HB
297

"An Act relating to the oil and gas reserves ad valorem tax and its relationship to other oil and gas taxation; and providing for an effective date."

COMMITTEE REPORT

4/17/75 HOUSE FINANCE

Mr. Speaker: Date 4-21-75

The Committee on RESOURCES has had SSHB 297 under consideration. A Majority of the members of the Committee

( ) recommends it DO PASS

( ) recommends it DO NOT PASS

( ) recommends it DO PASS WITH ATTACHED AMENDMENT(S)

(X) recommends it BE REPLACED WITH CS FOR SSHB 297 AND THAT CS FOR SSHB 297 ~~DO PASS~~ DO NOT PASS

( ) "and" recommends it BE REFERRED TO THE ______ COMMITTEE

( ) reports it back WITHOUT RECOMMENDATION

( ) "other"

Members signing the Majority report:

[illegible signatures] Do NOT PASS

Nels A. Anderson, Jr. — Do Not overpass — Novel

[illegible] — Do NOT PASS — Mike Hershberger

[illegible] — [illegible]

Members NOT concurring in the Majority report:

______ recommends:

______ recommends:

______ recommends:

______ recommends:

______ recommends:

Nels A. Anderson, Jr. Chairman

AGO 547333

STATE OF ALASKA

JAY S. HAMMOND, Governor

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER / *POUCH S — JUNEAU 99801*

April 10, 1975

The Honorable Richard I. Eliason
Alaska State Legislature
State Capitol
Juneau, Alaska

Dear Mr. Eliason:

During our presentation on Senate Bill 276 yesterday we distributed copies of a memorandum and fiscal note which I prepared on March 18, 1975. One of the attachments to that memorandum is a table indicating an example of how the credit provisions of the bill would work. You expressed interest in the far right-hand column titled "Cumulative Credit Balance." This column represents the amount of cumulative Ad Valorem Tax paid which has not been credited against severance taxes at the end of each fiscal year.

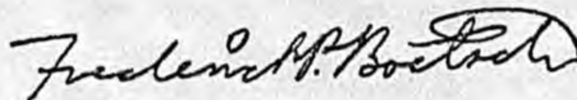
You asked that I calculate what the accumulated interest cost on this balance might be if it were borrowed at 8%. This would reflect the viewpoint of a taxpayer if he had to borrow the money to pay the tax. We should bear in mind, however, that the taxpayer would get a deduction on his Federal Income Tax Return for both the property tax and any interest expense. In effect, this means that the Federal government will actually pay part of the cost of both tax and interest. That proportion depends on the effective tax rate of the taxpayer. Since this varies from year to year and taxpayer to taxpayer, I have not attempted to calculate the net economic effect on the taxpayer of the tax and any interest expense he might incur in connection with it. I have, instead, calculated the gross interest based on the balances shown for each year on the attachment to my March 18 memo.

I have assumed that the balances would be drawn down from 1978 forward on a straight line basis so that the average between two year-end amounts is the amount on which interest would be paid. While this is not entirely accurate, it is quicker to calculate and does not materially distort the total interest figure. Total interest at 8% per year on the Cumulative Credit Balance for the years 1976 through 1981 would be about $150 million. I should emphasize that this is the gross amount before any Federal Income Tax benefits derived from the payment of the property tax or the interest.

A'D 547319

These benefits could amount to as much as $280 million in reduced Federal taxes.

Best regards,



Frederick P. Boetsch, C.P.A.
Deputy Commissioner, Taxation

FPB:eh

AGO 547320

oil: gas

(File)

Koniag, Inc.
REGIONAL NATIVE CORPORATION

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HARRY CARTER, V.P.
KARL ARMSTRONG, SEC.
PERRY EATON, TREAS.

Cherrier-King & Cherrier Bldg.
Post Office Box 746
KODIAK, ALASKA 99615
Telephones 486-4147/4148/4149
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DIRECTORS
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ALLEN HEITMAN
NICHOLAS PESTRIKOFF
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FRAN WAMSER
IVER MALUTIN
ALLEN PANAMAROFF
SVEN HAAKANSON
WALTER SIMEONOFF

LEGAL COUNSEL
ROY H. MADSEN — KODIAK
EDWARD WEINBERG — WASH.D.C.

April 3, 1975

Representative Nels A. Anderson
Alaska State Legislature
Pouch V
Juneau, Alaska 99801

Dear Nels:

I wish to inform you that I am in complete agreement with your views on taxing oil and gas in place as stated in your letter to Representative Mike Bradner, March 29, 1975. I believe that the Regional Corporations would suffer irreparable damage if this concept were adopted. Those regions who have signed exploratory agreements would face immediate bankruptcy if this tax were imposed on their known reserves.

The concept of taxing oil and gas in place would possibly enhance the State of Alaska's financial picture but at the same time retard the development of our hydrocarbon energy potential.

Also, as Harvy stated in his February 19th letter to you, once reserves are proven, Oil Companies will be forced to extract such reserves as quickly as possible.

Koniag, under such circumstances could not afford to find oil or gas reserves!

I would hope that the wisdom of our legislature address itself to resolving the financial crisis of the State in a manner that is fair and equitable to all.

Sincerly,

KONIAG, INC.

Jack Wick

Jack Wick
President

JW:com

cc: Kay Poland

AGO 547321

John Colberg, Jr.
Chairman of the Board

Ralph A. Johnson
President

COOK INLET
CIRI
REGION, INC.

Recd 4/14/75 3:00 p.m.

April 11, 1975

Mr. Nels A. Anderson, Jr.
Chairman - House Resource Committee
Pouch V
Juneau, Alaska 99811

Dear Nels:

Cook Inlet Region, Inc. takes the position that the land and subsurface resources of all Native Regions has been specifically given a non-taxable status until either development takes place, or January 1, 1992, whichever comes first and cannot be taxed.

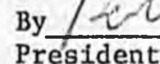
There is no question, however, as to the State's need for tax revenue and since the need is primarily due to the delay caused by the environmental impact of the Alyeska Pipeline, an equitable method of advance payment of taxes (advalorem, severance, etc.) or royalties should be proposed. However, there are other industries in Alaska and equity might require some contribution by them.

Since the largest forseeable source of revenue is from subsurface resources, fisheries and timber, ultimate payment will have to come from the consumers of the products sold by those industries.

Cook Inlet Region would like to hear the views and proposals of these industries before making a recommendation.

Sincerely,

COOK INLET REGION, INC.



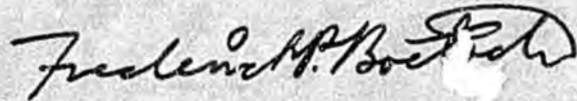
By
President

RAJ:bf

1211 W. 27th • ANCHORAGE, ALASKA • 99503 • PHONE 274-8638 AGO 547322

These benefits could amount to as much as $280 million in reduced Federal taxes.

Best regards,



Frederick P. Boetsch, C.P.A.
Deputy Commissioner, Taxation

FPB:eh

AGO 547323

STATE OF ALASKA

JAY S. HAMMOND, Governor

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER / *POUCH S — JUNEAU 99801*

April 10, 1975

The Honorable Richard I. Eliason
Alaska State Legislature
State Capitol
Juneau, Alaska

Dear Mr. Eliason:

During our presentation on Senate Bill 276 yesterday we distributed copies of a memorandum and fiscal note which I prepared on March 18, 1975. One of the attachments to that memorandum is a table indicating an example of how the credit provisions of the bill would work. You expressed interest in the far right-hand column titled "Cumulative Credit Balance." This column represents the amount of cumulative Ad Valorem Tax paid which has not been credited against severance taxes at the end of each fiscal year.

You asked that I calculate what the accumulated interest cost on this balance might be if it were borrowed at 8%. This would reflect the viewpoint of a taxpayer if he had to borrow the money to pay the tax. We should bear in mind, however, that the taxpayer would get a deduction on his Federal Income Tax Return for both the property tax and any interest expense. In effect, this means that the Federal government will actually pay part of the cost of both tax and interest. That proportion depends on the effective tax rate of the taxpayer. Since this varies from year to year and taxpayer to taxpayer, I have not attempted to calculate the net economic effect on the taxpayer of the tax and any interest expense he might incur in connection with it. I have, instead, calculated the gross interest based on the balances shown for each year on the attachment to my March 18 memo.

I have assumed that the balances would be drawn down from 1978 forward on a straight line basis so that the average between two year-end amounts is the amount on which interest would be paid. While this is not entirely accurate, it is quicker to calculate and does not materially distort the total interest figure. Total interest at 8% per year on the Cumulative Credit Balance for the years 1976 through 1981 would be about $150 million. I should emphasize that this is the gross amount before any Federal Income Tax benefits derived from the payment of the property tax or the interest.

AGO 547324

I hope that these comments are useful in putting the role of ad valorem taxation into perspective.

Sincerely,

Robert H. Paschall
Consulting Valuation Geologist
and Engineer

cc Senator Chancy Croft
Senator John Huber
Representative Steven Cowper

AGO 547325

File

460 Lovella Way
Sacramento CA 95819
14 April 1975

The Honorable Nels Anderson
Chairman, House Resources Committee
Alaska State Legislature
Juneau Alaska 99811

Dear Mr. Anderson:

It may be useful to you if I expand on something that we talked about at lunch in Senator Croft's office. It is my impression, looking back on my week in Alaska, that undue emphasis has been placed on the economic impact of ad valorem taxation. I readily grant your legislature's right and obligation to make its own decision on the alternatives now before you. At the same time, I would regret seeing even the right decision made for the wrong reasons. As a result, I would like to list the main elements that go into oil industry decision-making in regard to new leases. I contend that these elements are listed in the industry's order of priority.

1. Political Climate

The political climate is now very bad in the Mid East, North Africa, and Venezuela, only fair in Canada, and good in the United States, including Alaska.

2. Promising Geological Structures

No one will bid unless the geology is promising. If it is promising, it is hard to beat people off with a stick, as the money laid out for the 24th lease sale showed.

3. Availability of Money to Bid

Availability of money depends on the financial status of individual companies and on the money market, that is, on the amount of funds on hand for lending and the interest rate charged for those funds.

4. Availability of Pipeline or of Tanker Transportation

This problem is a familiar one to Alaskans, and needs no comment.

5. Availability of Drilling Rigs

The high costs of preparing rigs for Alaska operations and of shipping them makes rig availability especially important in your state.

6. Future Expenses

These expenses fall into three major categories: drilling and other development costs, oil and gas production costs, and royalty and taxes.

AGO 547326

01119235

TELEGRAM

02042 NL ANCHORAGE AK 57 04-11 1212P ADT

PMS REP NELS ANDERSON

JUN" 1053

RCA ALASKA COMMUNICATIONS
PHONE: 586-6440
JUNEAU, ALASKA 99801

SEVERANCE AND RESERVES TAXES PROPOSED ARE INEFFECTIVE AS REVENUE PRODUCERS IN LONG RUN BECAUSE THEY INHIBIT DEVELOPMENT. IF REVENUE IS AIM, SUGGEST FAIR TAXES BASED ON NET MINING INDUSTRY COULD HAVE SUBSTANTIAL BENEFITS IN PROVIDING INDUSTRIAL BASE AND BUSH EMPLOYMENT IF ALLOWED TO DEVELOP. PLEASE CONTACT IF DESIRE FORMAL TESTIMONY

C C HAWLEY CHAIRMAN AMA ANCHORAGE BRANCH STAR ROUTE A
BOX 78D ANCHORAGE 99507

AGO 547327

TELEGRAM

RCA ALASKA COMMUNICATIONS, INC.
PHONE: 586-6440
JUNEAU, ALASKA 99801

021-605

02051 ANCHORAGE AK 75 04-14 318A ADT

1975 APR 14 PM 6 34

PMS NELS A ANDERSON CHAIRMAN

HOUSE RESOURCES COMMITTEE 1298

JUN

REFERENCE HB102, HB297.

CALISTA CORPORATION GOES ON RECORD IN SUPPORT OF TEXTIMONY GIVEN ON THESE BILLS BY OTHER NATIVE REGIONAL CORPORATIONS. WE ARE ADAMANTLY OPPOSED TO THIS TYPE OF TAXATION AND THE RAMIFICATIONS OF SUCH TAXATION ON LAND HOLDINGS SOON TO BE CONVEYED TO NATIVE REGIONAL CORPORATIONS. WE FEEL THIS TYPE OF TAXATION IS ILL ADVISED AND RECOMMEND THAT THE STATE SEEK REVENUES FROM THE SALE OF ANTICIPATION NOTES AND BONDS

RAY C CHRISTANSEN CHAIRMAN OF THE BOARD

CALISTA CORPORATION

AGO 547328

TELEGRAM

RCA ALASKA COMMUNICATIONS, INC.
PHONE: 586-6440
JUNEAU, ALASKA 99801

Oil & Gas

NV 1975 APR 24 PM 1 46

18004 NL NOME ALASKA 59 04-24 930A BDT

PMS NELS ANDERSON

2442 HOUSE RESOURCES COMMITTEE

POUCH V

JUNEAU

WE STRONGLY OPPOSE AD VELOREM TAXATION ON OIL AND GAS BECAUSE OF THE ANTI CONSERVATION AND ANTI ENVIRONMENT NATURE OF SUCH TAX. IT IS INEQUITABLE BECAAUSE FULL AND TRUE VALUE CANNOT ACTUALLY BE DEFINED. SUCH TAXATION PRECLUDES ORDERLY DEVELOPMENT. IT IS DAMAGING TO INDIVIDUALS, PRIVATE AND PUBLIC SECTOR, AND ULTIMATELY IS DETRIMENTAL TO STATE INTERESTS.

JEROME TRIGG PRESIDENT BERING STRAITS NATIVE CORPORATION

AGO 547329

TELEGRAM

RCA ALASKA COMMUNICATIONS, INC.
PHONE: 586-6440
JUNEAU, ALASKA 99801

#CJ

1975 APR 30 PM 12 17

04004 POM TDA EAGLE RIVER 15 04-30 730A ACT

PMS REP NELS ANDERSON JR
3137

JUN

35 YEAR RESIDENT AGAINST HB297 HB294 REVERSING

AFFECT OIL AND MINING INDUSTRY

GARY CORTNEY BOX 648 EAGLE RIVER 99577

AGO 547331

STATES INTERIM FUNDING NEEDS, THAN YOU ARE MISREPRESENTING

FACTS TO THE PEOPLE THAT YOU REPRESENT

ROGER LANG PRESIDENT AFN

AGO 547332

HB 297

Alaska State Legislature

SENATOR CHANCY CROFT
PRESIDENT OF THE SENATE

POUCH V
JUNEAU, ALASKA 99811
PHONE 907-465-3755

425 G STREET
ANCHORAGE, ALASKA 99501

May 31, 1975

The Honorable Chancy Croft
President of the Senate

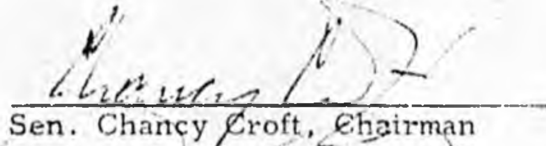
The Honorable Mike Bradner
Speaker of the House of Representatives

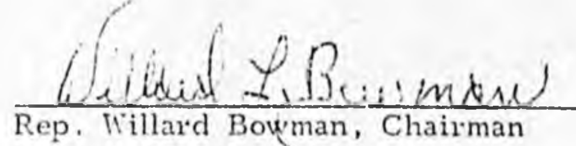
Gentlemen and Members of the
Senate and House:

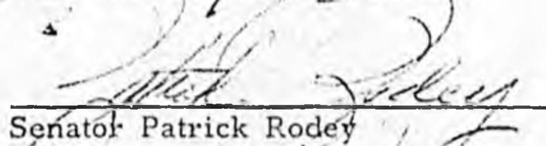
The members of the Free Conference Committee that considered Free Conference Committee Substitute for Senate Committee Substitute for Committee Substitute for Sponsor Substitute for House Bill 297 (oil and gas reserves ad valorem tax) are directing this letter of intent to accompany the Committee report of the bill to fully explain our intent with respect to certain provisions of the bill.

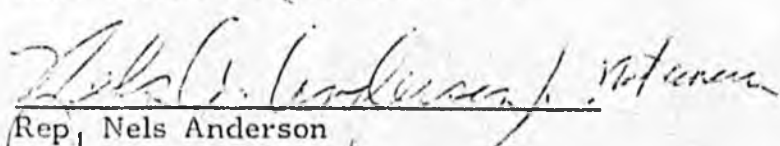
Section 43.58.020(3) provides an exemption for oil and gas properties until the earlier of any three conditions are met by certain persons with regard to transmission facilities to transport oil and gas that may be produced from the lease or property. It is our intent that the words "owner or operator" as used in these paragraphs includes any affiliate or subsidiary of such owner or operator.

With regard to A.S. 43.58.070 in the bill relating to appeals, it is our intent that the scope of review of an appeal to the superior court involving a tax assessment should be in accordance with the Administrative Procedure Act (A.S. 44.62).

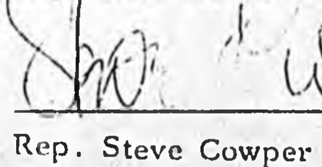

Sen. Chancy Croft, Chairman


Rep. Willard Bowman, Chairman


Senator Patrick Rodey


Rep. Nels Anderson

Senator John Sackett


Rep. Steve Cowper

AGO 547334

LAW OFFICES

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633 SEVENTEENTH STREET

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JOHN W. LOW
WILLIAM F. VOELKER
THOMAS B. FAXON
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DONALD W. ROE
MICHAEL D. GROSHEK
WILLIAM F. SCHOEBERLEIN
MICHAEL A. WILLIAMS
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GARY L. GREER
STEPHEN M. BRETT
CONSTANCE L. HAUVER
CHAPMAN B. COX

E. [illegible] DALE
CH[illegible]PHER LANE
CRAIG A. CHRISTENSEN
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KURT A. KAUFMANN
R. MICHAEL SANCHEZ
[illegible]DORE E. WORCESTER
ANDREW L. BLAIR, JR.
RODNEY D. KNUTSON
STEPHEN P. KREGSTEIN
EDWARD W. NOTTINGHAM
[illegible]AL B. TUDOR
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LARRY R. MARTINEZ
WILLIAM E. WALTERS, III
MARK L. FULFORD
JAMES F. WOOD

FRITZ A. NAGEL
COUNSEL

JAMES H. PERSHING (1863-1946)
ROBERT G. BOSWORTH (1888-1954)
LEWIS A. DICK (1889-1954)

TWX 910-931-0812

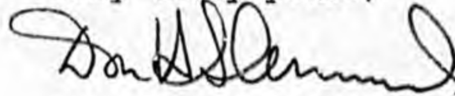
May 28, 1975

Hon. Nels A. Anderson, Jr.
House of Representatives
Alaska State Capitol
Juneau, Alaska 99801

Dear Nels:

Assuming that the oil and gas proven reserves tax bill was adopted at the end of the Legislative Session, I would very much appreciate it if you would have Mr. Van Doren send me a copy of the bill as it was finally enacted for my files and for a final review. I imagine that it would be useful for me to prepare a brief analysis of the potential effect of the bill, as finally enacted, upon the corporation.

Very truly yours,



DHS:vb

Sent 6/2/75
bctc

AGO 547335

STATEMENT OF JACOB ADAMS, VICE-PRESIDENT-
LANDS, ARCTIC SLOPE REGIONAL CORPORATION
ON H.B. 102, 247 SB 103, 276

My name is Jacob Adams. I am appearing before the Committee on behalf of the Arctic Slope Regional Corporation in my capacity as Vice-President in charge of Land Selection and Conveyance.

ASRC is strongly opposed to legislation which would impose a tax on proven oil and gas reserves. The proposed legislation would constitute an extremely damaging burden to ASRC and could very well bankrupt the corporation.

ASRC recognizes and appreciates the Legislature's concern over imminent near-term deficits in the State Treasury arising out of predictable imbalance between revenues and expenditures. Expenditures in recent years including revenue sharing with local governments has been a mainstay of supporting their local budget requirements especially in education.

While the Inupiat people of the Arctic Slope have benefited to some degree by State financial support, it has not been to the same extent that more urban areas have benefited.

At the present time, the present cash reserves and future anticipated revenues arising from the Alaska Native Claim Settlement Act, as well as programmed receipts

AGO 547336

under various exploration and development agreements with major oil companies, have been heavily committed to produce a viable economy in the Arctic based on a profit motivated, free enterprise system. ASRC, without special assistance or subsidy from the State, is underwriting many commercial business ventures, which will ultimately provide revenues to the State in the form of income and business taxes. If prevented from developing on its own initiative because of a new tax burden on proven reserves, which ASRC shall shortly inherit under its mineral in-lieu selection entitlement, the economic future of the Arctic will be seriously impaired.

A tax on reserves is a regressive tax in that it is not gauged on the ability to pay. True, large oil companies can accommodate such taxes by passing on to consumers those costs, but not every corporation, organization or individual can pay. Contrary to the bulk of public opinion there are others in the State of Alaska, in addition to large oil companies, that have a stake in ownership of oil and gas reserves. This other category includes individual lessees, royalty owners, and independent companies.

As you are also aware, at least six native regional corporations have entered into oil and gas exploration agreements which, in addition to base royalties as a land owner, provide for other benefits including net profits provisions,

AGO 547337

joint ventures or participations, carried working interests, or a combination of all three.

Although we are not here to argue the legal interpretation of Section 21(d) of the Alaskan Native Claim Settlement Act whereby a twenty year tax exemption applies to certain property interests of native corporations and individuals, there are those who believe that native interests in leases in the form of participations as well as royalty interests would be subject to a property tax in the same manner and to the same degree as oil company lessees.

We submit that the property tax being considered would depress the value of unleased native corporation lands as well as those that are presently leased or that shall be leased in the near future. The time of payout in order to receive benefits under a net profits interest would be much delayed. From the regional corporations' standpoint, paying taxes today with the uncertainties of developing a market and unknown future wellhead value of crude oil and natural gas, could create financial havoc if not bring upon the economic demise of the corporations.

A specific example will serve to illustrate our concern. ASRC previously filed in-lieu selections on approximately 18,000 acres within the boundary of the known geologic structure of the Kemik Unit. The Kemik Unit has one completed and shut-in gas well. A second exploratory well is currently drilling and a permit for a third exploratory well is pending. No development wells have been drilled;

AGO 547338

however, the U.S. Geological Survey has indicated that the discovery probably is commercial based on the KGS classification. The Survey and the original operator, Forest Oil Company, indicates a probable produceable volume of 475 bcf of gas. This is certainly no "barn burner" or as we call it "igloo melter" in terms of North Slope operations.

ASRC filed selections within the Kemik Unit because it has over 1.2 million acres of in-lieu subsurface entitlement and the Board of Directors believes such selections should be made first in proven areas of production where fee ownership is not important in order to maximize the spread of its overall land ownership throughout the Arctic Slope.

ASRC's interest in the Kemik Unit upon transfer of the subsurface estate from the Department of the Interior ranges from 12-1/2% royalty under existing Federal leases to 100% mineral interest under unleased lands within the unit boundary.

Based on the reserves attributable to ASRC's interests derived from the operators volumetric calculations, the volume of produceable gas is 213 bcf. Assuming an arbitrary value at the time production commences of $.50/MCF, the value of so-called proven reserves owned by ASRC is $106MM. A 20 mil property tax levy would amount to $2.1MM annually until production commenced.

AGO 547339

Since ASRC will probably lease its 100% mineral interest lands reserving a 16-2/3% royalty thereby decreasing its royalty reserves to 64 bcf, the amount of ad valorem taxes paid in the first few years after the tax is imposed may never be recouped as a credit against production taxes. This would be true unless ASRC receives title to the subsurface estate and leases its interest prior to the effective date of the tax law. Actions which force ASRC to land management decisions in haste due to factors (the new tax) beyond its control are unreasonable and patently unfair.

Another problem that we consider likely to develop that would be harmful to ASRC relates to the contract provisions of our several oil and gas exploration agreements. The agreements provide for, among other things, a reasonable continuous drilling provision in the event of discovery on a lease. It is almost a certainty that we would have to waive the continuous drilling provision until the law expires (if ever) thereby extending the period of field development for many years which would not only affect our cash flow projections but deprive the State of production taxes from ASRC lands.

Although reserves could be assessed under a single discovery well, you would obviously be inviting litigation.

AGO 547340

We believe that the Legislature should carefully explore all alternatives to raising sufficient revenues to offset near-term deficits and compare the impact against the obvious detrimental effects of the tax on reserves.

Several alternatives that have been advanced in recent weeks that should be thoroughly considered include the following:

1. Indirect borrowing against future oil and gas royalties through an "ABC" type transaction. Selling only a specified quantity of royalty reserves commits only that amount necessary to repay the loan. Royalty production thereafter is free from encumbrances. While further investigation of the applicability of "ABC" financing is needed, we believe it would avoid the question of constitutionality raised by opponents to funding through borrowing. Arlon Tussing, noted University of Alaska economist, has compared the cost effect of taxing reserves against borrowing at low interest rates and concluded that if the State wants to maximize the value of its oil revenues it would be far better off to issue revenue bonds rather than tax reserves in the ground.

2. Another alternative that should be considered is advance payment of severance taxes. Since the producers will be paying severance taxes based on gross wellhead price of oil or gas on a predictable declining basis, payment of advance severance taxes on production with a recapture provision after royalty revenues close the gap between receipts and expenditures should encourage

operators to produce a property beyond what would otherwise be its economic limit. The time of abandonment of marginal properties should be extended for a number of years which would benefit the State and promote good conservation practices.

3. A third alternative that should be considered is a purchase option on State royalty gas with the actual value to be determined at the time of transfer. An option of this nature could be made attractive to large gas utility companies who may be able to accommodate the option payment in their rate base. In any event, the State would not be committing its gas reserves at a fixed price in advance of what the actual value may be at the time production commences. It appears to ASRC that this alternative may be superior to all others.

4. Additional competitive lease sales should be programmed to coincide with calendar year budgets of major oil companies to maximize revenues. If the majority of the potential participants in a sale adopt a budget as of the first of a calendar year then it is unwise to schedule a sale for the fourth quarter of a year.

5. Another alternative that has been suggested is advance sale of royalty oil. This appears the least advisable at this time since the value would be heavily discounted by prospective purchasers. However, as an alternative it should be considered.

AGO 547342

We wish to thank you for the opportunity to present our viewpoint on the proposed property tax on reserves. Although such a tax may be relatively easy to administer, it has gross inequities and applications. Therefore, if there are other means to raise revenues without inequities, they should be thoroughly investigated and only as a last resort should serious consideration of a tax on reserves be implemented.

One factor that begins to worry ASRC is that the anticipated revenues from Prudoe Bay may not cover rapidly escalating costs of State government at the time production begins. If this occurs, we believe that the tax on reserves will not be phased out as provided for in the various bills with the result that exploration and development on native lands will be further impaired.

AGO 547343

COLORADO SEMINARY
UNIVERSITY OF DENVER
200 W. 14TH AVENUE • DENVER, COLORADO 80204

COLLEGE OF LAW

21 April 1975

Hon. Nels Andersen, Jr., Chairman
Committee on Resources
House of Representatives, State of Alaska
Juneau, Alaska

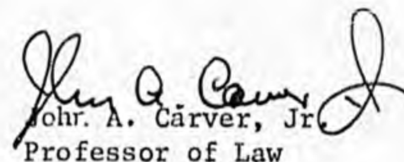
Dear Mr. Chairman:

I have given additional consideration to the questions which were asked in your hearings of April 15th on the matter of the power of the legislature to exempt lands held by native corporations from an ad valorem tax. I expressed the opinion that I thought the legislature had plenary authority to adopt reasonable classification with respect to the application of a tax, and that the authorities seemed to support the reasonableness of exemption for Indians.

Although I said that I was giving top-of-the-head opinions, I failed to recall the obvious fact that the Alaska Native Claims Settlement Act as an expression of Congressional intent may be pre-emptive in effect, and thus preclude the application of the general rule stated by Dean Griswold and affirmed by me in my answer to questions. Certainly the Congressional language concerning the village and regional corporations contemplates Alaska-chartered corporate persons who would not have the status of individual Indian persons, notwithstanding the requirement that the members (stockholders) be qualified as natives.

Thus, in summary, I would not want anything I said to be construed as a conclusion that native and regional corporations under the Alaska Native Claims Settlement Act would have the status of "native" for the purpose of determining the reasonableness of an exemption in favor of such corporations in a taxing law.

Sincerely,



John A. Carver, Jr.
Professor of Law

AGO 547344

ARCTIC SLOPE REGIONAL CORPORATION

PRESIDENT
JOSEPH UPICKSOUN
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JOHN OKTALIK
2ND VICE PRESIDENT
EDWARD E. HOPSON, SR.
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SECRETARY
NELSON AHVAKANA
TREASURER
OLIVER LEAVITT
LAND SELECTION CHIEF
JACOB ADAMS
EXECUTIVE VICE PRESIDENT
LAWRENCE A. DINNEEN

File

March 13, 1975

The Honorable Nels A. Anderson, Jr.
Alaska State House of Representatives
Pouch V State Capitol Building
Juneau, Alaska 99811

Re: H.B. 102, 297 and S.B. 103

Dear Representative Anderson:

The captioned bills are of major concern to the Arctic Slope Regional Corporation and we believe to virtually all eleven other regions. It is our opinion that the language of the bills, as drafted, is extremely harmful to the interests of the native corporations and could bankrupt ASRC if enacted.

We are confident that you will remain open-minded on the issue of taxing oil and gas reserves at least until you have had the opportunity to hear our views presented. We would like to offer testimony before the House Resource Committee next week at the time to be scheduled by Chairman Anderson.

Sincerely,

ARCTIC SLOPE REGIONAL CORPORATION

By [signature]
Oliver Leavitt
Treasurer

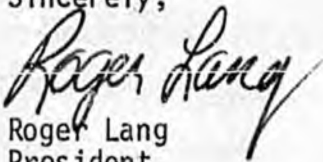
AGO 547345

Public access by eas[illegible], except at periodic points, and coast zoning are not compatible. I have not yet determined in which case the State is serious. And I am certainly becoming tired of those that live in rural Alaska being treated differently than those that reside in the more populated areas. It is time that those who govern realize, that we can, and do plan for land and coastal uses, that we are years ahead of the State and Federal Governments in knowing what the people who reside in villages want and need for the use of their lands, including beaches, and - finally, that we quit serving in an "advisory capacity" a long time ago. We are a part of Alaska, too, and demand no other treatment than that afforded other citizens of this State.

The Governor, the legislature, and every sworn official of this State are charged with the administration of Government according to provisions and the law of the Constitution of Alaska. I would ask those that want to own us before we receive our lands, to look very carefully into Section 12, Article 12 of that Constitution. We are getting to a point where this State is becoming a worse threat to our continued existence than the federal bureaucracies ever were, and it is pitiful.

Thanking each of you for your individual services, and for your contributions in the past, I am,

Sincerely,



Roger Lang
President

cc: AFN, Inc. Board of Directors

AGO 547346

ALASKA FEDERATION OF NATIVES, INC.
1675 C STREET
ANCHORAGE, ALASKA 99501
PHONE (907) 274-3611

Integrity, Pride in Heritage, Progress

EXECUTIVE OFFICES

April 17, 1975

Nels A. Anderson, Jr.
House of Representatives
State of Alaska
Pouch V
Juneau, Alaska 99801

Kay Poland
State Senate
State of Alaska
Pouch V
Juneau, Alaska 99801

Dear Nels:

I am concerned and wish to enter into the official record our opposition to the proposed legislation which directly affects the people that I represent.

Item: Taxation of Oil and Gas Reserves in Place. I think that the basic concept of taxation, especially this ad valorem tax, is one which will require a large administration: certainly the addition of persons competent in this field, not now in government. And, until production is started is so fraught with variables that the prospects of litigation is great. This is certainly not the method for insuring the continuation of government in the period between time the State goes broke and oil starts flowing. I particularly fear this tax, since history proves that none have ever been removed from the books once written. I also fear that a specific exemption for Native interests will not be sustained in the courts, and that in spite of the good intentions of the legislature we will be taxed, prior to any development or cash from the resources.

Item: The State of Alaska submitted a disastrous bill in its initial concept of Coastal Zoning. I find much fault with it, and fear that absentee planning will also take place in substitute provisions that I have seen. No one ought to provide plans for private lands, save the owners. I speak of more than an "advisory" capacity. The State of Alaska has not demonstrated a willingness to assume this responsibility, although it has been authorized the planning capability for years. I am also mystified as to the rationale of the State as it relates to Native lands, not only do they wish to plan for us, but they insist to the Department of Interior that they must reserve a right to a twenty-five foot easement on potential Native lands found on the ocean beaches. They speak with a forked tongue, on the one hand to you - they want and are capable of planning, and on the other hand - to Interior, saying in effect that no planning for Native beaches is necessary, since we want an easement there for the public.

AGO 547347

A major House leadership bill on oil and gas was introduced into the House of Representatives this morning. The bill, which would provide a tax of oil and gas in place, carried 18 sponsors. It would provide a major share of revenues required by the state to fill projected budget deficits which would otherwise result from delays in construction of the trans-Alaska pipeline.

The bill was developed by State Rep. Steve Cowper, D-Fairbanks, at the request of the House Finance Committee and House leadership, and was introduced carrying Cowper as the prime sponsor.

The bill included as sponsors all of those who had introduced HB102, an earlier bill on the subject developed by Rep. Fred Brown, D-Fairbanks. Cowper noted that the sponsors of the new bill include nearly all House committee chairmen, as well as House Speaker Mike Bradner and House Majority Leader Mike Miller.

The bill went to the House Resources and Finance Committees. It is expected to be among major oil and gas bills to be considered by the Resources Committee starting on March 19.

Cowper's bill would levy a 20-mill ad valorem tax on oil and gas reserves still in the ground, and is designed to draw taxes primarily from the Prudhoe Bay reserves. The bill also carries an automatic repealer that would remove the law from the books at the end of 1981.

The bill would draw hundreds of millions of dollars out of Prudhoe Bay but would give the industry a credit against future severance taxes. In other words, the companies could deduct their reserves-in-place tax from their severance taxes that would otherwise be paid on Prudhoe oil flow after the field begins pumping. The companies would be allowed to take a credit of up to 50% in any one year.

Under Cowper's bill, the tax would actually come into effect only when the state's general fund dips below $ 200,000,000.

AGO 547348

Rep Brown - Sources of Revenue for the State
what options other than taxing oil &
gas reserves in place -

distinguish between three sources of Revenue
(1) Voluntarily contribute to State
Bonuses - Royalties
must be at least 12½ under law

(2) Tax on current operations of the industry
independent of profit
gross production tax
minimum per barrel
property on equipment & pipe.
taxing on reserves as they
value of oil at the well-head is
the market price and is the same
for any well.
Our severance law % of production
cost.
value of Alaskan oil is determined
outside of Alaska at the market place

Severance tax

~~Res~~

* Reserve oil in place -
Bad tax - impossible to administer equity
How do arrive at a figure for the value
of the oil - What are the reserves (estimate)
How much - What is the value oil - the
longer its produced the less the value. what's
the price of the oil. Policy -?

AGO 547349

How do you determine between one field and another.

If tax passes - Tax payments are to be used as pre payment on their future severance tax bill - "Interest-free payment -

* Severance tax will be reviewed - Appropriate severance tax - Legislative history of development of oil taxes. Severance tax is not frozen.

Emergency tax for short term or long term concept of taking increasing total tax to be used for state

→ Dead Rentals } Could be raised.
Anticipatory tax }

All taxes should relate to profit of the companies.

Sale of Royalty oil in advance of production prior sale of royalties - people who buy this will not be the producers in the state, but other companies outside the state who would be interested in buying our oil for their use - They are not [illegible] financially -
But value could go up - Uncertainty as to what the future price will be, plus the corporate discount
Do not know how much oil you will have to sell. Could go either way -
~~[illegible]~~ It is not the time to sell because since we are broke (Magin) the companies could lower their price offer.

AGO 547350

The oil & gas Commission can only regulate intra-state tariffs.

The state should have the right to control its own gas and oil.

There is ~~all~~ already a reserve of oil in the world - There could be surplus oil on the market which could drive our price down.

If the price on the world market goes down, will it go so low ~~that~~ the U.S. cannot afford to explore?

The margin of profitability is uncertain.

annual reports of the oil companies get copies

leasing - a fire sale? NO production capacity - Prudhoe probably couldn't produce 2 hundred million gals per day.

largest amount of budget of companies is for exploration & drilling.

AGO 547351

HB 102

Sec 15

All leases should be competitive ~~Checkerboard~~

State should follow a widespread Exploration plan, to broaden out throughout the state. The companies need to have quite a bit to draw from. Put enough up to make it attractive for bids.

Principle of Checkerboard leasing is not bad, but literal translation is not nec good. Should be on a geological basis. Not a geographical basis. State should be selective - What is not leased can be leased later if it is a valid field. This gives the companies who come in first have an advantage. This concept could prove attractive to the companies. Selective leasing & holding.

→ No limit to Commissioner on a geographical basis. HB 60 is too restrictive - Could be amended.

If too restrictive on the Commissioner. He may need to make an administrative judgement which he should - Not by Legislative Mandate.

→ Those forms of taxation which reflect on the profile of the companies.

Alaska could go slower since it ~~was~~ is unknown.

One of the best Severance tax on any state books.

Alert to the changing oil & gas situation in the state

Even the companies expect changes.

AGO 547352

High prices are reflections of political entities of governments.

→ Louisana has gone to 12½ % Severance.

Circumstances dictate that Severance tax be looked at.

Federal Govt.

Present price: from Act of Congress expiring Aug 1

Fed. authority to set maximum amount.

old oil - produced from

every barrel of new oil producer can sell new oil not price controlled.

production from stripper wells - free from price control

Cook Inlet - old oil - new oil is free

Bill before Congress: Remove control on oil produced from inhanced recovery - If passed all oil would

① be free from price control

prospased. What he can do without Congress Exec order.

Trade agreement extension acts - Import is threatening Nat. security.

impose quotas - Impose fees and tarrifts.

Feb 1 - Import lic. fee 1.00 pr. barrel

Mar 1 2.00 barrell Apr. 1 3.00

Now 10.50 pr. barrell - 1.50 to transport in US. 11.50 - 12.00 pr. barrell in US. oil is around 11:50 - 12:00. If you put tarrift on goes to 13.00 - So U.S. oil will go up to that

April 1 - Pres said he will remove all price control on oil - old oil would go up that high

proposed to Congress

Import fee on foreign oil 2.00 he will roll back to that.

He feels this will lead to windfall profit tax. take away most of their profit at first - new oil producers would go down in their profits.

House has passed a 60 day moritorium

AGO 547353

check tape → Subtract from 12.00 the State Severance tax 7% of 12.00
4.84 taken off from Windfall tax
90% will be paid to the Fed govt. will be paying More to the state if the state rate were higher than 7% — Relationship between State & Fed + Producer.
All states will be reviewing their servence.
a state which has a below the average Severance tax Should take a hard look at their tax —
Consumer: Admin feels that coast of living will be 2 - 4% - Purpose is to raise cost so that less energy will be used.
Import 6 1/2 million barrels per day 4-4 1/2 is crude oil — fuel oil from Carribian
More + more being processed from Middle East Oil
→ What will this do to our own N.S. oil?
Slope oil would probably yield less profit, thus less monies to the state.
Anything which raises the cost lowers the profit
oil + gas Exploration Should be protected. Most new sources of gas + oil are going to be in Alaska or hard to get places. Should hope for a good Fed policy to reward companies for exploration

How much gas can be produced how quickly

Senate Tax + Rev. 1:30
Leg Council - 4:00
Finance committee 7:00 P.M.
Fri Senate Resource 1:30 P.M.

AGO 547354

THE FOLLOWING DOCUMENT(S) MAY NOT FILM LEGIBLY BECAUSE OF POOR QUALITY OF THE ORIGINAL.

HB 297

<u>Neither the Governor's Bill Nor the
Settlement Act Exempts Native Interests
in Lands Under Lease or Development</u>

The Governor's bill proposing an <u>ad valorem</u> tax on oil and gas reserves provides a narrow exemption for native-owned lands. The bill would institute a tax of 20 mills upon the full value of proven oil and gas reserves, subject to certain exemptions. Section 43.53.020(2) provides the relevant exemption:

> "any interest exempted from taxation by sec. 21 of the Alaska Native Claims Settlement Act (P.L. 92-203; 43 U.S.C. sec. 1620) [shall be exempt]."

Thus native interests in oil and gas lands would be benefited by whatever exemption is provided by the federal law, but no more.

The Settlement Act exempts certain native-owned lands from State property taxation, but not lands that are under lease or development. Section 21(d) provides in relevant part:

> "Real property interests conveyed, pursuant to this Act, to a . . . Regional Corporation which are not developed or leased to third parties, shall be exempt from State and local real property taxes for a period of twenty years . . . ."

43 U.S.C. § 1620(d). Thus, under the plain words of the Act, only real property interests owned by a regional corporation that are not developed or leased are free from property taxation. <u>See also</u> S. Rep. No. 92-405, 92d Cong., 1st Sess. 176

AGO 547355

(1971) (only "undeveloped and unleased" lands are exempt from property taxation). Lands which are leased or developed are fully taxable.*/

Tax exemptions are interpreted strictly against the assertions of the entity claiming the exemption and in favor of the taxing power. 3 Sutherland, _Statutes and Statutory Construction_ § 66.09 (1974). In the words of one court:

> "Exemptions from taxation claimed under legislative acts should be rigidly construed and established beyond reasonable doubt. It is only where a deliberate purpose of the Legislature to grant an exemption is expressed in clear and unequivocal terms that a claim to an exemption can be maintained."

Clarke v. _Union Trust Co._, 192 Md. 127, 63 A.2d 635, 638 (1949). The same rule of narrowly construing exemptions from taxation is followed by the Supreme Court of the United States. See _Bingler_ v. _Johnson_, 394 U.S. 741, 751-2 (1969), citing _Commissioner_ v. _Jacobson_, 336 U.[illegible], 48-49 (1949), and _Helvering_ v. _Northwest Steel Rolling Mills, Inc._, 311 U.S. 46, 49 (1940).**/

---

*/ Section 21(d) also provides that third-party interests in _any_ native lands are taxable. The issue here, however, is whether the regional corporation's interest is taxable, and, under the provision quoted in the text, clearly no exemption exists for leased or developed land.

**/ Under the weight of authority, this rule of strict construction is applicable even where the would-be taxpayer is a charitable organization. Sutherland, _supra_, § 66.09, at 209, 210 n. 9. The regional corporations, in any event, are all business corporations operating "for profit." 43 U.S.C. § 1606(d).

This rule should apply with particular force in onstruing exemptions for native groups under the Settlement ct. A basic policy of that Act was to avoid "adding to the ategories of property and institutions enjoying special tax rivileges" (43 U.S.C. § 1601(b)), and Congress indicated hat the exemptions granted were "limited" and only those necessary to effectuate a settlement . . . ." S. Rep. No. 2-405, 92d Cong., 1st Sess. 105-09 (1971). Congress also ecognized the troublesome problems created by the granting f special tax relief to "racially defined institutions."

Accordingly, neither the Governor's bill nor the ettlement Act can be construed as exempting native lands nder lease or development from operation of the ad valorem roperty tax. Both the regional corporations' and lessees' nterests in such lands would be subject to the same tax as he corresponding interests of non-natives and their essees.

COVINGTON & BURLING

AGO 547357

The Proposed Exemptions Would Violate
The Policy of the Settlement Act

It is clear from the language and legislative history of the Alaska Native Claims Settlement Act that native regional corporations were not intended to enjoy any special tax privileges beyond those explicitly provided for in that Act. Obviously the Settlement Act would not be violated by virtue of a State statutory exemption which merely incorporated those exemptions required under federal law. But any State exemptions beyond those given in the Settlement Act cannot be justified by virtue of that legislation, and would be inconsistent with the goals and policies of that Act.

The Settlement Act was clear in stating that its provisions, including those establishing regional corporations, should be implemented

> "without creating a reservation system or lengthy wardship or trusteeship, and without adding to the categories of property and institutions enjoying special tax privileges. . . ."

43 U.S.C. § 1601(b).[6] As explained in the Senate Report:

> "There is no intention under this Act to add to the categories of personal or real

---

6/ Similarly, the Act also provides -- with one exception not applicable here -- that the lands granted to the natives under the Act were not to be considered "reservations" or lands held "in trust." 43 U.S.C. § 1601(g). That provision, Congress directed, was to be strictly construed. H.R. Rep. No. 92-746, 92d Cong., 1st Sess. 40 (1971) (Conference Report). Thus such lands were not to be subject to ordinary tax exemptions applicable to reservation and trust lands.

AGO 547358

> property enjoying perpetual tax privileges or to create any permanent racially defined institutions. Other provisions in the bill do, of necessity, make racial distinctions and do grant special tax relief for limited periods of time. These provisions are of limited duration and are necessary to effectuate a settlement which, because of its nature, is based on ethnic considerations."

S. Rep. No. 92-405, 92d Cong., 1st Sess. 108-09 (1971). _See also_, H.R. Rep. No. 92-523, 92d Cong. 1st Sess. 6 (1971).

Section 21 of the Act creates the limited tax exemptions for native groups and individuals authorized by the Act. 43 U.S.C. § 20. It provides that the receipt of the properties and funds granted under the Act is not to be treated as a taxable event, this exemption being granted because of "the general principle that the [granted] resources . . . represent compensation for the extinguishment of Native land claims by the operation of this Act, and that in accordance with general principles of taxation such compensation does not represent taxable income." S. Rep. No. 92-405, 92 Cong. 1st Sess. 175-76 (1971). The section further provides that real property interests conveyed under the Act, "_which are not developed or leased to third parties,_" are to be exempt from State property taxes for 20 years. Various third-party interests in native lands "may be taxed in accordance with State or local law." Further:

> "All rents, royalties, profits, and other revenues or proceeds derived from such property interests _shall be taxable to the same extent as such revenues or proceeds are taxable when received by a non-Native individual or corporation._"

43 U.S.C. § 20(d) (emphasis added).

Congress thus found that certain limited exemptions -- limited both in time and nature -- were "necessary to effectuate a settlement" and "of necessity" had to be based on racial distinctions. S. Rep. No. 92-405, *supra*, at 109. The receipt by the natives of their compensation under the Act was not to be taxable, and for 20 years there was to be no taxation of lands not yet proven valuable by reason of development or leasing. Beyond those exemptions, taxation of native interests was to be the same as for non-natives, and "categories of property and institutions enjoying special tax privileges" were not to be created. 43 U.S.C. § 1601(b). Further, the Settlement Act required that the native regional corporations be incorporated under Alaskan law "to conduct business for profit." 43 U.S.C. § 1606(d) (emphasis added). These were not to be charitable institutions.

It also is significant that the limitation on native tax exemptions was expressly requested by the State government. In his statement to the Congressional committee, Governor Egan stated that the State opposed "[t]he establishment of tax exemptions applicable to developed lands or improvements" owned by native groups.

> "Though the mere transfer and possession of the cash appropriation and rights in land should not be taxable, land which is used for

AGO 547360

> development purposes and income and assets purchased from the investment and utilization of the money settlement should be taxable to the same extent as other commercial interests."

This policy would be in accord with the State's desire to "allow the steady and regulated development of oil lands preferably as one cooperative unit . . . ." Hearings on H.R. 3100, H.R. 7039, and H.R. 7432 Before the Subcomm. on Indian Affairs of the House Comm. on Interior and Insular Affairs, 92d Cong., 1st Sess. 128, 129, 131 (1971) (emphasis added). It would be ironic if the State legislature were now to consider precisely the same sort of preferential tax privilege that the State opposed before the United States Congress.

The Settlement Act was a joint effort of the United States, the State of Alaska, the natives of the State, and numerous private parties to resolve a divisive and long-standing legal dispute arising out of the native land claims. That legislation, and the institutions established pursuant to it, should not now be the source of new and divisive disputes. By attempting to grant new tax privileges to native corporations -- privileges which are unprecedented in the revenue laws of this State -- the legislature would be undermining the policies of the Settlement Act, and would be inviting a new series of disputes between native and non-native

AGO 547361

interests in the State. At a minimum, it is clear that any such discriminatory privileges cannot be justified by reference to the Settlement Act.

COVINGTON & BURLING

Counter Authority

During Senate hearings on the Settlement Act, the following colloquy occurred:

> "SENATOR BURDICK. Getting back to this
>
> [illegible]
>
> I guess we are dealing here with a State [illegible] and obviously if this land remains in the Federal domain, it would remain as it is, but if it is the part of the land that is given to them in fee, the tax character of that would be governed by the State of Alaska.
>
> "SENATOR BURDICK. That's what I thought. In other words, this isn't going to be in the frame of ordinary reservation. This will be straight fee ownership. There will be no trustee arrangement, or anything of that nature.
>
> "SECRETARY MORTON. The land?
>
> "SENATOR BURDICK. Of the fee land.
>
> "SECRETARY MORTON. That is correct, yes."

Hearings on S. 35 and S. 835 before the Senate Comm. on Interior and Insular Affairs, 92d. Cong., 1st Sess. 281 (1971). Although not entirely clear, this conversation may suggest that the question of taxation or exemption of native lands was left to the State.

Blacked out above: see land for a minute, what is the tax character of it? What will it be?

"Secretary Morton. Well, the tax character, (read above)

AGO 547363

An Exemption for the Lessees of Regional Corporations Would Serve No Rational Purpose

Even assuming that it would be constitutional for the State legislature to exempt native regional corporations from the proposed *ad valorem* reserve tax, no such exemption could rationally extend to the lessees of regional corporations. Such an exemption would be an unjustified and unconstitutionally discriminatory provision, serving no plausible State interest.

It is clear, first, that such an exemption with respect to *present* lessees would be wholly irrational. The regional corporations are, of course, entitled to succeed to the lessor's interests in State and Federal oil and gas leases with respect to certain lands selected by those corporations under the Settlement Act. 43 U.S.C. § 1613(g). The lessees under such leases could not have anticipated any windfall tax benefit at the time they bid for their leases from the State and Federal governments, and thus certain lessees would receive an unjustifiable windfall compared to lessees of State and Federal lands. Nor would exemption of existing lessees of native-selected lands yield any conceivable benefit to their new lessors, the regional corporations, since the terms of those leases are already fixed.

With respect to future leases, a lessee exemption is

still irrational. It has been a general policy of the tax laws not to extend tax exemptions of exempt lessors to their lessees. Although such taxation would presumably reduce royalty rentals which the exempt lessors might otherwise be able to obtain, the courts hold that such an effect was "too remote and indirect" to be given legislative weight. E.g., Oklahoma Tax Comm'n v. Texas Co., 336 U.S. 342, 353 (1949); Thomas v. Gay, 169 U.S. 264, 273 (1898); U.S. Dept. of the Interior, Federal Indian Law 851-52 (1958). It has heretofore been the policy of this State not to extend exemptions to profit-making lessees. E.g., 1960 Op. Alaska Att'y Gen., No. 25; 1959 Op. Alaska Att'y Gen., No. 14.

We may assume, however, that contrary to prior policy and precedents, the State legislature could conclude that exemption of future lessees of regional corporations was of sufficient benefit to the regional corporations (because exemption would make native leases relatively more attractive to bidders) to rationalize a new tax privilege. But if the legislature were correct in that judgment, two independent and serious constitutional questions are raised.

First, the justification for the exemption would be the desire to benefit the stockholders of the regional corporations — all of whom by law are members of these races — at the expense of the entire citizenry of the State who would

share in the proceeds from an otherwise applicable tax. State legislation which so explicitly is intended to benefit members of particular racial groups is highly suspect under the Federal and State constitutions.

Second, as to leases hereafter issued, the exemption would be designed to produce higher values for native leases than for comparable leases granted by the state and federal governments. The adverse effect would be visited upon the federal government without its consent. Indeed, although the federal government has under Section 32 of the Mineral Leasing Act consented to state taxation of its lessees, 30 U.S.C. § 189, such state taxation must not discriminate against Federal lessees. See Phillips Chemical Co. v. Dumas Ind. School District, 361 U.S. 376 (1959); Georgia Pacific Corp. v. County of Mendocino, 340 F. Supp. 1061 (N.D. Calif. 1972). The proposed exemption for regional corporation leases would constitute precisely such a discrimination against the Federal Government.

Accordingly, any exemption for leases of the regional corporations would in all likelihood be unconstitutional. No such legislation could be deemed justified if its only effect were to grant a preference to certain commercial lessees to the detriment of others. And if the anticipated effect were to benefit indirectly the native lessors, the tax would both incorporate an unconstitutional

racial classification and would improperly discriminate against the lessor interest of the Federal government. Thus no sustainable justification for the exemption can be advanced.

COVINGTON & BURLING

AGO 547367

An Unconstitutional Exemption Could
Be Ineffective In Protecting Regional
Corporations From Taxation

Under a variety of procedural avenues, an unconstitutional exemption for the regional corporations could be challenged, with the effect that the exemption would be stricken and the natives subjected to taxation.

One route to that result would be purely administrative. The Attorney General of the State could issue a ruling that an exemption for regional corporations was unconstitutional, and he could then direct the taxing authorities to proceed to collect the tax from regional corporations along with other property holders. In that event, the regional corporations could seek by judicial action to compel the State authorities to recognize the statutory exemption, but such an action would result in no relief if the Attorney General's opinion on the exemption's constitutionality were sustained. *E.g.*, *Moon Lake Elec Ass'n v. Utah State Tax Comm'n*, 9 Utah 2d 384, 345 P.2d 612 (1959). There the court upheld the state tax commission's refusal, upon advice of the Attorney General, to recognize two unconstitutional limitations on an *ad valorem* tax.

Alternatively, an Alaskan taxpayer might challenge the exemption for native corporations, seeking a declaratory judgment that the exemption was unconstitutional.

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For example, in *DeArmond* v. *Alaska State Development Corp.*, 376 P.2d 717 (Alaska 1962), a group of taxpayers sought a declaratory judgment regarding, *inter alia*, the constitutionality under Article IX, Section 4 of the State constitution of a tax exemption. (While unsuccessful on the merits of their claim, the standing of the plaintiffs was not questioned.) Or a taxpayer might seek an injunction or mandamus to compel the collection of the taxes from the regional corporations. Thus in *Walz v. Tax Comm'n*, 397 U.S. 664 (1970), a property owner sought an injunction to prevent the New York City Tax Commission from granting various arguably unconstitutional property tax exemptions to religious organizations. While unsuccessful on the merits, the plaintiff's standing was not challenged. In *Green* v. *Kennedy*, 309 F. Supp. 1127 (D.D.C. 1970), a three-judge court, on a showing of the plaintiffs' substantial probability of success, granted a preliminary injunction against the granting of a tax exemption to allegedly racially discriminatory private schools. A further example is *Kellems* v. *Brown*, 313 A.2d 53, 61-62 (Conn. 1972), *appeal dismissed*, 409 U.S. 1099 (1973). There the Connecticut Supreme Court struck down on sex discrimination grounds a widow's exemption from taxation of dividend income.

In this regard, the apparent importance of the proposed tax measure to the State suggests that a court

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would, if finding the exemption unconstitutional, be strongly inclined to enforce the tax against all taxpayers, without regard to the exemption. E.g., Utah Power & Light Co. v. Pfost, 286, U.S. 165, 185 (1932):

> "We find no warrant for concluding that the legislature would have been content to sacrifice an important revenue statute in the event that relief from its burdens in respect of particular individuals should become ineffective."

Finally, a taxpayer excluded from an exempted class has standing to challenge the constitutionality of the statute's exemption. This could be done in an action by the taxpayer to recover the taxes paid under protest. E.g., Allied Stores, Inc. v. Bowers, 358 U.S. 522, 525-26 (1959). If such a challenge were successful, the statute would be declared unenforceable so long as the exemption remained in effect. Presumably the result would then be either a decision by the Attorney General that the exemption should be ignored (see above), or reenactment of the tax provision without the challenged exemption.

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An Exemption from Property Taxation for the Interest of Native Regional Corporations Raises Most Serious Constitutional Questions

The Alaska legislature is considering passage of an *ad valorem* property tax on proven reserves of oil and gas in place. The tax bill as introduced by the Governor would exempt interests of the United States or the State of Alaska, and also any interests exempted from taxation by Section 21 of the Alaska Native Claims Settlement Act (43 U.S.C. § 1620). The Settlement Act prohibits, for a 20-year period, the imposition of State property taxes on undeveloped or unleased lands of native regional corporations, but provides no exemption for developed or leased lands under such ownership. 43 U.S.C. § 1620(d). Thus where regional corporation lands are under lease or development and contain proven reserves of oil and gas, the Governor's bill as introduced would provide no exemption.

Amendments to the Governor's bill are being considered which would operate to expand the presently proposed exemption for native corporations. Rather than limiting the exemption to that required by federal law, the effect would be to remove from taxation the property interests of native regional corporations, whether or not leased or under development. The State would, in effect, be granting a special tax privilege to the otherwise

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taxable property of specifically designated racial or ethnic groups. Any such effort would raise very serious legal questions under the United States and Alaskan Constitutions.

A. <u>The Present Exemptions in the Governor's Bill Provide No Justification or Precedent for a Broader Exemption</u>

As a preliminary point, it must be recognized that an exemption for all regional corporation lands would, as a constitutional matter, stand entirely apart from the exemptions included in the original Governor's bill. For example, the present exemption of federal interests in oil and gas reserves stands on a totally different footing, and is sustainable (if not compelled) by inter-governmental immunity doctrines under federal constitutional law. It cannot be seriously argued that native corporations must be accorded the same legal status as the State and federal governments. Further, the benefit of exemptions for State and federal interests accrues to the entire citizenry of those governments, regardless of race. Those exemptions thus provide no justification for an exemption of native interests, confined to specific races.

Neither can a provision incorporating the exemptions of the Settlement Act lend any legitimacy to a broader native exemption. Assuming for present purposes the validity of all exemptions granted by the Settlement Act (a question not yet litigated), they rest on a

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constitutional basis that would be wholly inapplicable to a broader State-granted exemption. The United States government's plenary power over Indian affairs extends to matters of taxation, and as trustee of Indians the United States may exempt Indian land from State taxation. See McClanahan v. Arizona State Tax Comm'n, 411 U.S. 164 (1973); U.S. Dept. of the Interior, Federal Indian Law 848 (1958). It is by virtue of the federal government's "unique" obligation toward Indians that Congress may enact "reasonable and rationally designed" preferential legislation. Morton v. Mancari, 417 U.S. 535, 555 (1974). The Settlement Act "by necessity" established "racially defined institutions," and granted those institutions the limited tax exemptions "necessary to effectuate a settlement."*/ Congress provided that otherwise the Act should be implemented to avoid "adding to the categories of property and institutions enjoying special tax privileges . . . ." 43 U.S.C. § 1601(b). The particular constitutional justification for the Settlement Act's exemptions thus in no way supports the legitimacy of the State legislature's granting special tax privileges to racially defined institutions.

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*/ S. Rep. No. 92-405, 92nd Cong., 1st Sess. 108-09 (1971).

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B. <u>The Proposed Amendment Would Establish A Racial Classification That Would Be Highly Suspect Under the Federal and State Constitutions</u>

The proposed amendment to exempt native interests from the *ad valorem* tax would clearly adopt a "racially defined" classification. S. Rep. No. 92-405, *supra*, at 109. The regional corporations established under the Settlement Act are wholly-owned by persons enrolled as natives under the Act (43 U.S.C. § 1606(g)), a privilege limited to persons of one-fourth Indian, Eskimo or Aleut blood. § 1602(b). It is also clear under the Settlement Act that the beneficiary-stockholders of the regional corporations will remain wholly native until 1991. § 1606(h)(1).

The proposed exemption thus raises the question of the propriety of granting a tax privilege to groups of a particular racial makeup. It is settled, of course, that "the States, in the exercise of their taxing power, are subject to the requirements of the Equal Protection Clause of the Fourteenth Amendment." *Allied Stores, Inc. v. Bowers*, 358 U.S. 522, 526 (1959). Ordinarily, the equal protection clause "does not mean that a State may not draw lines that treat one class of individuals or entities differently from the others . . . . [T]he States have large leeway in making classifications and drawing lines which in their judgment

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produce reasonable systems of taxation." Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 359 (1973) (holding that a State may subject corporations, but not individuals, to ad valorem taxes on personalty).

The proposed tax exemption, however, does not raise ordinary equal protection issues. It is clear that any racial classification emanating from "official state sources" (Loving v. Virginia, 388 U.S. 1, 10 (1967)), carries the heaviest possible presumption of unconstitutionality.

> "At the very least, the Equal Protection Clause demands that racial classifications . . . be subjected to the 'most rigid scrutiny,' Korematsu v. United States, 323 U.S. 214, 216 (1944), and, if they are ever to be upheld, they must be shown to be necessary to the accomplishment of some permissible state objective . . . ."

Loving v. Virginia, supra, 388 U.S. at 11. See also Hunter v. Erickson, 393 U.S. 385 (1969); McLaughlin v. Florida, 379 U.S. 184 (1964); Tancil v. Woolls, 379 U.S. 19 (1964); Anderson v. Martin, 375 U.S. 399 (1964).

The constitutionality of a racial classification does not turn on whether a legislature objectively regards the classification as invidious. The constitutionality turns on whether the classification works to the benefit of a particular race or races and, thereby, the deprivation of others, and on whether it is justified by a compelling interest, by "some overriding statutory purpose." McLaughlin v. Florida, supra, 379 U.S. at 192. "Without

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such justification the racial classification . . . is reduced to an invidious discrimination forbidden by the Equal Protection Clause." Id. at 192-93. Thus, if supported by a compelling State interest, a classification may be deemed to be not invidious and hence constitutional. If not so supported, it is invidious as a matter of law and unconstitutional, regardless of the intent behind it.

The degree of concern with which courts scrutinize racial classifications is illustrated by the recent Indian preference case. Morton v. Mancari, 417 U.S. 535 (1974). There the United States Supreme Court addressed the validity of a federal statutory hiring preference given to members of recognized Indian tribes for employment in the Bureau of Indian Affairs. Although upholding the preference, the Court's analysis nonetheless casts considerable doubt on the validity of the sort of classification proposed for the Alaska tax bill.

The Court noted first that the statutory preference

> "is not directed towards a 'racial' group consisting of 'Indians'; instead, it applies only to members of 'federally recognized' tribes. . . . In this sense, the preference is political rather than racial in nature."

417 U.S. at 553 n. 24. Here, by contrast, the Alaska exemptions

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would be incorporating the blood standards of the Settlement Act. "There can be no question but that [the proposed exemptions] rest solely upon distinctions drawn according to race." Loving v. Virginia, supra, 388 U.S. at 11.

Second, the Court emphasized the "unique" relationship between the federal government and the preferred quasi-sovereign tribal entities, and the fact that no "blanket exemption" from hiring standards was granted. 417 U.S. at 554-55. In each of these respects, the proposed Alaska tax exemption compares unfavorably. The State of Alaska has no constitutionally recognized obligation with respect to natives, let alone with respect to regional corporations. Further, the entities established pursuant to the Settlement Act are business corporations incorporated under State law and in no sense enjoy the privileges of quasi-sovereign tribes. Finally, as discussed in more detail below, the regional corporations are quite clearly receiving a "blanket exemption."

Third, despite the factors already mentioned in support of the federal preference legislation, the Court in Mancari nevertheless undertook to determine whether the preference was "reasonably and directly related to a legitimate, nonracially based goal." 417 U.S. at 554. That is a standard somewhat more lenient than is normally applied for

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preferential classifications, and properly so in light of the special factors mentioned in the Court's opinion. There can be no doubt by virtue of the Mancari decision that the proposed State exemption would have to undergo a very much higher standard of scrutiny.

C. Even If Not Racially Based, the Classification Must Be Rationally Justifiable

As discussed above, any special tax exemption for regional corporations is necessarily one based upon a racial classification. But it is worth observing that a tax classification, however phrased, must comport with the equal protection clause. That clause protects one

> "from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class. The right is the right to equal treatment."

Hillsborough v. Cromwell, 326 U.S. 620, 623 (1946). While the equal protection clause does not impose rigid requirements upon a State with respect to non-racial classifications, "there is a point beyond which the State cannot go without violating the Equal Protection Clause." Allied Stores, Inc. v. Bowers, 358 U.S. 522, 527 (1959).

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Thus, any "ground of difference" in a taxing measure must have a "fair and substantial" basis. Id.*/ A State has a constitutional obligation to tax similar entities in a similar manner. In striking down an Alabama statute that imposed an additional tax on foreign corporations as compared with a domestic corporation engaged in the same activity, the United States Supreme Court stated that differential treatment under the tax laws "must be based upon some real and substantial distinction, bearing a reasonable and just relation to the things in respect to which such classification is imposed; and classification cannot be arbitrarily made without any substantial basis." Southern Railway Co. v. Greene, 216 U.S. 400, 417 (1910).**/

An added factor bearing on the proposed exemption for the properties of regional corporations is the obvious resident/non-resident distinction drawn by that exemption. The native regional corporations are all Alaskan corporations (see 43 U.S.C. § 1606(d)) and their shareholders represent a substantial block of voting citizens in the State. These

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*/ Under State law, see e.g., Twentieth Century Invest. Co. v. City of Juneau, 359 P.2d 787, 788 (Alaska 1961) (different tax burdens must be "founded upon substantial and reasonable differences between the objects taxed").

**/ Other cases striking down tax statutes on equal protection grounds include WHYY, Inc. v. Glassboro, 393 U.S. 117 (1968); Wheeling Steel Corp. v. Glander, 337 U.S. 562 (1949); Raymond

Footnote Continued.

who are to be taxed, by contrast, would essentially be a few out-of-state corporations and their non-resident stockholders — stockholders who "are not represented in the taxing State's legislative halls . . . ." Austin v. New Hampshire, 43 L.W. 4400, 4402 (U.S.S.C. Mar. 19, 1975).*/ One must question the legitimacy of the State's imposing this new and onerous tax on the properties of non-residents, while exempting the same properties when owned by a politically influential resident group. And such action would violate at least the spirit of the State's constitutional prohibition on taxation of non-residents' property at a rate higher than residents' property. Art. IX, § 2.**/

Footnote Continued.
v. Chicago Union Traction Co., 207 U.S. 20 (1907); Falkenstein v. Oregon Dept. of Revenue, 350 F.Supp. 887 (D. Ore. 1972), appeal dismissed, 409 U.S. 1099 (1973); Mosher v. Commissioner, 459 F.2d 665 (10th Cir. 1972).

*/ Austin involved a tax on non-resident individuals, which was declared unconstitutional under the privileges and immunities clause of the Fourteenth Amendment. Although that clause is not applicable to corporations (Paul v. Virginia, 75 U.S. (8 Wall.) 168 (1869)), discrimination by a State tax against non-residents raises serious equal protection questions. E.g., WHYY, Inc. v. Glassboro, 393 U.S. 117 (1968); Wheeling Steel Corp. v. Glander, 337 U.S. 562 (1949); Southern Railway Co. v. Green, 216 U.S. 400 (1910); see Hellerstein, "Some Reflections on the State Taxation of a Nonresident's Personal Income," 72 Mich. L. Rev. 1309, 1332-33 (1974).

**/ That section provides:

> "Nondiscrimination. The lands and other property belonging to citizens of the United States residing without the State shall never be taxed at a higher rate than the lands and other property belonging to the residents of the State."

Hence even if the proposed exemption for regional corporations were not (contrary to fact) based on a racial classification, any asserted justification for the exemption would require careful examination.

D. No Rational Justification, Let Alone a Compelling One, Exists for an <u>Exemption Of the Regional Corporations</u>

As the above analysis demonstrates, the proposed exemption of regional corporations from the *ad valorem* tax must rest on a legitimate and substantial basis. It cannot be justified by virtue of the political strength of the natives, or by the convenience of focusing a tax on a few major oil companies. All this would be true even if the exemption did not rest on the racial affiliations of the exempted entities. Given the fact that the exemption is racially based, the State's justification must be a compelling one.

No rational justification, let alone a compelling one, exists for the exemption. It is shown above that no justification can be asserted to exist by reason of the Settlement Act. Congress carefully weighed in that legislation the issue of what tax exemptions were and were not necessary to effectuate the settlement. Freedom from property taxation of leased or developed lands was found not to be necessary, and Congress embodied that finding in the

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Act. 43 U.S.C. § 1620(d). The Act also stated a general policy that the native institutions being established should not enjoy special tax advantages (43 U.S.C. § 1601(b)), a view that the State government had strenuously asserted.*/ Thus the language and history of the Settlement Act weighs heavily against, rather than for, the proposed exemption.

Presumably the tax exemption would be defended on the theory that the exempted entities were newly-established companies without either substantial present earnings or an established credit base. The theory would be that the regional corporations, owned by a class of generally underprivileged members of the State, needed some period of years before they could bear the burden of a substantial property tax. But this justification, however plausible as an initial matter, on analysis proves to offer no rational justification for exemption from the proposed tax.

It is important for these purposes to focus on the nature of the tax in question. It is, of course, not an ordinary property tax. It is a tax on proven reserves of oil

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*/ Hearings on H.R. 3100, H.R. 7039, and H.R. 7432 Before the Subcomm. on Indian Affairs of the House Comm. on Interior and Insular Affairs, 92d Cong., 1st Sess. 128-31 (1971) (statement of Governor Egan).

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and gas. Moreover, by virtue of the exemption for oil and gas interests during the first five years of leasing or development under contract (§ 43.58.020(3)), the tax as a practical matter is applicable only where proven reserves have been available for development for a substantial period. And because the *ad valorem* tax may be credited against production taxes for the same property (§ 43.58.030), the *ad valorem* tax is in effect waived once the property is brought under production. Finally, by virtue of Section 21(d) of the Settlement Act (43 U.S.C. § 1620(d)), the tax is not applicable to native lands -- whether or not having known oil and gas reserves -- that are not yet under development or lease.

Once these characteristics of the tax are taken into account, any claim of indigency as a basis for the exemption is shown to be trivial. Without special exemption, the tax would be applicable to a regional corporation only -- where the corporation possessed known reserves of oil and gas that had been under lease or development for five years, but where significant production had not yet been reached. In short, the tax attaches only where the regional corporation owns known reserves which have been under lease for more than five years but are not yet in production. Why a taxpayer in this situation should be spared taxation only because of his racial identity is difficult to understand.

Where the regional corporation acquires the lessor's interest in an existing lease under the Settlement Act's selection provisions, presumably the argument would be that the native corporation should not be taxed by virtue of the slow development of the lease, a factor over which the natives had no control. But such an argument is equally valid for *all* private holders of oil and gas interests on the Arctic Slope, the area of principal if not exclusive relevance. As is well known, development of the Slope has been delayed for reasons wholly outside the control of the State and its lessees, and thus those delays mitigate in favor of a temporary exemption for all -- rather than just native -- interest holders. There is no justifiable basis for sparing only those interests owned by a specific race or races.

Similarly, an exemption with respect to prior leases cannot be justified by reason of an immediate cash-flow problem faced by regional corporations. One difficulty with such a justification is the questionable validity of its factual premise. The regional corporations are now receiving substantial payments from the Alaska Native Fund (see 43 U.S.C. § 1605), and the natives' recently publicized offer to make major loans to the State indicates that the regional corporations could pay their fair share of the tax burden. Here again, the special nature of the *ad valorem* tax must be kept

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in mind; since the tax is limited to interests in known oil and gas reserves under development for a five-year period, the tax is not being asserted against anyone who has no prosp ts for substantial revenues in the near future.

A second difficulty of the cash-flow justification is that the availability of the proposed exemption would not turn on the presence or absence of cash flow; rather, it would turn upon the racial affiliation of the taxable entity. Surely there is no compelling or even substantial justification for limiting the exemption to particular racial classes.

Further, the cash-flow problem -- if there is one -- can be cured by exemptions more properly limited to that problem. The proposed exemption apparently is not limited to the period prior to the receipt of cash royalties, but would extend beyond the time production becomes feasible and would last through the applicable period of the tax. A cash-flow difficulty could justify at most a temporary exemption or, more properly, a mere deferral of the payment date for the tax.

A blanket exemption for regional corporations has even less plausibility with respect to lands hereafter leased or placed under development. With respect to such oil and gas reserves, the present impediments to production will presumably not exist. (Of course, if the impediments continue,

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they would justify an exemption for <u>all</u> interest holders.)
Yet the exemption would permit regional corporations to voluntarily hold out of production any reserves upon their lands. And since production taxes are to be credited against the *ad valorem* taxes, the exemption would permit them to avoid both taxes, free from any incentive to develop the property. There is no plausible justification for a legislative judgment that regional corporations should be granted such a privilege.

B. The Exemption Would Create A Dangerous Precedent

The proposed exemption for regional corporations is the first, but presumably not the last, effort to inject into the State's tax laws a distinction based upon race. If an exemption were to be given to Indians, Eskimos, and Aleuts in this tax, similar exemptions would presumably also be permissible in the production tax, the State corporate income tax, other property taxes on corporate assets, and individual income taxes. Thus the legislature would be establishing a precedent for setting race against race in its deliberations, a precedent which surely would contravene the intent and purposes of the Fourteenth Amendment. Such a precedent would also contravene the policies underlying the Settlement Act,

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in mind; since the tax is limited to interests in known oil and gas reserves under development for a five-year period, the tax is not being asserted against anyone who has no prospects for substantial revenues in the near future.

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a major effort by Congress to eliminate divisive legal disputes between native and non-native interests in the State. The possibility of new decades of litigation and increased antagonisms by virtue of special tax privileges for native organizations would be reason enough for the courts to strike down a racially preferential tax privilege, regardless of the asserted justifications in this particular instance.

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