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Delivered Via Email

The Honorable Cathy Giessel
Senate President
Alaska State Senate
State Capitol Room 111
Juneau, AK 99801
Email: Senator.Cathy.Giessel@akleg.gov

The Honorable Chris Tuck
Chairman, Legislative Budget and Audit Committee
Alaska House of Representatives
State Capitol Room 24
Juneau, AK 99801
Email: Representative.Chris.Tuck@akleg.gov

Re: *Questions Regarding Constitutional Budget Reserve Fund Deposits*

Dear Senator Giessel and Representative Tuck:

This letter is in response to your requests for the Department of Law's opinion regarding deposits to the Constitutional Budget Reserve Fund (CBR). Your request focused on two main areas: (1) the Department of Law's opinion regarding money required to be deposited into the CBR including revenues received indirectly as the result of the termination of tariff disputes; and (2) a historical overview regarding interpretation of the CBR amendment. As set forth below, it is our opinion that revenues received indirectly as the result of the termination of tariff litigation before federal and state tribunals with jurisdiction only to resolve tariff disputes should be deposited in the general fund and not the CBR. We also provide the historical review requested.

A. The constitutional prohibition against dedicated funds and the CBR.

Money received by the State is presumed to be deposited into the general fund and available for general appropriation by the legislature. The Alaska Constitution reaffirms this basic principle with an express prohibition against dedicated funds under Article 9, Section 7 of the Alaska Constitution. There are limited exceptions to the anti-dedicated fund provision including dedicated funds that pre-date ratification of the Alaska Constitution, funds required for federal programs, the permanent fund, and the CBR.[1]

The CBR amendment authorizes the dedication of certain state revenues as follows:

> Except for money deposited into the permanent fund under Section 15 of this article, all money received by the State after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund.[2]

In other words, Article 9, Section 17(a) requires that money that the State receives from the settlement or other termination of administrative proceedings or court cases regarding oil taxes and royalties (among other things) must be deposited into the CBR rather than the general fund.

B. The deposit requirements of the CBR have been considered in one Alaska Supreme Court case and several informal Attorney General opinions.

In 1993, following advice by Attorney General Charles Cole to the Commissioner of Revenue on what monies should be deposited into the CBR,[3] members of the Senate majority coalition filed a complaint against Governor Hickel regarding the deposit into the general fund of money received by the Department of Revenue prior to a request for a formal hearing on a tax appeal.[4] Attorney General Cole advised that money received from

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1 Alaska Const. art. 9, secs. 7 and 17(a).

2 Alaska Const. art. 9, sec. 17(a).

3 1992 Att'y Gen. Op. 85 (April 24).

4 *Hickel*, 872 P.2d at 174.

the termination of "litigation in a state or federal court" was included in the CBR amendment, but concluded that informal conferences were not sufficiently adjudicatory to fall under the CBR amendment. The question addressed by the court was what counts as an "administrative proceeding" under the CBR.[5]

The superior court held that an administrative proceeding began with the filing of an appeal requesting an informal conference—disagreeing with Attorney General Cole's advice.[6] The Alaska Supreme Court requested the parties brief whether an administrative proceeding should begin earlier with the issuance of an assessment.[7] The Court thereafter in *Hickel v. Halford* held that a notice of assessment by the Department of Revenue after an audit is the beginning of an administrative proceeding for purposes of the CBR amendment.[8] The Court in *Hickel* found that a notice of assessment contained the three attributes of an administrative proceeding: (1) a dispute existed; (2) a document reflecting the fact of the dispute was served on one party by the other; and (3) the document set in motion mechanisms by law under which the dispute will be resolved.[9]

Shortly after the opinion in *Hickel*, the Department of Law published two informal attorney general opinions on CBR deposit issues. The first opinion advised that the Department of Revenue should deposit into the CBR the entire amount of a lump-sum tax settlement even if only some of the tax years for the settlement had been subject to a notice of assessment after an audit.[10] The opinion also advised the Department of Natural Resources that money received in settlement for royalty disputes should be deposited into the CBR once a party gives notice that it is invoking a binding administrative dispute resolution procedure in a royalty contract.[11]

The second informal attorney general opinion advised that payment received by the Department of Natural Resources from Petro Star under a royalty-in-kind oil sales contract due to an adjustment in the value of the sale oil from the resolution of litigation with oil and gas producers should have been deposited into the general fund instead of

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5 1992 Att'y Gen. Op. 85 (April 24).

6 872 P.2d at 174.

7 *Id.* at 175.

8 *Id.* at 176.

9 *Id.* at 183.

10 1995 Inf. Op. Att'y Gen. (May 18).

11 *Id.*

the CBR.[12] The opinion reasoned that the payment from Petro Star to the State was made as a result of the sales contract terms between Petro Star and the State.[13] The opinion more broadly asserted that the CBR amendment "does not apply to disputes between third parties that may indirectly affect an amount received by the State."[14]

While not an attorney general opinion, in 1997, Attorney General Bothelo stated to the media that money received from tariff litigation would be deposited into the general fund—meaning that this money would not be deposited into the CBR. [15] Despite this statement and the prior attorney general opinions, the practice at some point became to deposit money received due to tariff litigation into the CBR. We have been unable to locate any explanation behind the start of this practice. This practice continued until 2017.

C. The Attorney General's Office addressed the CBR deposit requirements again after passage of HB 111.

As noted in your letter, the legislature passed oil and gas tax credit reforms in 2017 with House Bill 111 (Ch. 3, SLA 2017). House Bill 111 included provisions that permit a taxpayer to apply certain tax credits against additional oil and gas production tax due for a prior year subject to certain limitations. This sort of provision is often referred to as a "carryback" of a credit.[16] Under the legislation, the carryback of a credit was prohibited if the additional tax revenue would be deposited into the CBR.[17] Accordingly, the passage of House Bill 111 required the Department of Revenue and the Department of Law to consider again what money was required to be deposited into the CBR.

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12 1994 Inf. Op. Att'y Gen. (May 23).

13 *Id.*

14 *Id.*

15 Juneau Empire, July 28, 1997 at 3.

16 The federal income tax provisions allow a "carryback" of net operating losses under certain circumstances. 26 USCA §172

17 We are not opining on whether the language in the current statute prohibiting the carryback of a credit if the additional tax revenue would be deposited into the CBR is required. The statute currently contains that prohibition, which is why the Department of Law had to endeavor to determine what revenues are properly deposited into the CBR.

In performing the review in 2017, we had the benefit of the Alaska Supreme Court's very recent decision in *Wielechowski v. State*[18] where the Court considered how broadly to interpret a constitutional amendment that created an exception to the prohibition on the dedication of revenues. The CBR of course is a constitutional amendment that created an exception to the dedicated funds prohibition, thus making it permissible to require that certain state revenues be placed in the CBR. In *Wielechowski*, the Court considered whether the permanent fund amendment authorized an exception to the dedicated funds clause for permanent fund income. In performing its legal analysis, the Court noted that an interpretation of the Constitution is based on "the words of the provision itself," and because the voters must approve an amendment, the Court looks to evidence regarding how the voters would have interpreted the proposed amendment based on the information in the voter pamphlet.[19] The Court in that case found it significant that the permanent fund amendment ballot language "did not expressly say the fund's income could be dedicated."[20] And in regard to the language of the amendment and the Court's determination of whether the amendment sufficiently provided an exception from the dedicated funds clause to permit the dedication of permanent fund income, the Court held that the amendment did not provide such an exemption:

> We remain unwilling to add missing terms to the Constitution or to interpret existing constitutional language more broadly than intended by… the voters. Without an explicit exception to the anti-dedication clause, we will not abstrusely interpret the Permanent Fund clause to permit the dedication of its income.[21]

Accordingly, although the *Wielechowski* decision concerned the permanent fund and not the CBR, the analysis in the opinion regarding how to interpret a constitutional amendment that creates an exception to the anti-dedication clause applies equally to an interpretation of the CBR.

In its recent review, the Department of Law analyzed the CBR amendment including its language, the voter pamphlet on the proposed CBR amendment, prior interpretations by the Department of Law, and the Alaska Supreme Court decisions on the CBR amendment. The Department concluded that additional production tax and royalties received by the State as an indirect result of adjustments in the value of oil following from oil pipeline tariff litigation should be deposited into the general fund instead of the CBR. We concluded that as with the question of permanent fund income

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18 403 P.3d 1114, 1152 (Alaska 2017).

19 *Id.* at 1150.

20 *Ibid.*

21 *Id.* at 1152 (internal quotations and citations omitted).

addressed in *Wielechowski*, the CBR amendment does not include an "explicit exception" to the dedicated funds prohibition for state revenues received after the resolution of tariff disputes. Additionally, the Department of Law concluded that the voters would not have reasonably considered "litigation…involving royalties…or taxes imposed on mineral income" as including oil pipeline tariff disputes before the Federal Energy Regulatory Commission ("FERC"). On this point, the FERC has no jurisdiction over state production taxes or royalties and the dispute in a FERC case is about the tariffs charged by pipeline owners to those shipping oil on a particular pipeline. The State is not even necessarily a party to such pipeline tariff proceedings, unless it chooses to intervene.

Moreover, tariffs are simply one component of transportation costs considered in the calculations of the value of oil or gas for the larger calculation of royalties and production taxes and there is nothing inherent to production taxes or royalties that requires consideration of tariffs to determine the value of oil or gas. Thus, the effect of tariff disputes on State royalties and taxes is far from direct given the level of calculations involved. While a taxpayer may dispute tariff issues in separate forums that may or may not involve the State, it does not follow automatically that the taxpayer would dispute the resulting change in tax flowing indirectly from the tariff dispute. Taxpayers can file amended returns to address those sorts of issues without disputing the amount of state tax. If the taxpayer does dispute the tax, then the amount that is ultimately paid to the State would go into the CBR.

And importantly, when considering how to interpret a constitutional amendment approved by the voters, the Court has held that the amendment must be given "a plain ordinary meaning"[22] and the attenuated relationship between tariff disputes and taxes and royalties is not a connection that would have been obvious to voters. The more natural reading of the CBR amendment requires, in order for a deposit to the CBR to be mandatory, that the subject matter of the litigation or administrative proceeding is a dispute on the amount of particular production taxes or royalties owed to the State and that the litigation itself would result in an order as to a particular tax or royalty dispute.

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22 *Id.* at 1146.

Significantly, this is also consistent with the Department of Law's prior views on this issue.[23]

D. Department of Law's determination of what monies should be deposited into the CBR.

Based on the above legal analysis, it is the Department of Law's view that revenues received as described below should be deposited in the CBR:

- Money received after an audit assessment by the Department of Revenue of oil and gas production taxes (AS 43.55), oil and gas corporate income taxes (AS 43.20), and mining license tax (AS 43.65). It does not matter whether the taxpayer appeals the notice of assessment from an audit or whether the taxpayer and the State settle following an audit.[24] Also, all money received in a tax settlement that covers multiple years even if not all the years have been subject to a notice of assessment following an audit is required to be deposited into the CBR as it becomes part of the disputed tax.[25]

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[23] 1992 Att'y Gen. Op. 85 (April 24) (litigation for the purpose of the CBR was litigation where the complaint itself involved a disputed mineral liability); 1994 Inf. Op. Att'y Gen. (May 23, 663-94-0591), 1994 WL 804635 (the CBR amendment "does not apply to disputes between third parties that may indirectly affect an amount received by the State"); 1995 Inf. Op. Att'y Gen. (May 18, 663-95-0475, 663-95-0474), 1995 WL 867852, at 1 (the Department of Revenue should deposit into the CBR the entire amount of a lump-sum tax settlement even if only some of the tax years for the settlement had been subject to a notice of assessment after an audit).

[24] *Hickel v. Halford*, 872 P.2d 171 at 179 nt. 15 (Alaska 1994)("[A] dispute may exist for our purposes even where the non-initiating party immediately agree with the initiating party's assertions and where the non-initiating party would have been disposed to agree prior to the initiation of the proceeding. It is the placing of the issue in controversy, under circumstances that require a response and eventual resolution of the issue, and not the exact means by which a resolution is reached, that indicate the presence of a dispute.")

[25] 1995 Inf. Op. Att'y Gen. (May 18) ("Lump-sum tax settlements received at the termination of a tax appeal must be deposited in the [CBR], regardless of whether some of the money received was to settle unassessed years").

- Money received by the Department of Revenue from the oil and gas exploration, production, and pipeline transportation property tax ("property tax") in AS 43.56[26] if
  - the notice of assessment was appealed[27];
  - the taxpayer appealed the statement of amount of tax due[28];
  - the statement of amount of tax due was the result of a supplemental assessment or audit[29]; or
  - the money is received following a notice of assessment and demand for payment for a failure to timely pay.[30]
- Money received by the Department of Revenue after a notice of assessment of a penalty for the oil and gas production tax, oil and gas corporate income tax, property tax, and mining license tax.[31]
- After the deposit of any portion that is required to be deposited in the permanent fund, money received by the Department of Natural Resources:
  - after a decision of the Department of Natural Resources that relates to an underpayment of royalty or a net profit share lease amount provided the decision states that the lessee may appeal the decision. This would include decisions on royalty audits and net profit share lease audits.

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[26] The CBR amendment supersedes the requirement in AS 43.56.150(c) to deposit property tax revenues into the general fund. Also, the property tax is distinct from the two taxes considered in *Hickel v. Halford* because the property tax is not a self-reported tax. Unlike the oil and gas production tax and the oil and gas corporate income tax, it is the Department of Revenue—not the taxpayer—that first provides an assertion as to the amount of tax due. The analysis in *Hickel* on what is an administrative proceeding is still relevant. But, a dispute does not exist for property tax until the taxpayer appeals the notice of assessment because that is the first time both sides would have made contrary assertions to create a dispute.

[27] AS 43.56.110.

[28] AS 43.56.135.

[29] AS 43.56.080; AS 43.56.140.

[30] AS 43.56.135; AS 43.56.150 – 160.

[31] *Hickel*, 872 P.2d at 183.

- after the appeal process in a royalty-in-kind sales contract has commenced.[32]
- after any litigation where the State's royalties, mineral lease bonus, or rental amounts are at issue in the complaint. This would include a State complaint alleging lost royalties as damages in a corrosion case or a settlement following a case concerning a request for royalty relief.
- following a decision that relates to an underpayment of a mineral lease bonus or rental amount provided the decision states that the lessee may appeal the decision.

- Money received by the State from an administrative proceeding or litigation involving federal mineral revenue sharing payments or royalties. This could include litigation between the State and the federal government over mineral revenue sharing payments.

E. The Department of Law's determination on what monies should not be deposited into the CBR.

- Money received by the Department of Revenue for estimated payments of oil and gas production taxes, oil and gas corporate income taxes, and mining license taxes.
- Money received by the Department of Revenue following an original tax return for the oil and gas production, oil and gas corporate income tax, and mining license tax.[33]
- Money received by the Department of Revenue for payment of property tax that has not been subject to an appeal of the assessment, audit, supplemental return, or demand for payment after a failure to timely pay.
- Money received by the Department of Revenue along with an amended return from an oil and gas production taxpayer or an oil and gas corporate income taxpayer that is a result of an administrative proceeding or litigation that does not involve the underlying state tax. This would include amended production tax returns filed due to changes in the value of oil or gas following from tariff litigation before the Federal Energy Regulatory

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[32] 1994 Inf. Op. Att'y Gen. (May 23) (Reasoning that either DNR or Petro Star would have needed to file a complaint or filed a document invoking the administrative remedy provisions in the sales contract to meet the document exchange requirement for initial of administrative proceedings for the purposes of the CBR).

[33] 1995 Inf. Op. Att'y Gen. (May 18) ("Money received for tax years for which no assessment has been issued, and for which liability has not been fixed at the termination of the administrative proceeding, however, should be deposited into the general fund.").

Commissioner ("FERC"), Regulatory Commission of Alaska ("RCA") or Quality Bank methodologies. It could also include amended returns filed to report changes to lease expenditures resulting from adjustments to the taxpayer's federal income tax returns required by the Internal Revenue Service.[34]

- Money received by the Department of Revenue from an amended return prior to a notice of assessment by the Department of Revenue that includes a self-reported penalty. This could happen if a taxpayer filed a return a day late, realized its error, and self-reported that late penalty in the return.[35]
- Money received by the Department of Natural Resources following amended royalty or net profit share lease reports that were filed due to litigation that did not address state royalties or net profit share leases.[36] This could include amended reports to address the changes to the value of oil or gas following from tariff litigation before the FERC, RCA or Quality Bank methodologies.
- Money received by the Department of Natural Resources following adjustments to the value of oil due to other litigation that require additional payments under a royalty in-kind sales contract.[37]

If you have any additional questions, please feel free to contact Cori Mills at (907) 465-2132 or cori.mills@alaska.gov.

Sincerely,

Kevin G. Clarkson
Attorney General

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34 AS 43.20.030(d); AS 43.55.075(b); 15 AAC 305(c) & (d).

35 15 AAC 55.305(d) (Example 5).

36 1994 Inf. Op. Att'y Gen. (May 23) ("[A] settlement or judgment may result in an increase in future revenues; yet, these revenues would not be subject to deposit in the [CBR] because they were not the subject of the decree or settlement.")

37 *Id.*