

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 16, 2012

1:13 p.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Alan Dick
Representative Bob Herron
Representative Cathy Engstrom Munoz
Representative Berta Gardner
Representative Scott Kawasaki

MEMBERS ABSENT

Representative Peggy Wilson, Vice Chair
Representative Neal Foster

COMMITTEE CALENDAR

HOUSE BILL NO. 328

"An Act relating to the oil and gas corporate income tax; relating to the credits against the oil and gas corporate income tax; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 328

SHORT TITLE: OIL AND GAS CORPORATE TAXES

SPONSOR(S): REPRESENTATIVE(S) SEATON

02/17/12	(H)	READ THE FIRST TIME - REFERRALS
02/17/12	(H)	RES, FIN
02/29/12	(H)	RES AT 1:00 PM BARNES 124
02/29/12	(H)	Heard & Held
02/29/12	(H)	MINUTE(RES)
03/16/12	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

MICHAEL HURLEY, Director
Government Relations and Community Affairs

ConocoPhillips Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 328.

MARIE EVANS, Tax Counsel
ConocoPhillips Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: Answered questions related to HB 328.

KARA MORIARTY, Executive Director
Alaska Oil & Gas Association (AOGA)
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 328.

DAN SECKERS, Vice Chair, Tax Committee
Alaska Oil and Gas Association (AOGA)
Anchorage, Alaska

POSITION STATEMENT: Answered questions related to HB 328.

ROBYNN WILSON, Income Audit Manager
Anchorage Office
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Answered questions related to HB 328.

JOHANNA BALES, Deputy Director
Anchorage Office
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Answered questions related to HB 328.

DEBBIE STOJAK, Assistant Attorney General
Commercial/Fair Business Section
Civil Division (Juneau)
Department of Law (DOL)
Anchorage, Alaska

POSITION STATEMENT: Answered questions related to HB 328.

ACTION NARRATIVE

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CO-CHAIR PAUL SEATON called the House Resources Standing Committee meeting to order at 1:13 p.m. Representatives Dick,

Kawasaki, Herron, Feige, and Seaton were present at the call to order. Representatives Munoz and Gardner arrived as the meeting was in progress.

HB 328-OIL AND GAS CORPORATE TAXES

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CO-CHAIR SEATON announced that the only order of business would be HOUSE BILL NO. 328, "An Act relating to the oil and gas corporate income tax; relating to the credits against the oil and gas corporate income tax; making conforming amendments; and providing for an effective date."

CO-CHAIR SEATON opened public testimony.

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MICHAEL HURLEY, Director, Government Relations and Community Affairs, ConocoPhillips Alaska, Inc., stated his company opposes the passage of HB 328. He said if the purpose of this proposed change to separate accounting is simply to increase revenue from the industry, ConocoPhillips Alaska, Inc. is unsure how that improves the fiscal environment to attract the additional capital investments needed to increase production in Alaska. In regard to the philosophy of state income taxation, he noted that ultimately any state income tax system must try to balance the kind of taxation on businesses that have business in multiple states. When dealing with multistate entities, a state must figure out how to separate the income appropriate to the state, and most states do that by utilizing an apportionment formula. Each state looks at the attributes of the business in its state; for example, how much payroll, or property, or sales the company has in the state compared to all the states or jurisdictions combined where the company does business. A fraction is then created based on some combination of those attributes to apportion the total income of the business into that particular state. That avoids the problem of double taxation which can occur when different states are trying to tax the same income where the income is not easily determinable. That system has become somewhat standardized through the Multistate Tax Compact, a compact between the states that is overseen by the Multistate Tax Commission, of which Alaska is a member. That is the system Alaska has now, although it has a few tweaks in terms of how Alaska does its apportionment factor.

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MR. HURLEY said separate accounting is the other methodology, whereby the business is looked at separately for each state. He said only 2 of the 45 states in which ConocoPhillips does business use separate accounting; the other 43 all do some kind of apportionment based on either the Multistate Tax Compact or some other methodology. From a policy perspective, Alaska has a worldwide apportionment system because the fraction is applied against the total income of his company. An apportionment factor is determined of how much divisible income is thought apportionable to Alaska of ConocoPhillips Alaska, Inc.'s worldwide income. That brings in things like the company's refining assets in the Lower 48, distribution assets, and upstream operations both in Alaska and in other places. He pointed out that refinery and distribution income tends to be countercyclical with oil and gas income. Upstream income varies a lot with oil prices and, notionally, when oil prices are high refining margins are low and when oil prices go down refining margins go up. So, apportioning worldwide income catches both sides of that balance for getting income taxable to the state. That countercyclical nature tends to make Alaska's state income tax much less volatile than, for example, Alaska's severance tax and royalties that are very tightly tied strictly to oil prices.

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MR. HURLEY warned that if the state were to adopt the separate accounting methodology proposed in HB 328, the state would in essence be doubling down on oil prices. Alaska's royalty and severance taxes are already tightly tied to oil prices, so going to a separate accounting system would add another tax that is highly volatile based on oil prices, rather than balanced out by the other income sources that ConocoPhillips Alaska, Inc. has throughout the country. He further pointed out that the current apportionment system has considerable value to the state in the ability of the Department of Revenue (DOR) to use the federal income tax return, which is what the apportionment factor is applied to as a basis for starting that apportionment calculation. The federal rules regarding what constitutes a deductible expense have long been debated and resolved between taxpayers and the Internal Revenue Service (IRS). The state is able to rely on federal audits of the taxpayer's revenues and expenses, saving the state the cost of creating its own audit staff and the grief of having to define all of those expenses, credits, appreciation, and such. Reiterating his company's opposition to HB 328, he said separate accounting would make the state's overall fiscal regime more dependent on oil prices with

that inherent volatility and would require the creation of a burdensome and costly system to administer.

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CO-CHAIR SEATON advised that HB 328 is not being put forward to increase revenue. He said Alaska-only businesses, such as Great Bear Petroleum LLC, Brooks Range Petroleum Corporation, and UltraStar Exploration, are paying 9.4 percent on their profits from Alaska. However, according to [consultant] Dan Dickinson the international oil companies paid less than 9.4 percent every year from 1982-1997. He asked why a worldwide player should be allowed to pay a lower percentage on its corporate income tax than an Alaska-only corporation.

MR. HURLEY allowed that may be true historically, but suggested it is not always going to be the case. He said apportionment factors tend to bring in other assets like countercyclical refining and marketing assets, as well as the overseas assets of worldwide companies. He suspected that if his company's geographic breakdowns were looked at on its Form 10-K, it would be found that the margins being taxed in other jurisdictions, especially outside the U.S., are actually higher and therefore Alaska is bringing in more income than it would if only Alaska is looked at.

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CO-CHAIR SEATON countered that [the bill sponsors] had Legislative Legal and Research Services look at the past 10 years, which includes years of both high and low oil prices, and that factor was not seen. He offered to work with Mr. Hurley to analyze that more and requested data be provided backing up Mr. Hurley's aforementioned suggestion. Co-Chair Seaton added that when separate accounting was in place from 1975-1981 there was a definite washout of taxes to overseas less profitable ventures and this was also the same every year from 1982-1997. Going back to 2006, the corporate income tax paid by the highest aggregate of the five largest taxpayers in the state was 5 and 6 percent, except for 2006 which had a slight amount. While he understood Mr. Hurley theoretically, he said that has not actually taken place regardless of whether the worldwide price was high or low.

MR. HURLEY agreed to supply the data for his company. He recalled that Mr. Dickinson's data went back to the late 1970s and said that while the discrepancy in the numbers was pretty

big, it fell off quite a bit in the latter part of Mr. Dickinson's analysis.

CO-CHAIR SEATON said Mr. Dickinson's analysis went through 1997 and [the discrepancy] was \$96 million in 1997, the second lowest year.

MR. HURLEY replied that is what he would expect to see.

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CO-CHAIR SEATON noted that Mr. Hurley's company participates in the North Dakota jurisdiction, a jurisdiction that adds a surtax of 3.5 percent to its 5.15 percent tax for those companies electing the taxation method of water's edge. Therefore, he concluded, North Dakota obviously had the same experience that apportionment definitely reduces its revenue amounts. He understood that North Dakota increases its corporate income tax by 60 percent for a company electing apportionment instead of separate accounting.

MR. HURLEY responded he did not know which method his company uses in North Dakota, but said he will find out and get back to the committee.

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CO-CHAIR FEIGE related that one argument for going back to separate accounting is that companies wanting to reduce their corporate tax liability against their significant incomes generated in Alaska would come up with deductions to balance that out; thus, separate accounting would result in more investment being made in Alaska. He asked whether that presumed effect would be true for ConocoPhillips.

MR. HURLEY answered he is unsure that that particular form of the tax would have that much of an impact on investment decisions in terms of the portfolio of in Alaska versus other places. As a large multi-national corporation, ConocoPhillips pays state income tax in 45 different states and most of them use apportionment. Therefore, most other states are taxing some portion of his company's Alaska income, whether the company uses water's edge or worldwide. Therefore, the amount paid to the State of Alaska does not represent all of the state income tax that ConocoPhillips pays on its Alaska income. One of the theoretical concepts behind apportionment is that if everybody tries to get the right percentage, and taxes the common pool of

income, there should not be double taxation and everybody gets the right amount for the business in each state. In the perfect world every state would use the same pot of income and would have the same apportionment factors so there would be no double taxation. However, it does not work that way because some states like to double up on the sales factor and Alaska uses an extraction factor not used by any other state. When talking about how much state income tax ConocoPhillips pays on its Alaska income, only part may be paid to the State of Alaska but the company is also paying income taxes at the state level on Alaska income to other states. So, when evaluating investments in Alaska, ConocoPhillips must evaluate the impact of that investment on its Alaska state income tax as well as all those other states where the income generated from that investment will be taxed.

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CO-CHAIR SEATON directed attention to the 3/9/12 memo in the committee packet from [consultant] Roger Marks which states that at the national level the tax is, in all cases, calculated on a separate accounting basis. Co-Chair Seaton asked how it is that all the other jurisdictions are doing separate accounting but not Alaska. He asked Mr. Hurley to relate that to how Alaska is getting an apportionment of the revenue generated in those jurisdictions.

MR. HURLEY replied he was talking about state income taxes within the U.S.

CO-CHAIR SEATON said he realized this, but separate accounting is the topic, plus Alaska has worldwide apportionment, not water's edge apportionment. Most jurisdictions have separate accounting, except Alaska. He asked Mr. Hurley to state why it works or does not work for ConocoPhillips to pay separate accounting in Norway and worldwide apportionment in Alaska.

MR. HURLEY responded ConocoPhillips is getting double taxed on some of its Norway income because Alaska is drawing in some of the Norway income and taxing it as part of the company's worldwide income base, but vice versa is not true.

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CO-CHAIR SEATON said HB 328 would prevent double taxation by doing separate accounting. Norway would tax the income and expenses there and Alaska would tax the income and expenses

here, which would eliminate any possibility of double taxation. He urged Mr. Hurley to provide diagrams supporting what ConocoPhillips is saying. Co-Chair Seaton allowed Mr. Hurley may be right because Alaska allows costs to come in and be written off Alaska income. He understood Mr. Hurley to be saying that this would be a tax increase if Alaska was taxing the revenue [in Norway] and if [Norway] was the same profitability as Alaska. He said his perspective is that Alaska is reducing its corporate income tax to subsidize less profitable overseas investments. As the bill sponsor he is trying to get oil companies to invest in Alaska and take that as an expense instead of investing in other places and taking those as expenses.

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CO-CHAIR FEIGE surmised that the more jurisdictions using one type of taxation system, the less the double taxation.

MR. HURLEY concurred, adding that the reason for the Multistate Tax Compact is to try to get some kind of uniformity between the states.

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CO-CHAIR FEIGE noted Alaska taxes all companies operating in the state under the Multistate Tax Compact. He said the small explorers in Alaska do not have any income so they do not pay any corporate income tax. Excepting Pioneer Natural Resources Company and Buccaneer Energy, it is the large international corporations that at this point are the producers. Under separate accounting the international companies may or may not pay more corporate income tax, but they are paying a significant amount of production tax, which the other companies are not. In terms of total overall contribution, he asked how much ConocoPhillips pays in production tax.

MR. HURLEY believed ConocoPhillips paid \$5 billion in taxes and royalties [in 2011].

MARIE EVANS, Tax Counsel, ConocoPhillips Alaska, Inc., said she will look at the company's Form 10-K and get back to the committee with an exact answer.

CO-CHAIR SEATON noted the committee has a copy of the Form 10-K and therefore has the information.

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REPRESENTATIVE HERRON recollected that in 1985 all but 19 states used some form of separate accounting and he presumed the Multistate Tax Compact had something to do with that. He said the Alaska State Legislature abandoned separate accounting in 1981, but talked about it again in 1985 when revenue was at a low point. He asked whether this type of legislation has not found its time yet because revenue is not low.

MR. HURLEY suggested it is a policy call about how to make that definition rather than a question of whether it has found its time. While he understood the intellectual argument for going with separate accounting, he said that from a policy perspective it has its downsides. Those downsides are the increased cost and grief of administering it because the state would be unable to rely on the IRS to do some of that for it. Additionally, it would tie the state much more to oil prices, which would make the State of Alaska's revenue stream that much more volatile.

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REPRESENTATIVE HERRON noted that the legislature came back to separate accounting in 1985 because the revenue stream was really low. He asked whether the political reality is that this bill is at the wrong time because the state is enjoying high revenue. He further asked whether the state should go back to separate accounting at a time in the future when revenue is low.

MR. HURLEY answered that that would be exactly the wrong time to go to separate accounting. The state's revenue stream would be much reduced because it would be unable to draw in the refining and marketing pieces of the business that tend to balance out the low crude price in the state income tax under apportionment.

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CO-CHAIR SEATON agreed the aforementioned is a good theoretical argument, but said this has not happened in actuality according to the analyses he had performed, even when prices in Alaska were really low. He asked whether Alaska can be compared to the other states since they use water's edge and Alaska uses worldwide apportionment.

MR. HURLEY admitted it is an imperfect system, given different states have different apportionment factors and some use water's edge.

MS. EVANS, responding to Mr. Hurley, offered her belief that some states have worldwide apportionment, although she could not recall which ones.

MR. HURLEY, continuing, said the other states have different apportionment factors, and different weighting between the apportionment factors, regardless of whether the income bucket is water's edge or worldwide. The Multistate Tax Compact was an effort to reach some uniformity, but that has not been reached.

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CO-CHAIR SEATON inquired how much of a problem it is for ConocoPhillips in the three other states that have separate accounting versus apportionment.

MR. HURLEY related that he recently talked with some of his company's state income tax people who said it is quite a problem trying to do separate accounting states and it is a lot of work to fill out the returns for those states. He added that the apportionment states, for the most part, work off the same bucket of income that is already audited by the IRS and it is fairly consistent in the accounting system. A problem with separate accounting is that each state has a slightly different definition of expenses and a different way of treating corporate interest, which is done at the corporate level rather than at a particular business unit level within a state. These different allocations make it an extremely time-consuming exercise for the company as well as the state's regulators.

CO-CHAIR SEATON presumed it is a little bit more difficult because the Lower 48 fields may be integral between some states rather than segregated by 1500 miles like they are in Alaska.

MR. HURLEY concurred.

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MS. EVANS pointed out that, in terms of compliance, company staff makes a judgment call and files the forms, but there is then a whole other regulatory entity making another judgment call. After that there is the reconciling of those judgment calls and if that does not happen there is litigation. Thus, separate accounting is difficult.

CO-CHAIR SEATON noted the State of Alaska has been through litigation on separate accounting.

MS. EVANS said her company has, too, but not in Alaska.

CO-CHAIR SEATON added that the discussion is not about whether separate accounting is legal, but rather is a policy issue.

MR. HURLEY concurred that that has been resolved, but said the question is in the details of filing a tax return and trying to determine a department's interpretation of what is an expense versus what the company thinks is an expense.

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CO-CHAIR SEATON specified that HB 328 is drafted on the previous separate accounting that Alaska had. He pointed out that some things have changed, however, and the rules for depreciation that the companies work under in Alaska are the 1981 federal rules rather than current federal rules. So, unlike before, a company would be unable to marry its tax and write a check.

MR. HURLEY concurred.

CO-CHAIR SEATON presented a hypothetical scenario in which Alaska adopts separate accounting and has a full write-off of expenditures in the first year instead of a depreciation schedule spanning many years. He asked whether that would be seen as beneficial and simpler to implement for the calculation of income tax.

MR. HURLEY agreed it would be a simplification that would reduce the level of administrative burden.

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CO-CHAIR SEATON asked whether Mr. Hurley has any comments on the presentations by Mr. Roger Marks.

MR. HURLEY answered not at this time because this afternoon is the first he has seen them.

CO-CHAIR SEATON said he will leave public testimony open so Mr. Hurley can come back to share his thoughts in this regard, as well as any other data he would like to present.

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CO-CHAIR SEATON distributed an amendment related to education tax credits, labeled 27-LS1142\B.1, Nauman, 1/24/12, for committee members to review. He explained there is no intention to eliminate the education tax credits by going to the proposed separate accounting, but including them in the bill would have doubled the length of the bill and made it severely complicated to read. He therefore chose to split out the education tax credits in the form of an amendment.

CO-CHAIR SEATON invited the Alaska Oil and Gas Association to testify next.

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KARA MORIARTY, Executive Director, Alaska Oil & Gas Association (AOGA), explained that AOGA is a business trade association with the mission to foster the long-term viability of the oil and gas industry in Alaska for the benefit of all Alaskans. She said AOGA's member companies account for the majority of oil and gas exploration, production, transportation, refining, and marketing activities in Alaska. Further, AOGA's members reflect the breadth and scope of the industry across the state. She emphasized that her testimony today on HB 328 reflects a 100 percent consensus of AOGA's diverse membership. She explained that when AOGA testifies on matters of tax policy it is required that it have a 100 percent consensus of its members.

MS. MORIARTY said AOGA opposes HB 328, which would re-impose the separate accounting income tax that Alaska had for oil and gas companies from 1978-1981. Effective with the 1982 tax year, Alaska abandoned separate accounting in favor of the present oil and gas corporate tax found in AS 43.20 and, in particular, AS 43.20.072, which uses apportionment. Noting that separate accounting and apportionment are terms of art in the context of taxing multistate and international businesses, she said she will describe what each one is, how it works, and the relative strengths and weaknesses of each.

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MS. MORIARTY began a PowerPoint presentation, saying that separate accounting and apportionment both seek to answer the same question [slide 1]: How much income of a multistate or international business is properly attributable to its in-state assets and activities so it can be taxed by that state? This is

the question the committee is trying to answer with corporate income taxes.

CO-CHAIR FEIGE inquired whether it would be more proper to say how much net income.

MS. MORIARTY replied it could, but it is just how much income.

MS. MORIARTY, continuing her testimony [slide 2], said separate accounting takes the approach of looking at "what the business actually has and does in the state and then seeks to determine directly the net-income as if that in-state portion of the business stood alone - separate from the rest of the business." Conceptually, separate accounting seems to tackle the question of how much income is made by the in-state portion of a multi-jurisdictional business. However, appearances can be misleading and separate accounting has some challenges.

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MS. MORIARTY said one challenge [slide 3] is that the "in-state portion of such a business does not actually stand alone from the rest of the business. Whether the overall business is conducted with a single corporate entity or through a unitary web of closely and carefully coordinated affiliates, the opportunities are often present for the in-state portion to engage in business transactions with the out-of-state portions that technically are completely legal and proper, but which have the effect of shifting income and expenses, gains and losses, into and out of the in-state part of the overall business."

MS. MORIARTY illustrated how difficult it can be to unravel transactions between or among parts of the same overall business by pointing out that regulations have been adopted under the Internal Revenue Code to "control artfully created tax opportunities" within such a business. She said Section 13 of Treasury Regulation 1.1502 is 70 single spaced pages and that "this mammoth regulation establishes the general principles for unraveling various tax effects otherwise created artfully by transactions between or among affiliated corporations." Sections 14, 15, and 16 apply and adapt those general principles to specific kinds of businesses or specific kinds of transactions. These regulations run in numerical order all the way out to 100, showing how complicated it can get when unraveling transactions between corporate affiliates as required by separate accounting.

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MS. MORIARTY explained that in contrast, apportionment "starts with a 'pie' containing the apportionable income for the in-state and outside business together and then determines how wide the 'slice' is attributable to the income-generating potential of the in-state portion of the business [slide 4]. It is the 'slice' that is then taxed by that state. This avoids the need to unravel transactions across parts of the overall business and it avoids the analytical difficulties that arise when a unitary business as a whole is greater than the sum of its individual parts [slide 5]. The key assumption underlining apportionment is that overall a dollar invested in-state has the same income generating potential as the dollar invested anywhere else, that a dollar of sales has the same potential as the dollar of sales elsewhere, that a worker in-state is as productive per dollar of wages and benefits as a worker outside, that a barrel of oil or its equivalent of a gas produced in-state represents comparable potential for profitability as one produced someplace else, or a similar assumption about comparable in-state and everywhere else potential as measured by a similar business attribute or indicator. So, the bottom line is for oil and gas producers and pipeline companies and their affiliates that are doing business in Alaska, the width of the Alaska slice of their respective business's pie is the average of the percentages of that business's real or tangible property or cost, its sales, and its oil and gas production that is present in Alaska."

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MS. MORIARTY noted that "after laying out this key economic assumption underlying and justifying apportionment methodology, the Alaska Supreme Court continued in 1985 that 'These factors are merely indicative of the business income producing capabilities. They are not intended to reflect the business's precise sources of income for any particular year. The factors in an apportionment formula represent an attempt to relate the taxpayer's presence within the state to its presence elsewhere.' So, what all the theory and economics boils down to is this: For any given taxpayer, the question of whether its Alaskan income tax will be greater under separate accounting than under apportionment depends on whether the actual profitability of its Alaska business is greater overall than the actual profitability of the combined in-state and outside business as measured by the per dollar invested per sales sold and per barrel produced. If the in-state part of the business is materially superior by these standards than the combination, it wants apportionment as

the lesser tax; if materially inferior it prefers separate accounting."

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MS. MORIARTY reminded members that AOGA represents a wide range of oil and gas companies, so the aforementioned means that certain oil and gas taxpayers can start out preferring separate accounting because they would pay less tax than under apportionment; others will start out preferring apportionment. The side of the line that a particular company falls on depends on its own circumstances. There is nothing inherent about separate accounting that causes the taxpayer's tax to be greater than that taxpayer's tax with apportionment. However, something inherent about a non-renewable resource like oil and gas is that no matter how long an oil company may initially start out preferring apportionment over separate accounting as the lesser tax, there will eventually come a day when its oil and gas resources in Alaska will become sufficiently depleted that separate accounting will become the smaller tax for that business. Therefore, AOGA believes it premature to restructure Alaska's corporate income tax. Also, depending on how Alaska structures the rest of its overall tax regime, which the legislature is currently debating, the enactment of separate accounting at this time could turn out to be a self-fulfilling prophecy in terms of hastening the crossover for more and more members of the industry in Alaska. That is particularly likely if separate accounting is enacted as part of an overall tax structure and policy of merely taking more money from the industry instead of optimizing the opportunities. There is a sweet spot between having 100 percent of nothing or 0 percent of everything; there is a sweet spot between these two extremes where the tradeoff is optimized between the size of one share and the size of what there is to be shared. She said AOGA believes that Alaska has too high a government take and has already overshot the mark in terms of the size of the state's share. Enacting separate accounting to increase the state's share would be a further mistake. She reiterated that AOGA opposes HB 328.

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CO-CHAIR SEATON disputed the assumption that the pie can be split because labor produces the same amount of revenue and costs the same regardless of location. He said labor was totally taken out of the formula because it was so problematic of not yielding the same. Although there is the theoretical of

what apportionment is supposed to do, apportionment has already been rejected on the basis of the three portions talked about by Ms. Moriarty. Apportionment would work if profitability around the world was the same, but this is not the case. According to publically released data, Alaska is more profitable than many other jurisdictions, which results in Alaska lowering its income tax to subsidize round-the-world investments.

MS. MORIARTY replied that as a trade association AOGA is prohibited from talking about the profits and sales of its member companies. However, she said, as a tax policy this is the difference between separate accounting and apportionment from a theoretical standpoint.

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CO-CHAIR SEATON noted that Alaska is doing worldwide apportionment and many of the jurisdictions being dealt with on that apportionment are doing separate accounting. For example, Norway has separate accounting and several companies doing business in Alaska are also doing business in Norway. He asked how those two things would interact.

MS. MORIARTY responded she does not know the specifics of the Norway tax structure and she is not a tax expert, but when AOGA's member companies looked at this bill as a whole, they preferred the current system.

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REPRESENTATIVE HERRON inquired whether Ms. Moriarty is saying that the state's potential revenue would be less for production from the outer continental shelf (OCS).

MS. MORIARTY answered she is saying that HB 328 would affect the companies that are currently operating on state lands; not that companies would make less on offshore and she will get back to the committee in this regard. Member companies, she continued, must look at her testimony before she can testify and the member companies operating in the offshore did not have a problem with opposing HB 328.

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REPRESENTATIVE GARDNER said she was struck by Ms. Moriarty's description of the federal tax code as it would apply for

separate accounting. She asked what industries this code applies to and how it works for them.

MS. MORIARTY, responding first to Co-Chair Seaton, confirmed she was talking about the tax code for separate accounting. In response to Representative Gardner, she understood that this federal tax code would apply to any consolidated business, not just oil and gas companies that have consolidated businesses.

REPRESENTATIVE GARDNER presumed someone must be using this federal tax code, so it must be fairly doable or the code would not have happened at all.

MS. MORIARTY replied she is saying it is very tenuous and complicated to separate those costs, but not impossible.

[2:22:04 PM](#)

REPRESENTATIVE MUNOZ requested Ms. Moriarty to comment on an earlier statement that Alaska's financial picture becomes more volatile with separate accounting when prices are low.

MS. MORIARTY responded that when prices are low the profits are going to be lower.

REPRESENTATIVE MUNOZ understood that, but asked why revenue to the state would be more volatile with separate accounting.

MS. MORIARTY deferred to AOGA's tax attorney, Mr. Dan Seckers, for further response.

DAN SECKERS, Vice Chair, Tax Committee, Alaska Oil and Gas Association (AOGA), concurred with ConocoPhillips that revenue to the state would be more volatile at lower prices. He said the principle reason is that under worldwide apportionment there are the attributes of other income from the business that are not so price sensitive that can buffer a low price scenario that could occur in Alaska. Under separate accounting, the Alaska income would be driven by price and therefore when prices go down the income that Alaska would see would go down.

MR. SECKERS, addressing Representative Herron's question about the OCS, explained that the OCS income would not be taxed by the State of Alaska because it is outside of the state. Therefore, separate accounting would not bring in much of the income from OCS, whereas apportionment would. In response to Co-Chair

Seaton, he confirmed that the entire organization of AOGA is unanimous in Ms. Moriarty's testimony.

[2:24:34 PM](#)

REPRESENTATIVE GARDNER, in regard to the statements that Alaska's income would be more volatile under a low price scenario with separate accounting, asked whether it would also be true to say that it would be less volatile at high prices.

MR. SECKERS replied that at high prices the overall worldwide income of the company would also hopefully be doing very well and therefore the pie would be bigger that Alaska would have a portion to. So, it is not necessarily a clear cut yes or no answer that separate accounting would be any worse off when prices are really high.

[2:25:39 PM](#)

CO-CHAIR SEATON pointed out that a company could own different types of businesses and some of those businesses could be countercyclical to oil prices, which under worldwide apportionment would make for less volatility. However, a company owning only upstream oil and gas is very price dependent, so the volatility would probably be exactly the same. He asked whether he is correct in this understanding.

MR. SECKERS confirmed this to be correct. He said a buffer is provided when an integrated oil company owns downstream, upstream, chemical, and other businesses, which is why modified apportionment provides a more stabilized corporate income tax stream to the state.

[2:27:31 PM](#)

REPRESENTATIVE HERRON presumed that around the world some jurisdictions have apportioned accounting and some have separate accounting.

MR. SECKERS confirmed the aforementioned.

REPRESENTATIVE HERRON inquired what the advantage is to Mr. Seckers' company [ExxonMobil Production Company] to have separate accounting in those jurisdictions.

MR. SECKERS responded he is present to speak as one voice through AOGA and therefore he cannot speak on behalf of a member company. He offered to get back to members on the question.

CO-CHAIR SEATON requested Mr. Seckers to also get back to the committee on the North Dakota example of separate accounting and water's edge apportionment and how the many of [ExxonMobil Production Company] businesses in North Dakota use separate accounting and how many use water's edge.

MS. MORIARTY replied AOGA would get back to the committee to the best of its ability.

[2:29:26 PM](#)

REPRESENTATIVE GARDNER asked whether there are other regimes around the world that give companies the option of selecting a tax method and how the companies decide which method to select.

MS. MORIARTY answered AOGA will try its best to get back to the committee on that.

REPRESENTATIVE DICK surmised a more accurate tax is what is being asked for. While there are disadvantages to doing business in Alaska, there must also be advantages because the profitability in Alaska seems to be greater than in other places. Therefore it is a matter of finding the sweet spot for taxation.

[2:32:14 PM](#)

CO-CHAIR SEATON drew attention to the 3/9/12 memorandum from Mr. Roger Marks, noting it states that almost every other jurisdiction around the world uses corporate income tax at the national level based on separate accounting rather than worldwide apportionment. A couple of different mechanisms are used and almost all have an income tax. Two jurisdictions, the U.S. and Canada, have corporate income tax at the sub-national level. He said he has been unable to find any other state besides Alaska that does worldwide apportionment; the other states do water's edge, meaning only within the U.S. itself. Alaska's current tax, depreciation schedules, and regulations are based on the 1981 federal income tax and not on the current federal income tax.

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CO-CHAIR FEIGE inquired whether the federal government uses separate accounting or apportionment.

CO-CHAIR SEATON replied that according to Mr. Roger Marks all the national levels deal with separate accounting.

CO-CHAIR FEIGE asked whether every country in the world uses separate accounting.

CO-CHAIR SEATON paraphrased from page 1, paragraphs 2 and 3, of the 3/9/12 memorandum by Mr. Marks, which states [original punctuation provided]:

At the national level, of the 57 countries in BP's 2011 "Statistical Review of World Energy"¹ that produce either a minimum of 80,000 barrels per day of oil, or 0.1 billion cubic feet per day of gas (see attached), nearly all of them impose a corporate income tax.² (Iran, Libya, Mexico, and Trinidad and Tobago do not.)

At the national level, in all cases the tax is calculated on a separate accounting basis....

[2:35:57 PM](#)

CO-CHAIR SEATON, responding further to Co-Chair Feige, confirmed that those 57 countries are oil producing countries. He said the memorandum from Mr. Marks was in response to the committee's questions and the committee did not include a question about what non-oil producing countries do. He inquired whether Co-Chair Feige would like to ask that question of Mr. Marks.

CO-CHAIR FEIGE affirmed he wishes to ask that question, saying it is pertinent because a company will have some areas in which it makes more income and has more expenses than in others. It is to an oil producing country's advantage to institute separate accounting. However, for non-oil producing countries, but in which oil companies operate, worldwide accounting would be used to tap into some of those profits. Therefore, it appears that each country is using the system that is to its best advantage.

[2:36:59 PM](#)

CO-CHAIR SEATON agreed to ask that question of Mr. Marks, but added he thinks it is difficult to tax something that a country has no relationship to the production of. He concurred it is to

an oil producing country's advantage to use separate accounting, which is why HB 328 is before the committee.

CO-CHAIR FEIGE maintained the aforementioned analogy is skewed because it does not look at all the countries in the world, it looks only at the oil producing countries. Responding further to Co-Chair Seaton, he said he would like to ask the question, "What do all the countries in the world use as far as an accounting system?" He pointed out that just about every country in the world has an oil company operating in it because there are cars in most countries. In further response to Co-Chair Seaton he agreed to write out the question and clarified he is asking about corporate income tax, not oil production.

[2:39:15 PM](#)

CO-CHAIR FEIGE surmised that changing from Alaska's current corporate tax structure to a separate accounting structure would entail a significant increase in manpower and time devoted to the accounting for the different system. He asked how much more resources, people, and money would be needed to institute separate accounting.

ROBYNN WILSON, Income Audit Manager, Anchorage Office, Tax Division, Department of Revenue (DOR), replied the DOR fiscal note shows four additional positions because HB 328 would essentially put the income into two baskets of an oil and gas company, and that is the separately-accounted-for production income which is on a state specific basis. Therefore, certain expenditures are allowed as expenses and certain are not, but [HB 328] has no real definition of those expenses. The rest of the business is then apportioned on a federal income tax basis. Instead of apples and apples, [HB 328] would be apples and oranges. The particular difficulty would be with intercompany transactions. Under the current system Alaska piggybacks off the federal rules where those rules are set up under specific rules. For example, an intercompany might have engineering expenses that one part of the business is providing to the production part of the business, but under HB 328 DOR would not know how to account for those. Further, DOR cannot rely on the Internal Revenue Service (IRS) to audit to the invoice level, so for those companies DOR auditors would have a lot more work auditing down to the invoice level.

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CO-CHAIR FEIGE inquired whether DOR could keep up with that with four more people.

MS. WILSON responded this is DOR's best estimate on its first look at the bill and it is continuing to evaluate resources.

CO-CHAIR FEIGE remarked that a company would be able to employ its own accountants to generate the transactions for legally shifting monies to the company's advantage. He asked how much additional work that would entail for DOR versus what the department has to do now.

MS. WILSON answered it would be a tremendous amount of work because DOR must look into intercompany transactions as well as such things as transfer pricing between parts of the business. Articles in the Wall Street Journal have reported on problems that even the federal government has with auditing transfer pricing. These problems include companies accounting for revenues such that income shows up offshore in different foreign corporations and escapes federal taxation. Problems include transfer prices, intercompany transactions, lack of definitions in the bill for expenses, and so on.

[2:44:15 PM](#)

JOHANNA BALES, Deputy Director, Anchorage Office, Tax Division, Department of Revenue (DOR), interjected that even within water's edge transfer pricing can be used to shift income offshore, and transfer pricing is one reason why a lot of the states that require apportionment went to a worldwide. She further noted that North Dakota requires worldwide apportionment and does not have separate accounting; a company can elect to do water's edge in North Dakota, but it then pays a premium and the reason for that is because of the intercompany transactions and the transfer pricing. North Dakota requires worldwide formulary apportionment, she reiterated, just like Alaska.

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MS. WILSON added that the states using water's edge, in general, struggle with the same problems the federal government does, but they do it in a different way. She understood that, in general, there is some political push in other states to go to water's edge rather than worldwide apportionment. The reason for water's edge as opposed to worldwide is that states then suffer when there is income reported in the foreign entities that they cannot pick up on their combined report, which is very similar

to what the U.S. government struggles with as activities and profits are reported, then, by foreign corporations rather than domestic corporations. Domestic corporations pay income tax on all activities; it is not on a separate accounting basis for the U.S. She further clarified that separate accounting is a term of art that does not mean separate corporate accounting. The U.S. federal government taxes corporations as a person - as a taxable entity; it does not subdivide within that corporate's books to do separate accounting, which is a geographic determination, not a legal entity.

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CO-CHAIR FEIGE inquired why the State of Alaska did not go back to separate accounting when the courts ruled in the state's favor in the mid-1980s.

MS. BALES replied she and Ms. Wilson have been with the state 19 and 17 years, respectively, so that history predates both of them. She and Ms. Wilson understood it was a policy decision not to return to separate accounting. In further response to Co-Chair Feige, she agreed to research why that policy decision was made.

[2:49:42 PM](#)

REPRESENTATIVE DICK conjectured that the dynamic was quite different that many years ago. While it might be to the state's advantage to do separate accounting today, it may not have been that way back then.

REPRESENTATIVE HERRON recalled a 1981 coup in the Alaska's House of Representatives and said that immediately following that coup the state abandoned separate accounting. In response to Co-Chair Seaton, he maintained that it was a policy decision.

[2:51:18 PM](#)

CO-CHAIR FEIGE asked whether there would be a chance of litigation if the state were to change its taxing method.

DEBBIE STOJAK, Assistant Attorney General, Commercial/Fair Business Section, Civil Division (Juneau), Department of Law (DOL), responded the area of taxation is wrought with controversy. Multiple changes have occurred within and outside the state since the last supreme court case involving the change to separate accounting - the Multistate Tax Commission being one

change outside the state and within Alaska there has been a total change to the state's production tax. Given these state and federal changes, she said "imaginative" lawyers could think of theories that would amount to challenges of a change to separate accounting. In further response, she said she cannot definitively say the state would get sued, but that she can certainly imagine a challenge. Given it was challenged back then, it is very likely that it could be challenged if the change is made again.

[2:52:58 PM](#)

CO-CHAIR SEATON recalled that separate accounting was upheld by the Alaska Supreme Court. The U.S. Supreme Court dismissed it saying there were no constitutional or federal statutory issues. Therefore, at this point in time, this is where the state is at.

MS. STOJAK concurred the aforementioned is correct in terms of that specific litigation.

[HB 328 was held over.]

[2:54:19 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 2:54 p.m.