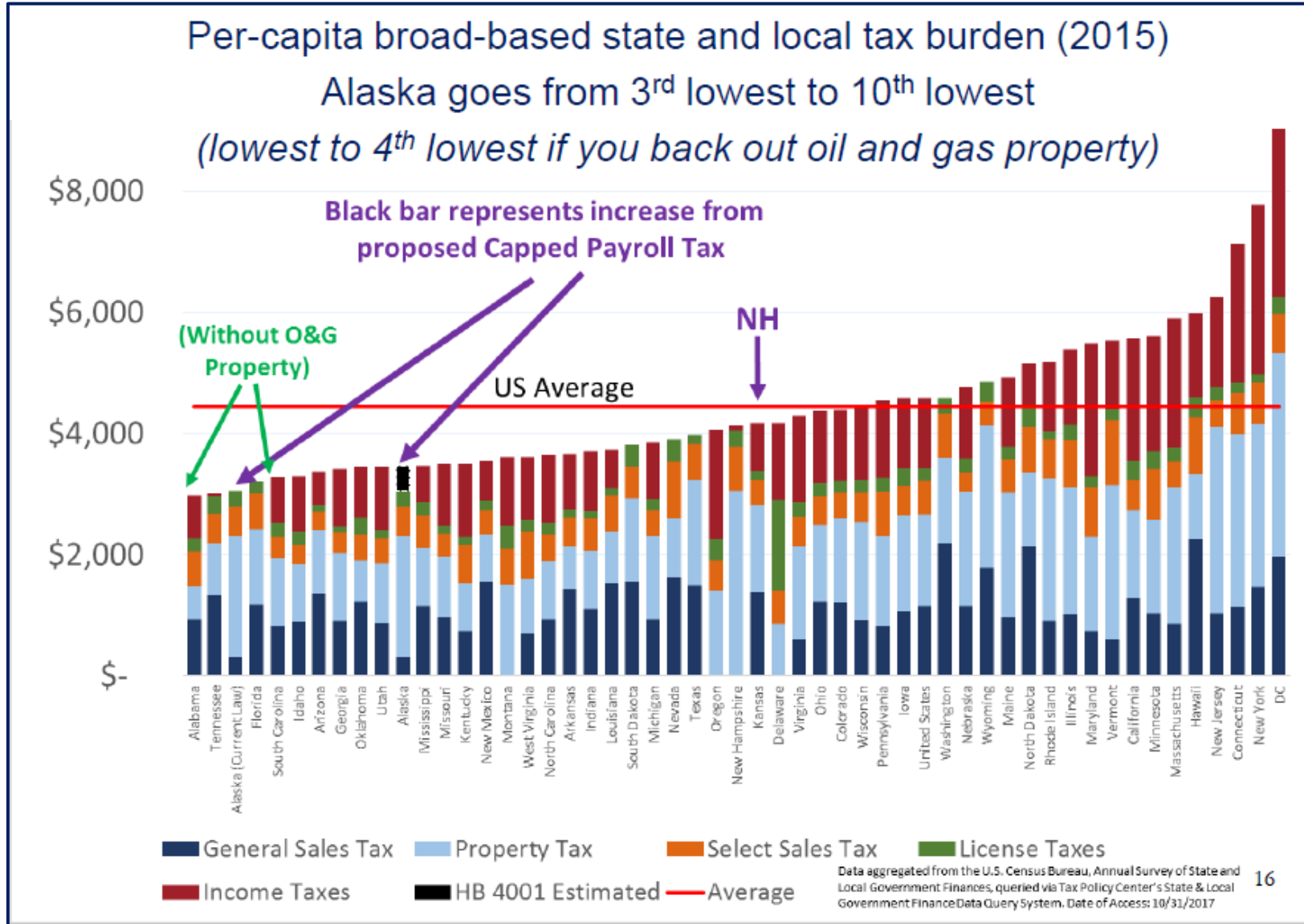


# Alaska's Per-capita Taxation is by Far the Lowest



Source data: Mouhcine Guettabi, ISER

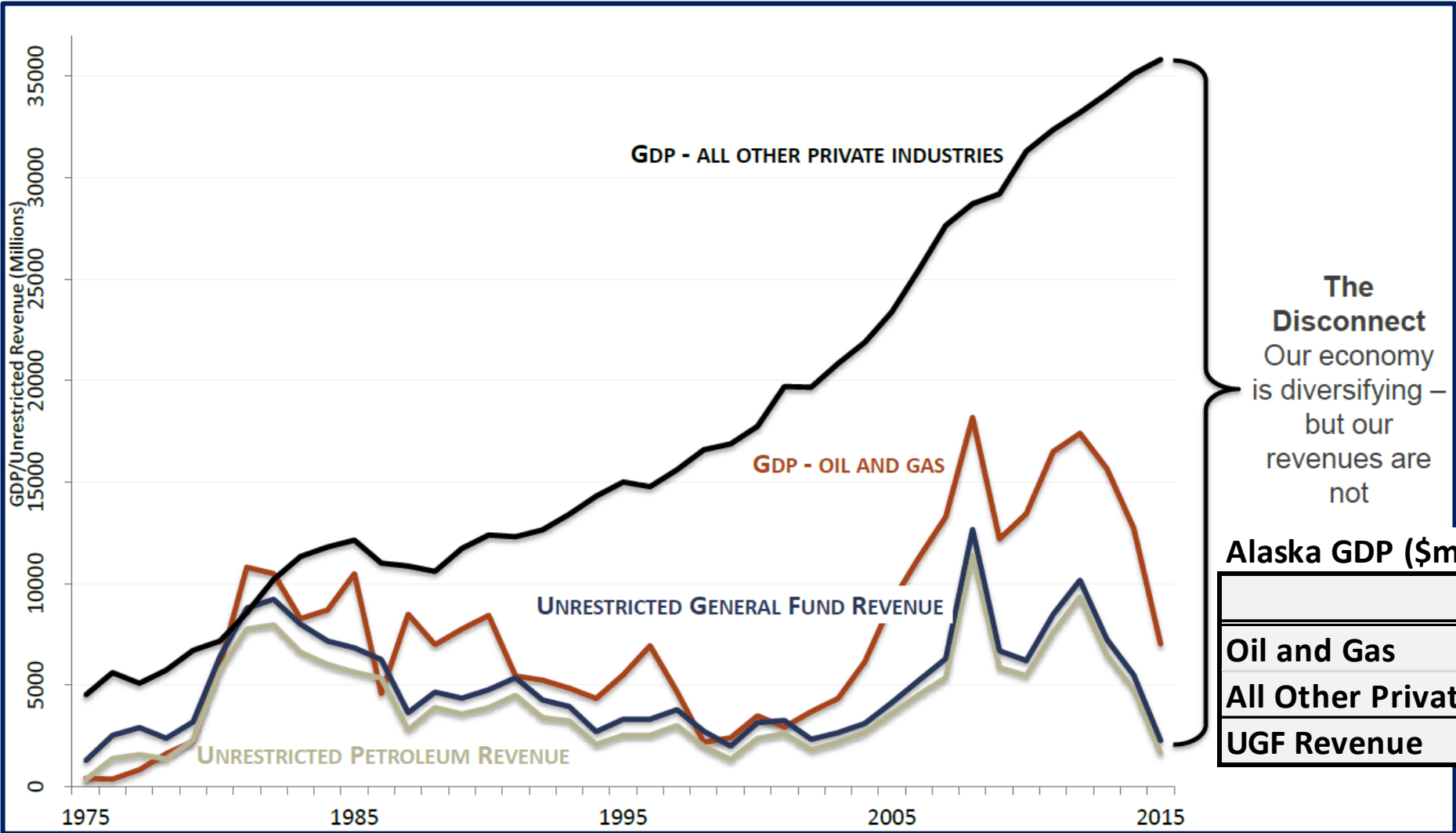
# Adding Municipal Taxes, We are Still Quite Low



**Note:**

This chart Tax models impact of a “capped payroll tax” proposed by Gov. Walker in 2017. It was about ½ the size of the income tax passed by the House earlier in 2017.

# The Alaska Disconnect: Alaska's revenue structure hasn't kept pace with our changing and diversifying economy



The Disconnect  
Our economy is diversifying – but our revenues are not

**Big new developments cost the state money**

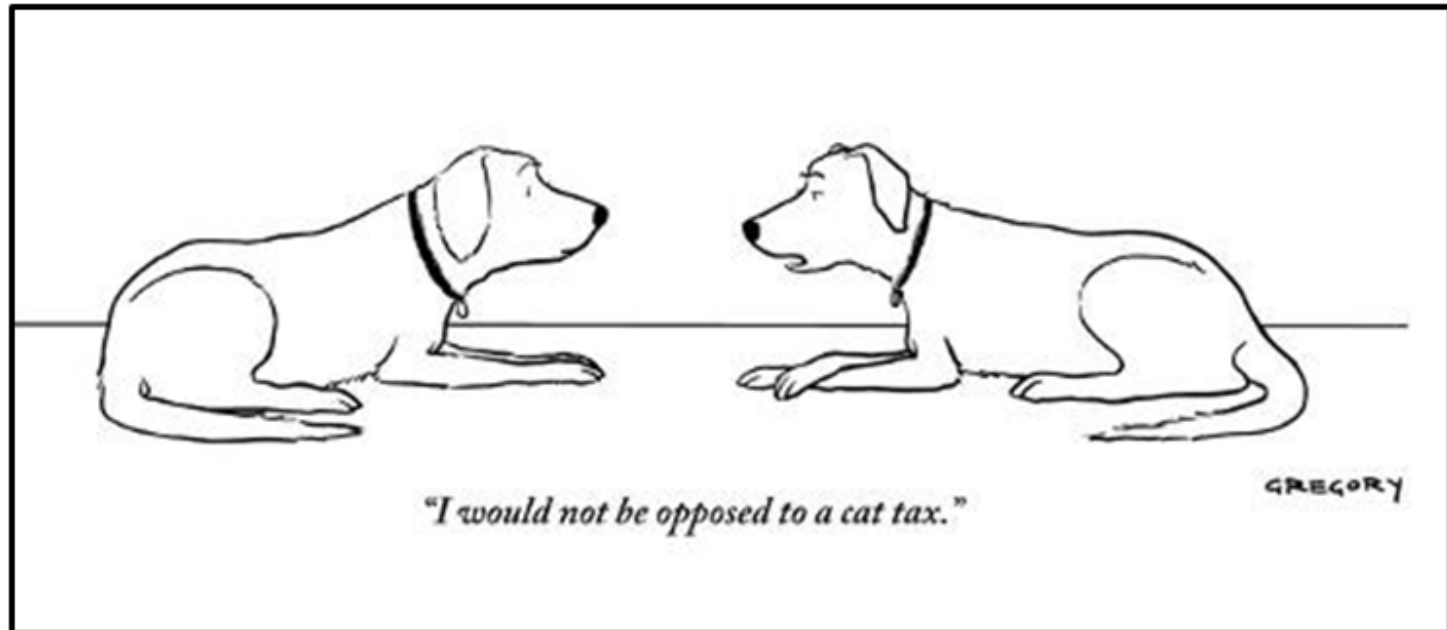
Alaska GDP (\$millions)

	2000	2019	growth
Oil and Gas	3,463.5	4,731.1	37%
All Other Private	17,745.6	38,066.2	115%
UGF Revenue	2,147.6	2,642.5	23%

Source: DCCED Commissioner Mike Navarre, Presentation to House Finance 3/20/18

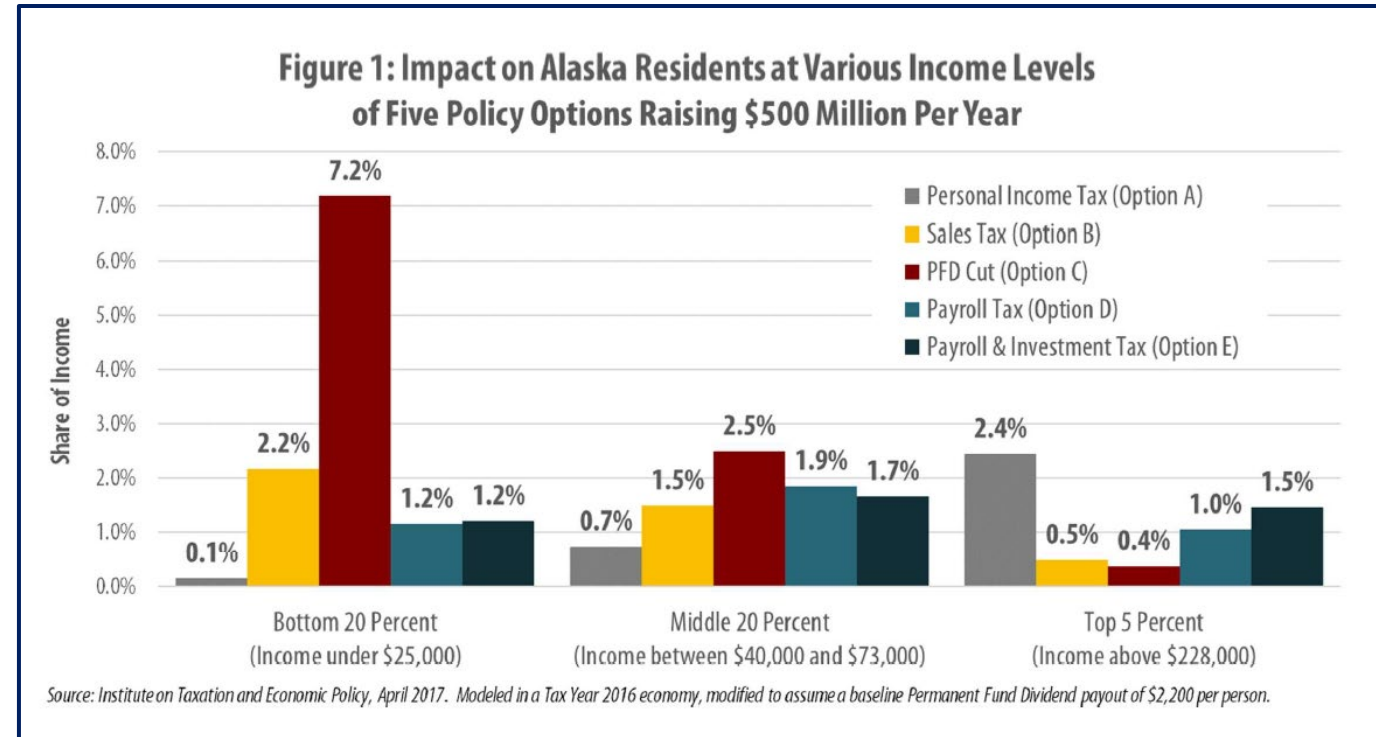
# How Much Money?

- Income Tax
  - Each 1% of Federal Adjusted Gross Income: about \$350 million
  - \$30 flat rate "school tax": \$15 million
- Sales Tax
  - Statewide 1% Sales Tax: about \$575 million
  - Exempt food, industrial equipment etc., much less
- Property Tax
  - Statewide 5 mil: about \$500 million



# Who Pays?

- Income taxes are most progressive, capture non-resident work force
- Sales taxes don't capture as much from high-income individuals, but get revenue from tourists
- Property taxes are limited to incorporated areas
- If you consider the current policy of reduced PFDs a "tax," it is a very regressive flat tax on residents only, regardless of income



**Source: Institute on Taxation and Economic Policy, 2017**

# Broad Based Taxes – Income vs. Sales

There are several reasons an income tax might be preferable:

1. Sales tax tends to be regressive; as incomes increase people use more of their earnings for savings, investment, and travel.  
A progressive tax might be a better counterbalance to dividend cuts, which has the most impact on low-income Alaskans and children
2. Alaska has 105 municipal sales taxes, each with different rules.  
Adding a state tax introduces many questions: does the state (or AkML) take over statewide collection? Do we force caps on local rates, unified exemption rules, transaction caps, etc.?
3. Regional price disparities, a relatively unique Alaska phenomenon, would disproportionately hurt rural residents
4. Our history with sales tax legislation included aggressive exemption seeking by various interest groups

# Pros / Cons / Politics

## Liberal perspective

- Progressive / regressive issue
- Ability to pay / regional disparities

## Conservative perspective

- Sales tax liability can be “controlled” whereas income tax punishes “success”
- A sales tax is on “consumption” while an income tax also taxes “investment”

Also- any broad-based tax will take 18 months to implement

- Staffing, procurement, software development, forms, public education

**The debate between Income vs. Sales isn't yet ripe.**

**The current debate is still between “yes” and “no.”**

# THANK YOU



Feel Free to Visit, Call, or Email with Any Questions

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