Selling permits on contract reduces risk

by Norman Stadem
for the *Tundra Times*

Most people object to paying more taxes than they have to. When a person sells a permit, he has to pay income tax on the net profit he receives during a calendar year. The present Commercial Fisheries Entry Commission law, by restricting the opportunity for installment sales, forces sellers to sell their permit on a lump sum, cash basis.

The only way we can avoid this is to get other collateral to secure a term loan — and this generally is a complicated procedure — or take the extreme risk of lending as an unsecured creditor. Thus, the law makes it extremely difficult for an individual to avoid the higher income tax bracket associated with a lump sum payment.

Consider, for example, a person who sells a permit for $150,000. Suppose the owner could choose the option of:

•Selling on a 15 year contract with interest at 10 percent per year, secured by the permit.

•Or selling it for a single lump sum.

This example is intended to illustrate the tax effect so it is very general. The basic assumptions are that the taxpayer files a joint return and has no children, he uses a standard deduction of $3,750 and exemption of $3,800, all other costs are ignored and all income from the sale is taxed as ordinary income. The 1987 tax rates are used.

Under the installment sales agreement, the annual payment to pay off the loan is $19,725. The seller takes a standard deduction of $3,750 and an exemption of $3,800. Annual taxable income is then $12,175.

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His annual federal income tax is $1,706 which totals $25,590 over the 15-year loan period. He receives an annual income, after taxes, of $18,019 — this includes principal and interest on the loan. Total income over the 15-year period is $270,285. This seller earns an additional $120,285 — $270,285 - $150,000 — in interest income. This interest income stays in the village adding to local wealth, rather than being paid outside the village.

Now compare the lump sum sales. The fisherman gets the full $150,000 in one year. His standard deduction of $3,750 and exemption of $3,800 leaves him with taxable income of $142,450. His federal income tax bill is $44,783. This is 1.75 times as much as the total tax he has to pay under the 15-year plan. His total after tax return on the permit is $105,217. This is only 39 percent of what he gets under the 15-year plan.

The goal of preventing absentee ownership could still be achieved by allowing only legitimate sales contracts — perhaps a standardized sales contract specified by the CFEC — to govern the transaction.

That is, the contract would have to have a structured amortization plan to pay off the loan, provision for transferring title to the buyer, and other legal provisions.

To allow some flexibility, leases could be allowed but limited to two or three years out of 10, for example, so as to discourage absentee ownership.

In summary, the prohibition on using limited entry permits as collateral has worked to the disadvantage of rural Alaskans.

One of the purposes for this restriction on individual freedom was to prevent fishermen from going into debt and eventually losing their permit in foreclosing proceedings.

Few things in life, however, are all good or all bad — even well intentioned protectionist legislation is often burdened with undesirable side effects.

In this case, one of the most undesirable effects is that it has contributed to the loss of permits from rural local ownership. Secondly, it has made it difficult for people in remote rural areas to enter new fisheries.

Alaska rural local residents are more seriously impacted than their urban counterparts because they do not have access to the same set of financing alternatives.

The primary reasons for this are:

•Capital is not well developed in many rural communities.

•Alternative sources of cash income are limited in rural communities.

As a consequence, individuals find it difficult to qualify for institutional financing.

Editor's Note: This is the final article in a three-part series by Norman Stadem, economist with Bi[illegible] Economic Research & Analysi[illegible] presi- dent of the Alaska Independent Fish[illegible] Association and [illegible] United Fish[illegible] of Al[illegible]