A Proposed Solution to the Federal Taxation of Alaska Permanent Fund Dividend Payments*

This note addresses the federal taxation of payments made to Alaska residents under the Permanent Fund Dividend Program. It argues that the State must develop a method of distributing Permanent Fund revenue that will not result in federal taxation of the payments. The note proposes that the dividend program be restructured to provide residents with rebates for fossil fuel expenditures and reimbursements for tuition expenses. Such payments are arguably non-taxable and would further the initial purposes of the dividend program.

I. INTRODUCTION

Since their inception, annual payments to Alaska residents under the Alaska Permanent Fund ("the Fund") have been treated as taxable income.1 Such treatment has been affirmed by the Ninth Circuit and the United States Tax Court.2 Consequently, while the Fund distributes nearly $500 million in annual dividends,3 Alaskans retain only part of this amount. Approximately twenty percent, or $100 million, is lost to federal income taxation each year,4 a fiscally unsound result for a state running a multi-million

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1. See infra text accompanying notes 28-35.


3. See ALASKA PERMANENT FUND CORP., 1993 ANNUAL REPORT 8. On October 1, 1992, the Commissioner of Revenue announced that the dividend distribution for the 1993 fiscal year exceeded $473 million, with over 517,000 Alaskans qualifying. See id. On June 30, 1993, $532 million was set aside for the fiscal 1994 dividend distribution. Id. at 23.

dollar deficit.\(^5\)

To maintain fiscal stability, the state legislature must find a way to bring the benefit of the Permanent Fund to all Alaskans without income tax liability. One obvious solution is to redirect the disbursements to government agencies and away from individual Alaskans. Such a proposal, however, would be politically infeasible, as Alaskans have begun to view their individualized disbursements as annual entitlements. The challenge facing the legislature, therefore, is to restructure the dividend program to avoid income tax liability while retaining broad-based, individualized annual distributions.

This note provides a potential solution to this problem, arguing that the Permanent Fund disbursements can be restructured as rebates for personal fuel expenditures. In this form, dividend payments may be excludable from gross income under the tax benefit rule. One large group left out of such a program, however, would be minors, who probably would not maintain the requisite level of fossil fuel expenditures to qualify. To alleviate this potential problem, minors could receive non-taxable disbursements in the form of scholarship payments or reimbursements for tuition expenses, which are not includable in gross income. Together, these two disbursement programs would offset both increasing fuel costs (one of the stated purposes of the dividend program) and increasing tuition costs—costs shared by nearly all Alaskans.

The origins and current status of the Permanent Fund are discussed in part II of this note. Part III addresses the legal background of the federal taxation of Permanent Fund dividend

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\(^5\) Scott Goldsmith, Safe Landing: A Fiscal Strategy for the 1990s, 7 INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH FISCAL POLICY PAPERS 1 (1992). Alaska is facing a fiscal crisis, as oil revenues have been declining steadily at a rate of 11% since 1988. Oil revenue comprises 85% of Alaska's general revenue and creates 30% of Alaskans' personal income. Id. The 1992 budget shortfall was $600 million, which the State covered, in part, by drawing upon reserve funds. Id. at 16. By restructuring the dividend program so that disbursements do not incur federal taxation, however, the State can reduce the amount of annual payments without substantially decreasing the net amount received by Alaskans, thereby freeing funds for State programs. See infra text accompanying notes 23-27.
payments, including the Internal Revenue Service's ("IRS") position, the reasoning behind the Ninth Circuit's decision in Greisen v. United States and an analysis of the dividend payments under contemporary tax doctrine. Part IV discusses possible solutions to the taxation of Permanent Fund dividend payments, concluding that the Fund should be restructured as a rebate program for personal expenditures on fossil fuel products.

II. THE ORIGIN AND CURRENT STATUS OF THE ALASKA PERMANENT FUND DIVIDEND PROGRAM

After the discovery and development of oil on Alaska's North Slope, the State received revenues far in excess of amounts needed for ordinary governmental functions. In response, Alaska established the Permanent Fund in 1976. Alaska then made a constitutional dedication to the Fund of at least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses. Subsequent legislation increased the applicable percentage to fifty percent for certain types of oil and gas receipts.

As the Fund grew, Alaskans demanded that some of the wealth be returned to the citizenry through tax repeal and cash distributions. In 1980, the legislature responded by distributing one-half of the earnings of the Fund annually to state residents in the form of dividend payments. Three purposes underlaid the 1980 Act:

(1) to provide a mechanism for equitable distribution to the people of Alaska of at least a portion of the state's energy wealth derived from the development and production of the natural resources belonging to them as Alaskans;
(2) to encourage persons to maintain their residence in Alaska and to reduce population turnover in the state; and
(3) to encourage increased awareness and involvement by the residents of the state in the management and expenditure of the Alaska permanent fund.

7. ALASKA CONST. art. IX, § 15.
8. See Beattie v. United States, 635 F. Supp. 481, 482 (D. Alaska 1986), aff'd sub nom. Greisen v. United States, 831 F.2d 916 (9th Cir. 1987), cert. denied, 485 U.S. 1006 (1988). In addition, the legislature has made two special appropriations of surplus revenues to the Permanent Fund. The first, in 1981, was for $900 million; the second was for $1.8 billion in 1982. Id.
11. Id. § 1(b).
The legislature made additional statutory findings that such a program supported the public interest by distributing a portion of Alaska's energy wealth to its citizens\(^\text{12}\) and by providing a buffer for citizens against rising fuel costs.\(^\text{13}\)

Under the 1980 legislation, the amount a resident received was tied to the duration of his or her residency in Alaska, with each resident eighteen years or older receiving fifty dollars for each year of residency since 1959, the year of statehood.\(^\text{14}\) This provision was challenged by two relatively new residents of Alaska, who argued that it violated their rights of interstate travel and equal protection. In \textit{Zobel v. Williams},\(^\text{15}\) the United States Supreme Court ruled that the 1980 Act violated the Fourteenth Amendment of the United States Constitution.\(^\text{16}\)

Before this decision was announced, the Alaska legislature had amended the 1980 Act, providing for the immediate replacement of any terms deemed unconstitutional by the United States Supreme Court.\(^\text{17}\) This legislation became operative shortly after the \textit{Zobel} decision and directed that equal payments be distributed to all eligible residents, including minors, provided they intended to remain permanently in the state.\(^\text{18}\) In 1982, the first dividend checks of $1000 per resident were distributed, totaling approximately $458 million. Eighty-eight million dollars was collected in federal income tax on these dividends.\(^\text{19}\)

Since 1982, the Permanent Fund has grown from about $3 billion to over $15 billion as of June 1993.\(^\text{20}\) The net income produced since the Fund's inception now exceeds $10 billion, including $1.2 billion of investment earnings produced during the 1993 fiscal year.\(^\text{21}\) Alaskans have received nearly $3.5 billion in dividend distributions.\(^\text{22}\)

\(^{12}\) \textit{Id.} § 1(c).

\(^{13}\) \textit{Id.} § 1(d).

\(^{14}\) \textit{Id.} §§ 2(a), 3.

\(^{15}\) 457 U.S. 55 (1982).

\(^{16}\) \textit{Id.} at 65.

\(^{17}\) \textit{ALASKA STAT.}, \textsc{TEMPORARY AND SPECIAL ACTS AND RESOLVES} 276-77 (1982).

\(^{18}\) \textit{ALASKA STAT.} § 43.23.095(8) (Supp. 1992). In addition to the residency requirement being struck down by the United States Supreme Court, there were problems with fraudulent and duplicate applications, garnishment requirements and establishing the legal existence of minors. \textit{Domestic News: Checks}, Reuters, Oct. 16, 1983, \textit{available in} LEXIS, Nexis Library, Reuters File.

\(^{19}\) KNAPP ET AL., \textit{ supra} note 4, at 5.

\(^{20}\) \textit{ALASKA PERMANENT FUND CORP.}, \textit{ supra} note 3, at 4.

\(^{21}\) \textit{Id.}

Ironically, however, as the fund grows, Alaska's fiscal problems worsen. Oil revenues supply eighty-five percent of the State's general revenues and thirty percent of residents' personal income. Oil revenues are dropping, however, and the State is currently having difficulty funding education and other programs. While revenue from the Permanent Fund could be channeled to State services, such a move is likely a political impossibility, as any mention of tapping dividend money results in public uproar. Yet, if the legislature can restructure the fund so that disbursements are tax-free, nearly $100 million can be redirected away from the IRS to the State's coffers each year. This result will be both fiscally sound and politically feasible.

III. LEGAL ANALYSIS OF THE TAXATION OF DIVIDEND PAYMENTS

A. The Position of the IRS: Private Letter Ruling 81-21-122 and Revenue Ruling 85-39

After the enactment of the Permanent Fund Dividend Program, the Alaska Department of Revenue sought advice from the IRS concerning the tax treatment of the dividends. In a 1981 private letter ruling, the IRS informed the State that the dividends were not gifts and were taxable as income. The IRS later issued a revenue ruling which stated that monies received by Alaskans from the dividend program would be taxed as income under section 61 of the Internal Revenue Code.

25. One rationale for creating the Fund was to ensure that the State could maintain basic services once revenues from current oil production became insufficient to support existing programs. Goldsmith, supra note 5, at 1, 3. Phasing out dividends by itself will not sufficiently meet the State's future fiscal needs. The State must also continue to cut spending; expand the economy and tax base by fostering development; reimpose the state personal income tax; and conserve windfalls, which include budget reserves, anticipated settlement payments and any unexpected revenues. Id. at 6-7.
26. Id. at 6-7.
27. The average tax rate of 20%, see supra note 4, applied to the amount of dividend payments, which is anticipated to be over $500 million in fiscal 1994, results in federal tax payments of over $100 million.
29. Id.
The ruling held that the payments were not gifts because the stated purpose of the program was to provide an incentive to residents to continue uninterrupted residence in the state. The IRS further held that the program was distinguishable from general welfare program payments because the bonus was payable to state residents regardless of financial means, health, educational background or employment status. Consequently, when the State began mailing dividend checks, a statement was attached informing residents that the dividend amount must be reported as taxable federal income.

B. *Greisen v. United States*: Permanent Fund Dividend Payments are Taxable

In *Beattie v. United States*, Alaskan taxpayers challenged the assessment of federal income tax on the Permanent Fund dividend payments. The district court granted the government's motion for summary judgment, holding that the payments were "income" within the meaning of the Sixteenth Amendment and section 61 of the IRC. The court also held that the payments were not gifts and thus not excludable from gross income under section 102(a) of the Code. The Ninth Circuit affirmed the *Beattie* decision in *Greisen v. United States*.

1. *The dividend payments constitute income under section 61(a) of the IRC.* The *Greisen* court first addressed the question of whether the dividend payments constituted income under the Sixteenth Amendment and section 61 of the IRC. The appellant taxpayers asserted that the applicable definition of income was the

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31. *Id.*
32. *Id.* at 22.
33. See infra notes 48-50 and accompanying text.
36. 635 F. Supp. 481 (D. Alaska 1986). *Beattie* was a consolidation of three suits, two of which were brought by the Beattie children by and through their father. The third was brought by David Greisen, by and through his father. *Id.* at 484-85. The latter's name attached to the case when it was appealed to the Ninth Circuit.
37. *Id.* at 492.
38. *Id.*
40. *Greisen*, 831 F.2d at 918.
common definition at the time of the adoption of the Sixteenth Amendment: "a ‘coming in’ of wealth from a source exterior to the taxpayer." The appellants argued that the Permanent Fund dividends do not come from an outside source because they are derived from Alaska’s natural resources, which are already owned by state citizens. The court rejected this assertion, and noted that even if the people do own the state’s natural resources (and therefore the principal of the Fund), the dividend payments are derived from interest on that principal and thus come from an external source. Thus, the court held that the payments constituted income under the appellant taxpayers’ definition.

Though the court used the appellant taxpayers’ definition of income, its holding is applicable even under the modern definition of income, as articulated by the United States Supreme Court in Commissioner v. Glenshaw Glass—“undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.” Undoubtedly, the dividends are accessions to wealth, and, as cash payments, immediately realized and controlled by the taxpayer. Thus, even under the Glenshaw Glass standard, the dividend payments are income under the Sixteenth Amendment.

2. The dividend payments fail to qualify for the general welfare payment exclusion from gross income. Consequently, the payments are taxable unless they fall within the IRC’s explicit exclusions or qualify as “general welfare payments.” Many types of governmental disbursements “made ‘in the interest of the general

41. Id. (quoting Beattie, 635 F. Supp. at 491).
42. Id.
43. Id.
44. Id.
46. Id. at 431. Although the IRC nowhere defines the term “income,” a broad, expansive definition of income has evolved under case law. In Glenshaw Glass, the Supreme Court replaced the then-obsolete definition of income found in Eisner v. Macomber, 252 U.S. 189, 207 (1920). The issue faced by the Court in Glenshaw Glass was whether punitive damages awarded in private antitrust actions were taxable. Glenshaw Glass, 348 U.S. at 431-33. Instead of reconciling these windfalls with Macomber’s definition of income as “the gain derived from capital, from labor, or from both combined,” id. at 430 (quoting Macomber, 252 U.S. at 207), the Court limited the Macomber holding to its facts, stating that it was “not meant to provide a touchstone to all future gross income questions,” id. at 431. In its place, the Court set forth what is today the accepted definition of income. See Boris I. Bittker & Lawrence Lokken, Federal Taxation of Income, Estates, & Gifts §§ 5-1, at 5-11 n.32 (1989).
welfare” are excluded from gross income, such as disaster relief and aid to low-income families and the elderly and disabled. Although there is no clear common law origin for this doctrine, the IRS has consistently held that payments made pursuant to legislation adopting social benefit programs are not included in gross income. To qualify as a general welfare program, however, payments must be based on the recipient’s health, education, financial status or employment status. Because the Permanent Fund dividend payments are available to all residents of Alaska who apply regardless of their individual characteristics, the distributions fail to meet this requirement.

3. The payments do not qualify as gifts under section 102 of the IRC. Although the Permanent Fund dividend payments are income within the meaning of the Sixteenth Amendment, they are nonetheless excludable from gross income, and thus not taxable, if they qualify as gifts under section 102(a) of the IRC. Section


49. See, e.g., Rev. Rul. 74-205, 1974-1 C.B. 20 (Replacement housing payments received under the Housing and Urban Development Act of 1968 are not includable in gross income.). A possible rationale for excluding general welfare transfers from gross income is that these payments are unique in that they are applied directly to established needs. To tax these payments would contradict the redistributive goals of these programs, as well as the redistributive design of the income tax system. Despite the absence of a stated rationale, a clear doctrine has materialized whereby payments under social benefit programs are excludable from gross income even though they are not statutorily exempt. See Ricketts v. United States, 405 F.2d 1293, 1295-96 (Ct. Cl. 1969) (rejecting taxpayer’s claim that military retirement bonus was excluded from gross income because it was not a payment made for the general welfare, such as social security payments, which were fully excludable at that date).

50. See Rev. Rul. 76-131, 1976-1 C.B. 16 (Payments under the Alaska Longevity Bonus Act based on residency and age, without regard to that person’s health, education, financial status or employment status, are not general welfare payments.).
102(a) provides that "[g]ross income does not include the value of property acquired by gift, bequest, devise, or inheritance."

As neither Congress nor the Treasury has ever promulgated an authoritative definition of the term "gift" as used in section 102(a), the task of defining the term has been left to the courts. In *Commissioner v. Duberstein*, the Supreme Court defined a gift as a transfer that proceeds from a "'detached and disinterested generosity'" and arises "'out of affection, respect, admiration, charity or like impulses.'" 

Disbursements from government entities to individual citizens, as is the case with the Alaska dividend, are conceptually difficult to place within the *Duberstein* definition, since governments generally do not proceed out of a detached and disinterested generosity. Rather, political, sociological and constitutional considerations factor into government transfers. Still, courts have held that a government can make a "gift." In *Dewling v. United States*...
States, the Court of Claims found that annuity payments from the federal government, made in recognition of past service in the construction of the Panama Canal, were "gifts" and were not to be included in the taxpayer's income. Similarly, in United States v. Hurst, a district court found that a gift had been made when the discoverer of mineral deposits was rewarded with a land grant. The IRS has also recognized that a transfer made by a government may qualify as a gift.

When this issue came before the Ninth Circuit in Greisen v. United States, the court noted that the Duberstein standard was sufficient for analyzing transfers made by government entities. In applying Duberstein, the court held that the dividends were not gifts because the legislature lacked the requisite donative intent. The court reasoned that the dividends were paid out of a sense of moral or legal duty and that the legislature intended the dividends to benefit the state economically, as indicated by the preamble and statement of purpose of the 1980 Act that created the dividend program.

58. Id. at 893-94.
59. 2 F.2d 73 (D. Wyo. 1924).
60. Id.
61. Rev. Rul. 57-233, 1957-1 C.B. 60 (Payments to American Indians for relocation and vocational training are gifts under section 102(a) because the federal government receives no consideration for such grants and the Indians incur no obligations.); Rev. Rul. 55-609, 1955-2 C.B. 34 (Death gratuity payments out of Congress's contingency fund are gifts.).
62. 831 F.2d 916 (9th Cir. 1987), cert. denied, 485 U.S. 1006 (1988).
63. See supra notes 53-56 and accompanying text.
64. Greisen, 831 F.2d at 916. The court refused to adopt the quid pro quo analysis used in evaluating gratuitous transfers for charitable purposes under IRC § 170, stating that no precedent required them to adopt that test and that they were not prepared to make such a sweeping change in the law. Id.
65. Greisen, 831 F.2d at 920.
66. Id. at 919-20.
The court's application of the *Duberstein* standard was sound. The language from the preamble and statement of purpose of the 1980 Act do indicate a lack of donative intent on the part of the legislature. In the preamble, the legislature stated that it was acting because of a "duty" regarding Alaska's natural resources. According to *Duberstein*, "if the payment proceeds primarily from 'the constraining force of any moral or legal duty,' . . . it is not a gift."68

The objectives of the 1980 Act also indicate that the legislature anticipated an economic benefit from the dividend program, which, according to the *Duberstein* standard, removes the transfer from gift status. Section 1(e) of the Act characterized Alaska's high rate of population turnover as "a serious problem," leading "to political, economic, and social instability."69 Alaska lawmakers therefore hoped that the dividend program would benefit the state economically by encouraging people to remain in Alaska. The Act's third purpose, increased involvement by residents in the management and expenditure of the Permanent Fund,70 also indicates that the legislature anticipated a benefit from the transfer.

That these benefits are arguably illusory is irrelevant, for under the *Duberstein* standard, only the transferor's intent controls.71 The Ninth Circuit adhered to this principle in *Olk v. United States*.72 In *Olk*, the taxpayer was a dealer in Las Vegas casinos and received "tokens" from gamblers, who hoped that such payments would bring them good luck. When the IRS tried to tax these tips as income, the taxpayer argued that the payments did not involve any real benefit and were therefore excludable as gifts.73 However, because the gamblers believed that the tokens would bring them some benefit, the court rejected this argument.74 Similarly, the Alaska legislature's belief that the state would receive benefits from the dividend payments denies the disbursements gift status.

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67. Act of Apr. 16, 1980, ch. 21, § 1(a), 1980 Alaska Sess. Laws 1 ("It is the duty and policy of the state with respect to the natural resources belonging to it and the income derived from those natural resources to provide for their use, development, and conservation for the maximum benefit of the people of the state.").


70. Id. § 1(b)(3).

71. See supra text accompanying note 56.

72. 536 F.2d 876 (9th Cir.), cert. denied, 429 U.S. 920 (1976).

73. Id. at 878.

74. Id. at 879.
4. The payments were motivated by substantial benefits and thus fail even the proposed quid pro quo standard. The taxpayers in Greisen also asserted that their case was distinguishable from Duberstein, which involved interpersonal transfers, because payments from the Fund came from the government. Since such transfers are generally not motivated by affection and admiration, factors on which the Duberstein court focused, the appellants argued that the Duberstein analysis should not control. Rather, they asserted that the court should supplement the Duberstein analysis with the more specific standard developed by the Court of Claims for analyzing gifts made for charitable purposes under section 170 of the IRC.

Although courts, including the Ninth Circuit, have used the Duberstein standard to define charitable gifts under section 170, the Court of Claims has offered a more specific standard for assessing their taxability. In Singer Co. v. United States, the Court of Claims had to determine whether the distribution of sewing machines to schools and various charities qualified as a gift made for charitable purposes. Opting for a standard that focused directly on the specific and unusual type of relationship involved in the case, the court stated:

> It is our opinion that if the benefits received, or expected to be received, are substantial, and meaning by that, benefits greater than those that inure to the general public from transfers for charitable purposes (which benefits are merely incidental to the transfer), then in such case we feel the transferor has received, or expects to receive, a quid pro quo sufficient to remove the transfer from the realm of deductibility under section 170.

The court stressed that incidental benefits resulting from charitable giving do not invalidate the deduction; "[i]t is only when the

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76. Id. The court refused, stating that "[n]o precedent requires us to employ" any standard other than Duberstein. Id.
77. See Allen v. United States, 541 F.2d 786, 787 (9th Cir. 1976); DeJong v. Commissioner, 309 F.2d 373, 379 (9th Cir. 1962); Transamerica Corp. v. United States, 254 F. Supp. 504, 514 (N.D. Cal. 1966), aff'd, 392 F.2d 522 (9th Cir. 1968); Fausner v. Commissioner, 55 T.C. 620, 624 (1971).
78. 449 F.2d 413 (Ct. Cl. 1971).
79. Id. at 423 (emphasis added). The specific Singer standard is simply a refinement of the more general Duberstein test of detached and disinterested generosity. If a transferor makes a transfer and receives, or expects to receive, a quid pro quo involving substantial benefits, then the transferor's intention is not one of detached and disinterested generosity. The Singer standard merely assists in the analysis of unusual fact situations, such as the present one.
benefits derived are substantial enough to provide a quid pro quo for the transfer that the deduction is not allowed.\textsuperscript{80}

The IRS has expressly relied upon \textit{Singer}, paraphrasing the quid pro quo standard in revenue rulings.\textsuperscript{81} The IRS also applied the exchange concept of the quid pro quo doctrine in holding that government transfer payments to groups of American Indians for relocation and vocational training were gifts under section 102(a) of the Code.\textsuperscript{82} In light of these revenue rulings, the taxpayers in \textit{Greisen} argued that this quid pro quo standard should apply to disbursements made under the dividend program.

Although the dividend program is more similar to the large distribution made by the Singer Corporation than to the typical business situations that inspired the general \textit{Duberstein} standard, the transfers of payments from the Permanent Fund still fail to qualify as gifts even under the quid pro quo standard. The three purposes expressed by the State in the 1980 Act\textsuperscript{83} indicate that the State anticipated substantial benefits through Permanent Fund distributions, benefits which negate the possibility of the payments being considered gifts.

Although the Act's first purpose, the equitable distribution of a portion of the state's energy wealth, anticipates no substantial benefit as a quid pro quo from the program, the second purpose, encouraging population stability, does. The legislature explicitly stated that Alaska had a "serious problem of population turnover."\textsuperscript{84} By adopting the dividend program, the State hoped to improve its economic and political situation, thereby receiving a substantial benefit. The State also anticipated the benefit of "increased awareness and involvement by the residents" in the management of the Permanent Fund.\textsuperscript{85} By giving the populace a vested interest in the Permanent Fund, Governor Hammond and the legislature tried to create a motivated citizenry that would help regulate legislative spending.\textsuperscript{86}

These perceived benefits led the Alaska Supreme Court to find that the purposes of the dividend program were legitimate goals under the Alaska Constitution,\textsuperscript{87} which requires that any appropri-

\begin{thebibliography}{99}
\bibitem{80} Id.
\bibitem{82} Rev. Rul. 57-233, 1957-1 C.B. 60-61.
\bibitem{84} 1980 Alaska Sess. Laws § 1(e).
\bibitem{85} Id. § 1(b)(3).
\bibitem{86} KNAPP ET AL., \textit{supra} note 4, at II-5.
\end{thebibliography}
ation be made for a public purpose. The anticipated benefits that fueled the enactment of the 1980 Act, therefore, preclude the categorization of the dividend payments as gifts even under the more expansive Singer test.

IV. PROPOSED SOLUTIONS TO THE FEDERAL TAXATION OF PERMANENT FUND DIVIDEND PAYMENTS

This analysis suggests at least four possible approaches to restructuring the existing program to provide for non-taxable disbursements from the Permanent Fund. Three of these proposals either fail to make the payments non-taxable or do not further the original purposes of the dividend program. But the fourth proposal discussed here, a fossil fuel rebate program, may succeed in avoiding the taxation of dividend payments while promoting the main purposes of the original disbursement program.

A. Proposal 1: Redraft the Statute to Clarify the Legislature’s Donative Purpose

The Greisen decision to tax Permanent Fund distributions focused on two of the stated goals underlying the 1980 Act: reducing population turnover and increasing the economic and political stability of Alaska. The Ninth Circuit reasoned that these anticipated benefits indicated that the transfer program did not arise out of a detached and disinterested generosity. But the Act’s third purpose, to distribute Alaska’s energy wealth to the citizenry, was not addressed by the court, and may satisfy the Duberstein standard. The legislature could redraft the Act to make clear that its motivation is a disinterested generosity in distributing the state’s energy wealth to its owners—the people of Alaska—and thereby demonstrate that the “dominant purpose” of the dividend program is donative. Thus, under the Duberstein standard, which focuses on the intent of the donor, the disbursements would arguably qualify as gifts.

It is doubtful, however, that a redrafted version of the statute would be sufficient to establish the donative intent necessary for exclusion under section 102(a) of the IRC. As the Supreme Court

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88. ALASKA CONST. art. IX, § 6.
89. As one goal of this note is to stimulate discussion among the Alaska legal community, the author welcomes any other suggestions for restructuring the dividend program.
91. Id.
stated in *Duberstein*, “the donor’s characterization of his action is not determinative . . . . [T]here must be an objective inquiry as to whether what is called a gift amounts to it in reality.” Furthermore, it is well established that legislative intent alone does not govern federal tax consequences. The IRS could likely establish that the initial goals of the Act were still in place, and that donative intent was not the “dominant purpose.” As the payments would remain taxable under this proposal, it fails to provide an adequate solution.

B. Proposal 2: Channel the Revenue from the Dividend Program into State “General Welfare” Programs

A second possible solution is to dedicate revenue from the dividend program to State social benefit programs whose distributions qualify for tax exemption under the “general welfare” doctrine. The earnings from the Permanent Fund could then be distributed tax-free through State programs that are now feeling the squeeze of Alaska’s fiscal crisis. According to the recent fiscal strategy paper of the Institute of Social and Economic Research (University of Alaska, Anchorage), it is crucial that Alaska develop a plan to phase out the Permanent Fund Dividend Program. The strategy paper argues that Alaska should use the earnings to help pay for basic services—one of the original rationales for creating the Fund. This proposal completely eliminates the dividend program, however, and is antithetical to one of its stated purposes. That purpose is to give Alaskans a more direct stake in budget decisions in order to counteract “the perceived inequity in the distribution of other State benefits.”

The enactment of the Permanent Fund followed a pattern of legislative mismanagement of windfall revenues that the State received after the discovery of the Prudhoe Bay Oil Field. In 1969, the State received $900 million in bonus payments for petroleum leases on state land, an amount eight times more than its annual

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95. See Sharaf v. Commissioner, 224 F.2d 570 (1st Cir. 1955) (The Commissioner’s determination of deficiency is presumed to be correct, and taxpayer has the burden of proof in overcoming this presumption.).
96. See supra text accompanying notes 48-50.
97. Goldsmith, supra note 5, at 10.
98. Id.
99. KNAPP ET AL., supra note 4, at Π-3 to Π-4.
budget at that time. The legislature spent the entire amount in less than four years. By 1974, the $900 million was gone, and "many Alaskans felt that the [money] had been poorly spent." One of the reasons for giving each resident a share in the dividend program was to create an incentive for Alaskans to "defend the fund against possible raids by legislators and bureaucrats who would rather spend the money" than save for Alaska's future. This purpose has been achieved: Alaskans are fervently antagonistic to even the slightest mention of tampering with the Fund. In this atmosphere it is doubtful that Alaskans would allow the legislature to abruptly halt their dividends to provide for general social benefits programs in the absence of any direct personal benefit to themselves. While it may be fiscally sound to use dividend funds for basic services, it appears that such a drastic proposal is currently a political impossibility.

C. Proposal 3: Enact a "Cafeteria Style" Social Welfare Benefits Dividend Program

An alternative to halting dividend payments outright and channelling the funds into basic services would be to provide eligible residents with the option of receiving disbursements either through tax-free State social benefit programs or through the existing taxable dividend format. On the annual application for dividend payments, a resident could choose to waive his dividend payment and apply to receive payments from the State under a social benefit program or programs. The application would contain a menu of benefit programs under which payments would arguably be excludable from income. The menu could include options such as home heating fuel rebates, property tax and rent refunds, scholarships for college tuition and child care and food subsidies. This proposal would enable residents to apply

100. Id. at II-1.
101. Id. at II-1 to II-2.
102. Id. at II-2.
103. Enders, supra note 22, at B5.
104. Spencer, supra note 24, at A19.
105. See, e.g., Rev. Rul. 78-170, 1978-1 C.B. 24 (State-financed credits against winter energy bills of elderly low income individuals are not taxable.).
107. I.R.C. § 117 (1992) (Scholarships are not taxable if they meet certain criteria.).
108. See, e.g., Rev. Rul. 79-142, 1979-1 C.B. 58 (Payments to day care home operator by charitable organization under Child Care Food Program are
for those programs for which they are eligible and which they most
need, and the options would be as expansive as possible to
maximize the number of residents who could benefit. To
maintain equity among those residents who opt for the existing
taxable dividend format, the amount receivable under these
programs could be limited to the after-tax value of the annual
dividend payment. The flexibility of this approach may make this
program politically feasible.

Under current law, however, payments under this program
would probably be taxable under the constructive receipt doctrine,
which prevents a taxpayer from "turn[ing] his back upon income"
in order to avoid tax liability. The IRS has applied this doc-
trine in the analogous situation of employer fringe benefits offered
through non-qualified cafeteria plans. In that context, the
Service has ruled that an employee who may choose between non-
taxable and taxable benefits must include in gross income the
amount of the taxable benefits that the employee could have
elected to receive. The IRS, therefore, will likely treat a
taxpayer's choice of non-taxable benefits in lieu of cash under the
proposed cafeteria style dividend program as a constructive receipt
of taxable income—that is, as if the taxpayer had taken the cash
and used it to purchase the benefits he actually received.

excludable to the extent they compensate expenses incurred in feeding children
eligible for assistance.

109. Additionally, the data collected from people applying for the benefit
programs would provide information about what type of programs the people of
Alaska most need and would help fund those social programs that are currently
being strangled by Alaska's fiscal crisis. Most importantly, this program would
demonstrate to Alaskans that there is a cost to providing State programs and
services. See Goldsmith, supra note 5, at 12.

110. See Hamilton Nat'l Bank of Chattanooga v. Commissioner, 29 B.T.A. 63,
67 (1933) (citations omitted). The income tax regulations provide that cash,
property or services are taxable to cash-basis taxpayers when "actually or
constructively received." Treas. Reg. § 1.446-1(c)(1)(i) (as amended in 1987).

111. Code section 125(a) provides that no amount is includable in gross income
of a participant in a cafeteria plan solely because the participant may choose
among the benefits of the plan. I.R.C. § 125(a) (1992). However, this exception
is statutorily expressed for qualified plans and does not trump the common law
constructive receipt doctrine when the benefits are offered through unqualified
programs. To qualify, a plan must meet the statutory requirements, and the
benefits must be statutorily non-taxable. These benefits include group term life
insurance, accident and health insurance, dependent care benefits and some
qualifying deferred compensation arrangements. See BITTKER & McMAHON,
supra note 48, at 8-20.

112. See I.R.C. § 125(a) (1992); BITTKER & McMAHON, supra note 48, at 8-20.
D. Proposal 4: Restructure the Dividend Program to Provide a Rebate for Fossil Fuel Expenditures and Qualified Scholarship and Tuition Payments

The last suggested approach is to use proceeds from the Permanent Fund to provide non-taxable rebates for personal fossil fuel expenditures. Since such expenditures are non-deductible, these rebates would not be taxable under the tax benefit principle. Additionally, by providing rebates to offset the rising cost of home heating and transportation, the State would satisfy one of the original purposes of the Permanent Fund Dividend Program. In the 1980 Act, the legislature found that "state residents have been paying increasingly high prices for fossil fuels, while few have received direct monetary benefits from the production and development of fossil fuels belonging to them as Alaskans," and stated that it intended to return to the residents of Alaska "a portion of the state's income from oil . . . production to help offset rising fuel costs."

The residents of Alaska deserve a respite from spiraling fuel costs since they have to bear the externalities associated with oil exploration and production. Alaskans have to live with the environmental hazards of oil spills and pipeline ruptures, as well as the economic risks of the volatile oil market. The rebate program would thus serve an equitable purpose by compensating Alaskans for the personal costs imposed by these externalities. All residents could qualify for this program by demonstrating, in an annual rebate application, a certain level of annual expenditures in home heating oil and automobile fuel.

Although most minors would not have incurred the necessary fuel expenses to qualify for a rebate, disbursements to minors could be maintained through a scholarship program. The IRC excludes from gross income "qualified scholarships" received by any individual who is a candidate for a degree at an educational institution with a regular faculty and student body. These scholarships would not have to be based on need, so all minors

113. For a discussion of the tax benefit rule, see infra notes 120-122 and accompanying text.
115. I.R.C. §§ 117, 170(b)(1)(A)(ii) (1992). A scholarship is qualified if used for tuition and related expenses by a student who is a candidate for a college degree or in a program of training to prepare students for gainful employment in a recognized occupation. Id. § 117(b)(1); BITTKER & MCMAHON, supra note 48, at 5-25.
could receive disbursements upon matriculating at a qualified institution.116

While the above rebate and scholarship disbursements programs would not provide the flexibility of the cafeteria style plan, they would focus on needs shared by nearly all Alaskans. Most Alaskans have substantial home heating and automobile fuel costs which have been compounded by a recent sharp increase in gasoline taxes.117 Recent statistics indicate that each Alaskan household spends, on the average, approximately $1472 per year on fossil fuels, compared to a nation-wide average of only $1068.118 Most residents could therefore easily demonstrate that they have extensive fuel expenses from home heating and automobiles. And, in order to prevent waste, the rebate could be tied to a maximum consumption level. The advantage of the rebate program is that it would provide tax-free payments while furthering an expressed purpose of the current dividend program, returning a portion of State revenues from oil production to residents to offset rising fuel costs.119

The disbursements under this program would be excludable from gross income because the payments would reimburse personal expenditures that were not used to justify a deduction or another form of tax benefit. Normally, when a taxpayer recovers an item the tax benefit rule is activated, requiring a taxpayer to include the item in income if the taxpayer obtained a prior deduction or credit attributable to it.120 However, if there was no prior tax allowance, a recovery need not be included in income: the tax benefit rule "does not embrace the recovery of items that did not give rise to tax allowances when paid or incurred, such as the refund of an amount paid for personal goods or services or a non-deductible

116. The State could provide scholarships for residents who attend colleges or vocational institutes in Alaska and thus subsidize Alaska residents' efforts to obtain additional education.


118. See ENERGY INFO. ADMIN., STATE ENERGY PRICE AND EXPENDITURE REPORT 1990, Sept. 1992, at 21, 27. See also U.S. CENSUS BUREAU, 1990 CENSUS OF HOUSING: GENERAL HOUSING CHARACTERISTICS, UNITED STATES 1; U.S. CENSUS BUREAU, 1990 CENSUS OF HOUSING: GENERAL HOUSING CHARACTERISTICS, ALASKA 1. These statistics were derived as follows: the total energy expenses incurred by the entire residential sector in the United States and Alaska were divided by the number of residences in the United States and Alaska.


120. I.R.C. § 111 (1992). Under the tax benefit rule, refunds of non-deductible amounts are not includable in gross income and thus are not taxed. See Clark v. Commissioner, 40 B.T.A. 333, 335 (1939).
The rule is one "of inclusion and exclusion: recovery of an item previously deducted must be included in income; that portion of the recovery not resulting in a prior tax benefit is excluded."  

The expenses that the rebate program would relieve are non-deductible personal expenses which do not result in a tax benefit; therefore, they should not be included in income under the tax benefit rule. Personal fuel expenses are not deductible under section 262(a) of the IRC, which denies deductions for personal, living or family expenses. Gasoline taxes are not deductible because they are not specifically included under section 164(a) as deductible state and local taxes. The net effect of the rebate program, therefore, would be equivalent to a situation in which the taxpayer never incurred the expense. Thus, the rebates would not cause an increase in the taxpayer's net worth and would not be taxable.

The fact that the rebates do not come from the same party to whom the taxpayer's original payment was made is irrelevant. In Clark v. Commissioner, the Board of Tax Appeals held that under the tax benefit rule, the taxpayer did not receive income.

121. Boris I. Bittker & Stephen B. Kanner, The Tax Benefit Rule, 26 UCLA L. Rev. 265, 274 (1978) (emphasis added); see also Rev. Rul. 78-194, 1978-1 C.B. 24 (Property tax rebate was not includable in taxpayer's gross income because the rebate was in the nature of a return of rent, a previously non-deductible item.). The same principle has been applied to the recovery of an amount which was not deductible when paid because the taxpayer was an exempt organization at the time. California & Hawaiian Sugar Ref. Corp. v. United States, 311 F.2d 235, 239 (Ct. Cl. 1962).

122. Bittker & Kanner, supra note 121, at 271 (quoting Putoma Corp. v. Commissioner, 66 T.C. 652, 664 n.10 (1976)).


124. Id. § 164(a).

125. This offsetting of expenses is similar to the non-taxable imputed income that an individual earns when he mows his lawn, paints his own house or performs his own domestic services. See Bittker & Lokken, supra note 46, at 5-22. Congress has chosen not to tax this source of economic gain because in theory, there is no reason to distinguish between individuals who perform self-help and those for whom an hour of leisure is worth more than a neatly trimmed lawn or a freshly cleaned house. Id. at 5-24. Rigorous consistency in the treatment of imputed income would require taxing leisure as well as unpaid services rendered by taxpayers to themselves. Similarly, taxing the recoupment of expenses would require taxing those who did not incur expenses due to their personal choices. To tax individuals who receive a reduction in their expenses would be to punish their initiative in pursuing activities that require the incurrence of expenses, similar to the punishment of the individual who performs self-help.

126. 40 B.T.A. 333 (1939).
from a payment from his accountant for a tax return error even though the payment came from a source other than the one to whom it was originally paid.\textsuperscript{127} Similarly, the IRS has allowed exclusions from gross income for homeowners' property tax rebates and renters' rebates, even though such rebates came from the State rather than the local entity that collected the real property taxes.\textsuperscript{128}

The IRS might challenge the exclusion of these payments on the ground that every resident would still be entitled to roughly the same payment, regardless of individual need. However, rebates would be contingent on individual demonstrations of expenditures by each applicant and would therefore be distinguishable from the current dividend program. The proposed rebate program should likely withstand an IRS challenge, thereby providing tax-free payments from the Permanent Dividend Fund.\textsuperscript{129}

The fuel assistance rebate program would be politically feasible because it allows for widespread payments that would appear equitable to Alaskans. The program also would help to address Alaska's pending fiscal crisis. Dr. Scott Goldsmith, professor of economics at the Institute of Social and Economic Research (University of Alaska, Anchorage), believes that the two primary criteria of a successful restructuring of the dividend program are making the payments non-taxable and encouraging fiscal responsibility through increased citizen awareness of the cost of social programs.\textsuperscript{130} A fuel assistance rebate program would meet both of these goals. First, payments from the program would not be taxable by the federal government, thus preventing the leakage of close to $100 million annually. Second, since the program would provide payments linked to tangible needs, Alaskans would better understand that social programs have a cost and that the State can no longer afford to distribute funds if a need has not been shown.

V. CONCLUSION

The problems surrounding the taxation of the Alaska Permanent Fund dividend payments are complex. The Ninth Circuit correctly decided in \textit{Greisen} that the payments are income and do

\textsuperscript{127} Id. at 335.


\textsuperscript{129} To prevent uncertainty as to the taxation of these rebate programs, the state legislature should pursue an advance ruling from the IRS. Although the IRS does not appear to have any direct policy against issuing rulings in this area, such a ruling may be difficult to obtain due to the large amount of revenue at stake. See generally Rev. Proc. 93-1, 1993-1 I.R.B. 10-49.

\textsuperscript{130} Telephone Interview with Scott Goldsmith, Professor of Economics, Institute of Social and Economic Research (Nov. 15, 1992).
not qualify for statutory exclusion as general welfare payments or as gifts under section 102(a) of the IRC. Therefore, the only feasible alternative to continued taxation of the payments and the resulting leakage of approximately $100 million annually in federal income taxes is to restructure the existing program.

By restructuring the program to create a fossil fuel rebate program, tax-free payments could be made from Permanent Fund earnings. With its focus on common needs, this program would retain a broad base of recipients and would therefore be politically viable. Additionally, the rebate program would meet all three purposes of the original dividend program: encouraging the retention of a high level of interest in the management of the Permanent Fund; providing for the equitable distribution of a portion of the state's energy wealth; and encouraging residential longevity in Alaska. Finally, by tying the payments to well-established needs, the restructured program would encourage fiscal responsibility by demonstrating that State benefit programs have tangible costs and that the State can no longer afford its current level of spending.

Laurence S. Smith