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1 IN THE HOUSE

BY THE FINANCE COMMITTEE

2

HOUSE BILL NO. 353

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FOURTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to the taxation of oil and gas  
7 corporations; and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 \* Section 1. FINDINGS. (a) The legislature finds that it is fair and  
10 reasonable to view income from oil or gas exploration or production as  
11 earned when and where exploration occurs or the oil is produced. It is  
12 also fair and reasonable to view income from the pipeline transportation of  
13 oil or gas as earned when and where the oil or gas is transported.

14 (b) The legislature finds that the amount of a unitary business'  
15 income that is attributable to oil or gas exploration, production, or  
16 pipeline transportation within a state can be fairly apportioned to that  
17 state through the use of separate accounting. Separate accounting in  
18 AS 43.22 reaches and is intended to reach profits reasonably attributable  
19 to in-state exploration, production, or transportation, and does not reach  
20 other profits attributable to out-of-state activities such as refining and  
21 marketing.

22 (c) The legislature finds that the use of a formula is not as fair as  
23 separate accounting for estimating in-state income from oil or gas  
24 exploration, production, or pipeline transportation. While formulas are  
25 generally suited to most industries, oil or gas exploration and production  
26 income is better apportioned through separate accounting because

27 (1) use of a formula presumes that all segments of a business  
28 are equally profitable; oil and gas production, however, is disproportion-  
29 ately profitable when compared to other segments of an integrated oil

1 company's business, so formulas tend to understate income attributable to  
2 production activities;

3 (2) the property factor used in most formulas does not include  
4 the value of oil reserves, and as a result understates income attributable  
5 to oil production; use of the property factor also assumes that all  
6 property is currently producing income, so it can create a tax burden on  
7 companies that are exploring for but not producing oil or gas in the state;

8 (3) use of an extraction factor presumes that each barrel of oil  
9 produced is equally profitable, which can result both in undertaxation of  
10 large, profitable fields, and overtaxation of marginal fields;

11 (4) use of a payroll factor understates production income,  
12 because oil production is not labor intensive;

13 (5) in this state use of a destination sales factor is not  
14 sensitive to the magnitude of production activity;

15 (6) use of a formula results in in-state tax liability that is  
16 dependent upon factors unrelated to the actual profitability of in-state  
17 exploration or production, so use of a formula has resulted and will result  
18 in identically situated oil producers paying widely disparate income taxes  
19 to the state; and

20 (7) for the reasons set out in (1) - (6) of this subsection, the  
21 use of separate accounting will result in more comparable tax rates on  
22 in-state earnings among and between multi-state companies engaged in prof-  
23 itable oil exploration or production activity and other taxpayers than the  
24 use of a formula.

25 (d) The legislature finds that separate accounting is the customary  
26 means of estimating oil or gas pipeline transportation income, and there is  
27 no need to rely on a formula to estimate pipeline transportation income.

28 (e) The legislature finds the use of separate accounting by the state  
29 between 1978 and 1981 under former AS 43.21 to apportion oil or gas

1 production and pipeline transportation income resulted in a fair  
2 apportionment of this income to the state. The repeal of AS 43.21 by ch.  
3 116, SLA 1981, reflected the legislature's desire to limit the state's  
4 potential liability in Atlantic Richfield Company, et al. v. State of  
5 Alaska et al. (Alaska Supreme Court No. S-52). While the legislature  
6 believed that its risk of loss in that litigation was small, the magnitude  
7 of a possible refund for tax years extending beyond 1981 was unacceptably  
8 high. Additionally, the legislature believed in 1981 that the enactment of  
9 ch. 116, SLA 1981, would not result in a substantial reduction in the fair  
10 tax liability created by former AS 43.21. Since enactment of ch. 116, SLA  
11 1981, however, the tax liability of those subject to former AS 43.21 has  
12 declined to levels that do not fairly reflect in-state earnings.  
13 Additionally, subsequent decisions of the United States Supreme Court have  
14 improved the state's chances of success in the litigation. Therefore, it  
15 is in the public interest for the state to reinstitute separate accounting.  
16 However, because it is also in the public interest to avoid creating new  
17 uncertainty regarding the receipt of state tax revenue, the effective date  
18 of this Act is deferred until the Alaska Supreme Court reconfirms that  
19 separate accounting is a constitutionally permissible means of  
20 apportionment.

21 \* Sec. 2. AS 43.20.011 is amended by adding new subsections to read:

22 (g) The tax on a corporation engaged in exploration for or  
23 production or pipeline transportation of crude oil or natural gas in  
24 the state shall be determined and paid in accordance with AS 43.22.  
25 The taxable income of the corporation not subject to AS 43.22 shall be  
26 determined so that

27 (1) the total taxable income of the corporation is its  
28 entire income less the portion of that entire income attributable to  
29 the worldwide exploration for and production and pipeline

1 transportation of oil and gas;

2 (2) the numerator and denominator of the property factor,  
3 the payroll factor, and the sales factor shall be calculated without  
4 reference to that portion of property, payroll, or sales directly  
5 related to the worldwide exploration for and production and pipeline  
6 transportation of oil or gas.

7 (h) For purposes of this section, "exploration" has the meaning  
8 given in AS 43.22.900.

9 \* Sec. 3. AS 43 is amended by adding a new chapter to read:

10 CHAPTER 22. OIL AND GAS CORPORATE INCOME TAX.

11 Sec. 43.22.010. APPLICATION. This chapter applies to a corpora-  
12 tion doing business in the state that is engaged in the exploration  
13 for or production or pipeline transportation of oil or gas in the  
14 state. The tax calculated under this chapter is measured by the total  
15 taxable income of the corporation during the tax period as determined  
16 under AS 43.22.020 - 43.22.040 and is calculated at the rates estab-  
17 lished under AS 43.20.011(e).

18 Sec. 43.22.020. DETERMINATION OF TAXABLE INCOME FROM OIL AND GAS  
19 EXPLORATION AND PRODUCTION. (a) The taxable income of a corporation  
20 from the exploration for or production of oil and gas in the state is  
21 the corporation's net income as calculated by the department under  
22 this section.

23 (b) Gross income from oil and gas exploration and production is  
24 the gross value at the point of production of oil or gas produced from  
25 a lease or property in the state. The department shall by regulation  
26 determine a uniform method of establishing the gross value at the  
27 point of production. In making its determination the department may  
28 use the actual prices or values received for the oil or gas, the  
29 posted prices for the oil or gas in the same field, or the prevailing

1 prices or values of oil or gas in the same field. In addition, in its  
2 determination of gross value at the point of production of oil or gas  
3 produced from a lease or property, the department shall determine the  
4 reasonable costs of transportation from the point of sale to the point  
5 of production of the oil or gas. Transportation costs set by a tariff  
6 properly on file with the Alaska Pipeline Commission or other regula-  
7 tory agency shall be considered prima facie reasonable, but if a  
8 tariff properly on file with a regulatory agency is subsequently  
9 amended, changed, or overturned retroactively, the reasonable costs of  
10 transportation shall be recomputed for that period using the newly  
11 determined tariff.

12 (c) Net income from oil and gas exploration and production shall  
13 be determined by the department by deducting from gross income the  
14 following:

15 (1) royalties paid in kind or in value;

16 (2) taxes imposed under AS 43.55 and AS 43.57 that are  
17 actually paid or incurred by the corporation on the production from a  
18 lease or property in the state;

19 (3) taxes imposed under AS 29.53 and AS 43.56 that are  
20 actually paid or incurred by the corporation on property used directly  
21 in the production of oil or gas from a lease or property in the state,  
22 including property used in producing, gathering, treating or preparing  
23 the oil or gas for pipeline transportation, but only if those property  
24 tax payments were due and payable only after the date of commercial  
25 production from the lease or property with which the property was  
26 associated;

27 (4) the direct costs incurred by or for the corporation in  
28 operating the lease or property, including the direct costs of produc-  
29 ing, gathering, treating or preparing the oil or gas for pipeline

1 transportation, but net of any payments received for those activities  
2 and not including any indirect cost or overhead expense;

3 (5) depreciation, using the unit of production method or  
4 other reasonable methods the department may by regulation establish,  
5 on property used directly in producing, gathering, treating or prepar-  
6 ing the oil or gas for pipeline transportation, including amortization  
7 of capitalized interest for investments in this property at a rate not  
8 to exceed the average cost of borrowed capital to the taxpayer during  
9 the year in which it is capitalized;

10 (6) the amortization of lease acquisition payments and  
11 taxes paid or incurred under AS 29.53 and AS 43.56, including capital-  
12 ized interest on both, for or on producing properties before the  
13 commencement of commercial production from the lease or property for  
14 which the property is being used;

15 (7) interest expense of the corporation not capitalized  
16 during construction, that was paid or incurred in connection with  
17 property in the state; however, unless (f) of this section applies,  
18 the interest expenses may not exceed that portion of the total inter-  
19 est paid by the consolidated business of which the corporation is a  
20 part, determined by multiplying the total interest by a fraction, the  
21 numerator of which is the value of the corporation's real and tangible  
22 personal property used directly in the production of oil or gas from a  
23 lease or property in the state and the denominator of which is the  
24 value of all real and tangible personal property of the consolidated  
25 business; in this paragraph, "total interest paid by the consolidated  
26 business" does not include interest expense arising from intercompany  
27 obligations within the consolidated business except to the extent that  
28 the interest expense reflects a pass-through of interest on a third-  
29 party borrowing by the parent or other member of the consolidated

1 business with the purpose, expressed at the time of the third-party  
2 borrowing, of financing business activity in the state by the taxpayer  
3 corporation;

4 (8) expenses incurred by the corporation after December 31,  
5 1984, related to unsuccessful exploration for oil or gas in the state,  
6 including the acquisition costs of abandoned properties, dry hole  
7 costs, and the costs of geological and geophysical exploration related  
8 to those abandoned properties;

9 (9) general overhead or administrative expense incurred by  
10 the corporation attributable to oil or gas exploration or production  
11 activities in the state to the extent, except as provided in (f) of  
12 this section, that it does not exceed that portion of the total gen-  
13 eral overhead or administrative expense incurred by the consolidated  
14 business of which the corporation is a part, determined by multiplying  
15 the total general overhead or administrative expense by a fraction,  
16 the numerator of which is the value of the corporation's real and  
17 tangible personal property used directly in the exploration or produc-  
18 tion of oil or gas in the state and the denominator of which is the  
19 value of all real and tangible personal property of the consolidated  
20 business;

21 (10) the amount of income from the production of oil and gas  
22 from a lease or property that is divided among the regional Native  
23 corporations under 43 U.S.C. 1606(i) (sec. 7(i) of the Alaska Native  
24 Claims Settlement Act).

25 (d) Deductions from gross income under this section do not  
26 include expenses previously deducted on a return filed under AS 43.20.

27 (e) If a corporation subject to this chapter shares the produc-  
28 tion or proceeds of the production from a lease or property through a  
29 working interest, royalty interest, overriding royalty interest,

1 production payment, net profit interest, joint venture or other agree-  
2 ment, the department shall allocate the deduction from gross income  
3 between the corporation and the persons with whom it has such an  
4 agreement in accordance with the terms of the agreement.

5 (f) If a corporation demonstrates to the satisfaction of the  
6 department that it paid or incurred actual expenses for interest or  
7 for general overhead or administration attributable to oil and gas  
8 exploration or production activities in the state in an amount greater  
9 than the amount determined under (c)(7) or (c)(9) of this section, the  
10 department may allow the corporation to deduct the greater amount.

11 Sec. 43.22.030. DETERMINATION OF INCOME FROM OIL AND GAS PIPE-  
12 LINE TRANSPORTATION. (a) Except as provided in (c) of this section,  
13 taxable income attributable to the transportation of oil in a pipeline  
14 engaged in interstate commerce in the state shall be determined by the  
15 department and shall be the amount reported or that would be required  
16 to be reported to the Federal Energy Regulatory Commission or its  
17 successors as net operating income, less those portions of interest  
18 and general administrative expense attributable to the pipeline trans-  
19 portation of oil in the state, except that taxable income also  
20 includes taxes on or measured by income. The department shall adopt  
21 regulations governing the determination of interest and general admin-  
22 istrative expense attributable to pipeline transportation of oil in  
23 the state.

24 (b) Except as provided in (c) of this section, taxable income  
25 attributable to the transportation of natural gas in a pipeline en-  
26 gaged in interstate commerce in the state shall be determined by the  
27 department and shall be the amount reported or that would be required  
28 to be reported to the Federal Energy Regulatory Commission as net  
29 operating income less that portion of interest and general

1 administrative expense attributable to pipeline transportation in the  
2 state, except that the taxable income also includes taxes on or  
3 measured by income. The department shall adopt regulations governing  
4 the determination of interest and general administrative expense  
5 attributable to pipeline transportation of natural gas in the state.

6 (c) Taxable income attributable to the transportation of oil or  
7 natural gas in the state by any corporation not under the Federal  
8 Regulatory Commission jurisdiction, or by a corporation under the  
9 jurisdiction of the Federal Energy Regulatory Commission but not  
10 reporting the operation of pipelines in the state separately from the  
11 operation of pipelines elsewhere, shall be determined by the depart-  
12 ment and shall be based upon an amount equal to that which would have  
13 been reported to the Federal Energy Regulatory Commission under (a) of  
14 this section in the case of oil pipelines, or (b) of this section in  
15 the case of natural gas pipelines, had the corporation been, in fact,  
16 under Federal Energy Regulatory Commission jurisdiction for the tax-  
17 able year and required to report on the operation of pipelines in the  
18 state separately from the operation of pipelines elsewhere.

19 Sec. 43.22.040. DETERMINATION OF INCOME FROM ACTIVITIES OTHER  
20 THAN OIL AND GAS EXPLORATION, PRODUCTION, OR PIPELINE TRANSPORTATION.

21 (a) Taxable income of a corporation subject to this chapter from  
22 activities in this state, other than oil and gas exploration and  
23 production or pipeline transportation in the state, shall be  
24 determined under the combination and apportionment method established  
25 in art. IV of the multistate tax compact (AS 43.19.010) and in  
26 AS 43.20.071, as modified by (b) - (d) of this section.

27 (b) The total taxable income of the consolidated business is its  
28 entire income less the portion of that income attributable to world-  
29 wide oil and gas exploration and production or pipeline

1 transportation. In this subsection,

2 (1) for a member of a consolidated business who is required  
3 to file under the Internal Revenue Code, "entire income" means taxable  
4 income under Subtitle F and chapter 1 of Subtitle A of the Internal  
5 Revenue Code of 1954, as amended;

6 (2) for a member of a consolidated business who is not  
7 required to file under the Internal Revenue Code, "entire income"  
8 means book income, except that a taxpayer may elect to report income  
9 as the income would be determined under (1) of this subsection.

10 (c) The numerator and denominator of the property factor, the  
11 payroll factor, and the sales factor shall be calculated without  
12 reference to that portion of property, payroll, or sales directly  
13 related to the worldwide oil and gas exploration and production or  
14 pipeline transportation.

15 (d) The value attributed to vessels that are not owned or effec-  
16 tively owned by consolidated business but are transporting oil or gas  
17 of the consolidated business produced in the state shall be excluded  
18 from the property factor.

19 Sec. 43.22.050. ASSESSMENT OF INCOME AND TAX. (a) The depart-  
20 ment shall assess taxable income and the amount of tax payable on that  
21 taxable income.

22 (b) On or before August 15 of each year the department shall  
23 send to every corporation taxable under this chapter a notice of  
24 assessment showing the amount of income taxable under this chapter for  
25 the previous year and the amount of tax payable on that taxable in-  
26 come.

27 (c) The department may combine taxable incomes of corporations  
28 subject to tax under this chapter if they are part of the same  
29 consolidated business.

1 (d) If the methods of allocation and apportionment provided in  
2 this chapter do not fairly represent the extent of a corporation's  
3 business activity in the state, the corporation may petition for or  
4 the department may require, in respect to all or any part of the  
5 corporation's business activity, if reasonable, the employment of any  
6 method authorized under art. IV, sec. 18, of the multistate tax com-  
7 pact (AS 43.19.010) to achieve an equitable allocation and appor-  
8 tionment of a corporation's income. The commissioner shall include in  
9 the annual report required in AS 43.22.110 a report on all relief  
10 granted under this subsection, including for each case a statement of  
11 the changes in tax liability resulting from the granting of relief,  
12 the tax years involved, and a description of the method of determining  
13 taxable income that was substituted for those provided in this chap-  
14 ter.

15 Sec. 43.22.060. RETURNS. On or before April 15 of each year, a  
16 corporation subject to tax under this chapter shall submit a return in  
17 a form prescribed by the department setting out information required  
18 by the department to determine taxable income. The department may  
19 require corporations subject to tax under this chapter who are part of  
20 the same consolidated business to file a single return.

21 Sec. 43.22.070. PAYMENT OF TAX. The tax levied under this  
22 chapter is payable to the department on or before September 30 of each  
23 year or in installments, including prepayments of estimated tax, at  
24 the times and under the conditions the department may by regulation  
25 require. This tax is payable on the due date set out in this section  
26 even though the assessment is under appeal or the validity, enforce-  
27 ability or application of this chapter or any provision of this chap-  
28 ter is challenged before the department or in the courts.

29 Sec. 43.22.080. REGULATIONS. (a) The department shall adopt

1 transitional regulations for corporations subject to tax under  
2 AS 43.20 before January 1, 1985, to avoid double taxation of the same  
3 income and double deduction of the same expense of those corporations  
4 as a result of becoming subject to tax under this chapter. The  
5 department shall provide by regulation for crediting taxes paid under  
6 former AS 43.20.072 to the tax due under this chapter, and for refund-  
7 ing any excess.

8 (b) The department may adopt regulations in accordance with the  
9 Administrative Procedure Act (AS 44.62) to administer and enforce this  
10 chapter.

11 Sec. 43.22.090. PENALTIES. The penalties established in  
12 AS 43.20 apply to this chapter.

13 Sec. 43.22.100. PUBLIC REPORTING. (a) The commissioner of  
14 revenue shall compile and submit to the legislature an annual con-  
15 solidated report of state revenue and taxation policies under this  
16 chapter. The report must include total aggregate income tax paid by  
17 corporations covered under this chapter and aggregate income and  
18 deductions by category, classified to prevent the identification of  
19 particular returns or reports.

20 (b) The legislative auditor shall submit to the legislature an  
21 annual report reviewing the actions of the department in administering  
22 this chapter.

23 Sec. 43.22.900. DEFINITIONS. Unless the context requires other-  
24 wise, the definitions contained in AS 43.55.140 are applicable to this  
25 chapter. In addition, in this chapter

26 (1) "consolidated business" means a corporation or group of  
27 corporations having more than 50 percent common ownership, direct or  
28 indirect, or a group of corporations in which there is common control  
29 either directly or indirectly as evidenced by any arrangement,

1 contract, or agreement;

2 (2) "exploration" means those exploration activities under-  
3 taken before production by a corporation with a production interest or  
4 a prospective production interest in a lease or property, but only to  
5 the extent of that interest; it does not include activity or income  
6 earned or expense incurred if another party has the production  
7 interest or prospective interest in a lease or property, such as oil  
8 field services performed for compensation.

9 \* Sec. 5. AS 43.55.011(b) is amended to read:

10 (b) The percentage-of-value amount equals 12.25 percent of the  
11 gross value at the point of production of taxable oil produced [ON OR  
12 BEFORE JUNE 30, 1981,] from the lease or property [AND 15 PERCENT OF  
13 THE GROSS VALUE AT THE POINT OF PRODUCTION OF TAXABLE OIL PRODUCED  
14 FROM THE LEASE OR PROPERTY AFTER JUNE 30, 1981; EXCEPT THAT FOR A  
15 LEASE OR PROPERTY COMING INTO COMMERCIAL OIL PRODUCTION AFTER JUNE 30,  
16 1981, THE PERCENTAGE-OF-VALUE AMOUNT EQUALS 12.25 PERCENT OF THE GROSS  
17 VALUE AT THE POINT OF PRODUCTION OF TAXABLE OIL PRODUCED FROM THE  
18 LEASE OR PROPERTY IN THE FIRST FIVE YEARS AFTER THE START OF COMMER-  
19 CIAL OIL PRODUCTION AND EQUALS 15 PERCENT OF THE GROSS VALUE AT THE  
20 POINT OF PRODUCTION OF TAXABLE OIL PRODUCED THEREAFTER FROM THE LEASE  
21 OR PROPERTY].

22 \* Sec. 6. AS 43.20.072 is repealed.

23 \* Sec. 7. Sections 1 - 4 and 6 of this Act are retroactive to Janu-  
24 ary 1, 1985.

25 \* Sec. 8. Section 5 of this Act applies to tax years beginning Janu-  
26 ary 1, 1987.

27 \* Sec. 9. This Act takes effect on the date that the Alaska Supreme  
28 Court renders a final decision wholly affirming the superior court in the  
29 case of Atlantic Richfield et al. v. State of Alaska et al. (Alaska Supreme

1 Court No. S-52).