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A Brief Review of the Multistate Tax Compact

- A) What The Compact Does (And Does Not Do)
- B) The Economic And Financial Effects Of The Compact
- C) The Allocation Formula
 - 1) The Property Factor
 - 2) The Payroll Factor
 - 3) The Sales Factor
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- E) Alternatives to the Compact
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A) What the Compact Does

Basically, the Compact provides a means which has not been available in the past to enforce a state's corporate income tax laws. By providing for a general uniformity between the tax laws and regulations of the member states, corporations (and other multistate taxpayers) can be forced to provide the same income reports to all of the states. This makes it possible for states to pool their auditing resources and more carefully check the accuracy and consistency of multistate taxpayer reports. This basic uniformity also helps avoid disputes based on charges of double taxation, charges which could develop if every state's tax laws were significantly different. If disputes as to the proper allocation of incomes do arise, a method of arbitration is provided by the Compact. What the Compact does not do is depart any significant way from past policy in the treatment of multistate corporations. Thus the Compact is basically an agreement between states to ensure the effective and fair taxation of multistate businesses.

B) The Economic And Financial Effects Of The Compact

The Compact has two significant characteristics which a state by itself does not have. First, the enforcement capabilities of the Compact provide a tool by which states can approach a greater equity in the treatment of interstate and intrastate businesses. Without the Compact

it is possible for some multistate corporations to shift their net incomes to non- or low-tax states, something that one-state businesses can not do. Second, the basically uniform allocation of a corporation's income between states combined with the arbitration mechanism reduces the possibility of significant double taxation to its practical minimum. This eliminates the claim that multistate taxpayers should have special (lower) tax treatment due to the double taxation possibility, and allows the state to tax at whatever rate it deems reasonable.

C) The Allocation Formula

The advantages of enforceability and equity are bought at the price of basic uniformity in the allocation formulas and regulations of the member states. Although the details of the formula may be shaped by each state, the basic formula which all member states must use is given in Article IV, Sec. 9 of the Compact. The following is a discussion of the three factor formula of property, payroll, and sales, as it relates to Alaska.

1) The Property Factor: This factor, according to the Multistate Tax Compact, Article IV, 10 includes, "... the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period." The Alaska Administrative Code, 15 AC10.120(a) states that the property factor numerator "...shall include the average value of the taxpayer's real and tangible personal property in this state during the tax period used, is available for use, or is capable of being used for the production of business income." For most businesses the above definitions are adequate, however, they do not clearly include mineral reserves in the property factor of extractive industries.

Although they imply that reserves may be included, it is suggested that

the phrasing adopted by the Multistate Tax Commission, Feb. 13, 1973, be included in the updated revenue code (to be proposed by the Dept of Revenue in the near future) as follows: "Property held as reserves or standby facilities or property held as a reserve source of material shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor" (Commission Reg. IV. 10.(b),).

This would remove any doubt concerning the inclusion of oil, gas, and mineral reserves in the property factor of extractive industries. With the clear inclusion of mineral reserves in the property factor of multi-state taxpayers, the property factor should fairly reflect the property interests of a business in this state. (Note: The Alaska Code might also specifically state by what method mineral reserves will be valued, e.g. the same method as for ad valorem tax purposes. This might help avoid debate as to what valuation of reserves should be used.)

2) The Payroll Factor: Fortunately for Alaska, this factor is based upon the "total compensation paid" to the taxpayer's employees rather than the number of employees paid by the taxpayer. Thus, the higher salaries paid in Alaska will be reflected in a higher portion of the payroll factor being allocated to Alaska than if a simple head count were used. This is economically justified by the fact that government services are also made more expensive than in other states. No significant changes to the payroll factor appear to be needed.

3) The Sales Factor: According to the Multistate Compact, both sales which occur in the state and sales which are predominantly due to "income

producing activity" in the state are allocated to the state (Article IV. 15 and IV.17.((a)(b).). The Administrative Code, 15AAC 10.280., defines an "income producing activity" as "the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit." The major exclusion from this allocation rule is "income producing activity" performed by an independent contractor. Such activity is not included in the sales factor because the contractor pays the income tax on that activity. For most business activities in the state this is a fair and reasonable method for the allocation of gross sales. The complex contractual arrangements between the several large petroleum corporations active in the state (and their vertical integration) make the allocation of their sales and "income producing activities" more difficult to determine. It is clear that the Multistate Tax Compact is referring to just the type of activity which extractive industries are pursuing in Alaska when it refers to "income producing activities." It is suggested that the Alaska Administrative Code for Revenue contain specific reference to the extractive industries and examples of how sales from their "income producing activity" should be allocated to Alaska.

4) The Adjustment Provision. This provision allows for unique situations which may arise in relation to specific states or businesses. Article IV. 18. of the Compact states:

If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (a) separate accounting;
- (b) the exclusion of any or more of the factors;
- (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

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(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Thus, in special cases (e.g. the sales factor for a vertically integrated industry cannot be made to reflect the industry's actual activity in the state) the adjustments can be made without affecting the Compact or allocation formulas in general. Such adjustments must be made only with very good reason and with great care, because their "reasonableness" may be challenged in the courts or during arbitration. The general uniformity of the Compact, however, is not a straight jacket.

D) Preliminary Results From Compact Membership

Although the Multistate Tax Compact did not go into effect in Alaska until July 1, 1970, and the current Administrative Code relating to the Compact did not go into effect until July, 1972, some tentative observations can be made. In 1970-71, the first year under the Compact, and in 1973-74, the first year in which extensive enforcement of the Compact allocation was implemented, corporate income tax revenues jumped 14.41 and 18.34 percent respectively over previous years. This compares with growth rates of 6.48 and 7.84 percent in fiscal years 1970 and 1971 respectively (Figures from "Revenue Projection Detail", 12/19/74). It is not clear just what portion of the greater increases in fiscal years 1971 and 1974 were merely due to surges in economic growth in Alaska, but it is possible that part of the extra growth in tax collections was due to the Compact and its enforcement. A more concrete example of the Compact's value is seen in the additional corporate income tax billings being sent to five or six major multistate (oil) corporations. These are based on Department of Revenue audits which the provisions of the Compact facilitate. Two of these billings are for well over one million dollars each, totalling approximately three million. The final amounts of the other billings

have not yet been determined. Note that this compares with the \$134,860 originally paid by 3 of the 10 oil producers operating in the state in fiscal year 1973 (April 17, 1975 memo by Kathy Hollier, Research Analyst, Department of Revenue). In addition to these billings, the state has already received over \$150,000 and has approximately \$2.5 million in pending assessments due from other multistate taxpayers' operations in Alaska. Thus, preliminary evidence indicates that the Compact is assisting the Department of Revenue in obtaining significant increases in corporation net income tax revenues. As Alaska's Administrative Code for the Compact is fine tuned to Alaska's needs, it is probable that the Compact will be even more helpful in the future.

E) Alternatives To The Compact

It is possible that the State could choose to develop its own tax allocation formulas and regulations independent from other states. The object of such an independent approach would be to allocate a greater share of multistate taxpayers' incomes to the state than is possible under the Compact. There are three major problems with this approach. First, if Alaska's corporate income tax varies in major ways from other states, Alaska would have to enforce the tax without the close assistance of other states. If past experience is any guide, the state would likely loose money rather than gain it. Second, if the formula caused the tax burden of multistate tax-payers to be significantly higher than intrastate taxpayers, the long term economic effect would be to discourage new investment in the state. Such a possibility should be considered carefully in view of the state's current employment situation. Third, and perhaps most important, all of the legal battles concerning the legal standing and equity of the new tax approach would have to be fought. These

battles have largely been fought and won for the basic formula and approach used in the Multistate Tax Compact. Thus, for enforcement, economic equity, and legal reasons, such an independent course would be difficult to pursue.

It might be suggested that the state withdraw from the Compact but maintain the basic tax approach of the Uniform Division of Income for Tax Purposes Act (UDITPA - the basis of the Compact). This would gain the state nothing in the way of really new tax options while weakening its enforcement ties with other states. Such an approach would seem to be the worst of both worlds.

Finally, the state could remain within the Multistate Tax Compact, refine the state's implementing code, and make any further adjustments needed through the Compact's adjustment provisions. In those industries, specifically extractive industries, which may impose special burdens on the state and/or on future citizens of the state, severance taxes and/or ad valorem taxes could be used to supplement revenues from the net income tax.

F) Conclusion

The Multistate Tax Compact generally appears to be well suited for the needs of Alaska. Preliminary indications are that the Compact is assisting the Department of Revenue in the enforcement of the state's corporate net income tax. The allocation formula lends itself to a basically equitable treatment of both intrastate and interstate taxpayers while allowing for special or unusual cases. If such revenues are considered too low in certain industries, additional separate taxes should be used.

APPENDIX II

TITLE: LEGAL ANALYSIS OF THE MULTISTATE TAX COMPACT
REQUESTED BY: Senator John Huber, Chairman
Committee on Taxation and Revenue
DATE SUBMITTED: 10/16/75

STATEMENT OF FACTS

The Committee on Taxation and Revenue's staff in its initial review of corporate income taxation has put special emphasis on taxation of multistate corporations, under the present Alaska income tax statutes. Alaska is one of forty five (45) states and the District of Columbia which levies an income or franchise tax based on the net incomes of corporations and other similar organizations. Alaska's tax base is tied to the Federal income tax net income figure.

The State of Alaska is a member of the Multistate Tax Compact. The Compact was drafted in 1966 and became effective in 1967 after seven (7) states had adopted it. Alaska became a member on July 1, 1970. The purposes of the Compact are: 1) To facilitate proper determination of State and local tax liability of multistate taxpayers by equitable apportionment of tax bases and, 2) To avoid duplicative taxation.

On this, the initial review of the corporate income statutes, it has been tentatively decided that more revenue can be raised from the multistate corporations by use of the Compact. The method of accomplishing this would be through strict enforcement of the present allocation formula or through changes to the present allocation formula.

Questions Presented

- 1) Is Alaska's participation in the Compact legal under the United State Constitution?
- 2) Will the use of an allocation formula on income derived in Interstate commerce run afoul of the Commerce Clause and Fourteenth (14th) Amendment Due Process Clause of the Constitution?
- 3) Can the income from a subsidiary of a multistate corporation be unitized with the parent corporation for purposes of applying the allocation formula?

Brief AnswerLegality of the Compact

Under the correct interpretation of the U.S. Supreme Court, the Compact is legal. The Compact does not increase the political power of the states.

Use of Allocation Formula

The allocation formula set out in 15 AAC 10, Multistate Tax Compact, only levies taxes on that portion of the taxpayers net income arising from its activities within Alaska. The taxes imposed by the allocation formula are not a direct burden on interstate commerce and do not conflict with the Due Process Clause.

Unitizing Income of Subsidiaries and Parent Corporations

When the operation of business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary. The income from a subsidiary of a multistate corporation can be unitized with the parent corporation.

Applicable StatutesArticle I, Section 10, Clause 3 of U.S. Constitution

No state shall, without the consent of Congress ... enter into any agreement or compact with another state ...

Article I, Section 8, Clause 3 of U.S. Constitution

The Congress shall have power . . . to regulate commerce .. among the several states . . .

Fourteenth Amendment of U.S. Constitution - Due Process Clause

No state shall make or enforce any law . . . nor shall any state deprive any person of the life, liberty, or property,, without due process of law.

AS 43.19.010. Article IV

Article too long to reproduce

15 AAC 10 Multistate Tax Compact.

Compact too long to reproduce

DiscussionLegality of the Compact

Even though the words of the Constitution seem to prohibit all compacts entered into without the consent of Congress, current judicial interpretation limits the all or nothing aspect of the Article. The United States Supreme Court in 1893 laid down the rule in Virginia v. Tennessee, 148 US 503 (1893), 37 LE 537, which states: "...Looking at the clause in which the terms "compact" or "agreement" appear, it is evident that the prohibition is directed to the formation of any combination tending to the increase of political power in the states, which may encroach upon or interfere with the just supremacy of the United States..."

The several states have entered into the Compact as a means of insuring that the states power to tax multistate corporations will not be interfered with by Congressional action. Congress has set some restrictions in Pub Law 82-272 (15 USCS 381) and has made studies. Each session has seen the matter come up, but with the exception of Pub Law 86-272, nothing has been done.

The Compact does not increase the political power of the states. The states have the power to tax. In entering into the Compact they are facing the economic reality that much of the business in the country is carried out by multistate corporations. In order to derive a fair amount of tax from those corporations, the states have entered into the

Compact to ensure equitable apportionment among themselves and avoidance of duplicative taxation.

Consent of Congress can also be implied. Virginia v. Tennessee *supra*.

Since the Compact's inception in 1967, there has been continuing Congressional action on the matter. That action has not resulted in any legislation approving or disproving the Compact, of which Congress is well aware.

"..It seems fair to say that Congress impliedly consents to the existence of any compact of which it has knowledge and has not been negated by legislators..." The Compact meets the test of Constitutionality.

Use of Allocation Formula

The use of the allocation formula has been attacked on the following grounds by the multistate corporations: 1) It is a tax on the privilege of engaging in interstate commerce, 2) It is inherently discriminatory and 3) It results in a multiple tax burden. The first raises an issue under the Commerce Clause and the second and third raises issues under the 14th Amendment Due Process Clause of the U.S. Constitution.

Both issues have been extensively litigated and most decisions have been returned in favor of the allocation formula. A tax that is a direct burden upon the operation or act of interstate commerce is unconstitutional. The mere act of carrying on business in interstate commerce does not except a corporation from state taxation.

The U.S. Supreme Court stated in the leading case of Northwest States Portland Cement Co. vs. State of Minnesota, 358 US 450, 3 Led 2d 421, 79 S.Ct. 357: "...We conclude that net income from the interstate operation of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing state forming sufficient nexus to support the same..." In the case of General Motors Corp. vs Washington, 377 US 436, 440-441 (1964), the U.S. Supreme Court following Northwest stated this controlling test:

"...A careful analysis of the cases in this field teaches that the validity of the tax rests upon whether the state is exacting a constitutionally fair demand for that aspect of interstate commerce to which it bears a special relation. For our purposes the decisive issue turns on the operating incidence of the tax. In other words, the question is whether the state has executed its power in proper proportion to appellant's consequent enjoyment of the opportunities and protections which the state has afforded ... As was said in Wisconsin vs J.C.Penny, 311 US 435, 444 (1940), 'the simple but controlling question is whether the state has given anything for which it can ask return'..."

The U.S. Supreme Court has sustained the above decisions in Colonial Pipeline Co. vs Treigle, -US-, 44 L Ed 2d 1, 95 S.Ct. --.

Since the taxes imposed are only levied on that portion of the taxpayers net income which arises from its activities within the taxing state, they do not conflict with the Due Process Clause. Northwest supra. The use of an allocation formula that is nondiscriminatory, properly apportioned,

and related to local state activity to tax multistate corporations will not run afoul of the Commerce and 14th Amendment Due Process Clauses of the U.S. Constitution.

Unitizing Income of Subsidiaries and Parent Corporations

One of the major problem areas in taxing multistate corporations is where the activities done in the taxing state are carried out by a subsidiary of the parent multistate corporation. This issue has been decided principally in state courts. As noted in the immediate prior discussion, the allocation formula has been upheld.

The general test was stated by the California Supreme Court in Edison California Stores vs McColyes, 30 Cal. 2d 472, 183 P2d 16 (1947). It states "...If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary ... A more particular statement of the test is that a business is unitary if these circumstances are present: 1) Unity of ownership, 2) Unity of operations as evidenced by central purchasing, advertising, accounting and management division, and 3) Unity of use of its centralized executive force and general system of operations..."

The test was followed in Chase Brass and Copper Co. vs Franchise Tax Board, App. 86 Cal Rptr 350 (1970), dismissed 400 US 961 (1970). Chase was a wholly owned subsidiary of Kennecott Copper Corp. Kennecott did

no business in California. Applying the above test, the California Supreme Court found the business between Kennecott and Chase Brass unitary. The same rationale was followed by the Oregon Supreme Court in Coca Cola Co. vs Dept of Revenue, 533 P2d 792 (1975).

Following the lead of the various state courts, the income from a subsidiary of a multistate corporation can be unitized with the parent corporation for purposed of applying the allocation formula. The power to impose the tax on a unitary business flows from the authorized method of determining income from the taxpayers activities within the state, and authority to pursue the method is present whenever activities are partially within and partially without state, whether or not integral parts of the system are seperately incorporated, or the accounting system of the taxpayer does not clearly reflect the income. Edison California Stores, supra.

Conclusion

From a legal point of view the Multistate Tax Compact is valid under the United States Constitution. Use of an allocation formula that is not discriminatory will forestall any attack under the Commerce and Fourteenth Amendment Due Process Clauses. It is also possible to unitize the income from a subsidiary of the multistate corporation with the parent.

There is an area in which the Multistate Tax Compact is inadequate for the State of Alaska. That area is the taxation of oil and gas revenues.

Only a small amount of tax revenue would be generated if the Compact were used exclusively to get to the multistate oil companies' profits. For taxation of the multistate oil companies another type of tax is needed, ie severance, value added, ad valorem, in addition to the Compact.

Franklin D. Fleeks

Tax Counsel

ALASKA STATE LEGISLATURE

MEMORANDUM

APPENDIX III

October 16, 1975

TO: Senator John Huber, Chairman
Committee on Taxation and Revenue

FROM: Franklin D. Fleeks
Committee Tax Counsel

SUBJECT: Value Added Tax

At each of the meeting held, whether formal or informal, the topic of a value-added tax has been discussed. Though all participants had heard of a value-added tax, its concept and operation was not clearly defined. The purpose of this memo is to try to bring clarity to the subject.

History

The value added tax (VAT) is an out growth of multistate turnover taxes used in Europe. The multistate turnover tax was first introduced in Germany during World War I.¹ France adopted the value added tax in 1954. With the formation of the European Common Market (EEC) and its emphasis on harmonizing the various nations taxes, the vehicle chosen was the value-added tax. At present, all of the member states of the EEC have enacted value-added taxes.² In the United States, only the state of Michigan had a modified VAT. The modified VAT was repealed when Michigan revamped its law in 1967.³

Discussion

Just what is a value-added tax? The simple definition is that it is a tax on 'value added' by the taxpayer. The most accurate definition found is that VAT is a net turnover tax with prior tax deduction.⁴ What must be emphasized is that VAT is a sales tax collected in multistages.

"...It is a method of collecting a sales tax that insures that the tax is shifted to the consumer..."⁵ As another writer states "...The value-added tax is neutral as to businesses because it does not apply to businesses; rather it is a retail sales tax on the consumers of goods and services and not a tax on the producers or sellers of goods and services..."⁶

The way the tax works is as follows. A producer or seller of goods or services multiplies his total sales by the applicable rate. From this amount, by the tax credit system, the producer or seller subtracts the amount of tax he paid on his purchases and pays the net amount to the government.⁷

Application of the Tax to Alaska

The question to be asked is: Can a value-added tax increase significantly the revenues from multistate corporations and oil and gas?

Even though the tax has only been used in one state, Michigan, there is nothing in the Federal or State laws that would bar a VAT. Under Article IX, Section 1, of the Alaska Constitution, the State can enact a VAT law.

An Alaskan VAT tax would have one fatal flaw if applied to raise tax revenue from the multistate corporations and oil and gas. That fatal flaw is that the VAT is a sales tax. Under current Supreme Court decisions, Alaska cannot apply a sales tax on goods produced here and sold out of the state. The United States Supreme Court has stated:

"...The vice of the statute as applied to receipts from interstate sales is that the tax includes in its measure, without apportionment, receipts derived from activities in interstate commerce; and that the exaction is of such a character that if lawful it may in substance be laid to the fullest extent by States in which the goods are sold as well as those in which they are manufactured. Interstate commerce would thus be subjected to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids..."⁸

In a 1972 New Mexico case where the state levied on proceeds from contracts entered into outside the state with out of state clients, the U.S. Supreme Court in a unanimous decision stated: "...But a tax levied on the gross receipts from sales of tangible personal property in another state is an impermissible burden on commerce..."⁹

Conclusion

The purpose for which a value-added tax would be enacted is to raise significant tax revenues from multistate corporations and oil and gas.

Because the VAT is a sales tax and under current U.S. Supreme Court decisions the rate cannot be applied to total sales outside Alaska, the VAT would not generate significant additional tax revenues. It is my conclusion that enactment of a VAT tax would serve no useful purpose for the State of Alaska.

Sources

1. Norr and Hornhammer, The Value-Added Tax in Sweden, 70 Columbia Law Review 381 (1970)
2. Gordon T. Butler, The Value-Added Tax; A New \$40 Billion Tax For the United States, 50 Texas Law Review 267 (1972)
3. Michigan Compiled Laws Annotated, Chapter 206, Income Tax Act of 1967
4. Butler, supra
5. Butler, supra
6. Stanley Surrey, Value-added Tax: The Case Against, 48 Harvard Business Review 77-94, Nov.-Dec. 1970
7. Norr, supra; Butler, supra
8. J.D. Adams Mfg. Co. vs Storen, 304 US 307, 82 L.Ed 1365, 58 S.Ct 913.
9. Evco vs Franklin Jones, 459 US 91, 34 L.Ed 2d 325, 93 S.Ct 349 (1972).

ALASKA STATE LEGISLATURE

MEMORANDUM

APPENDIX IV

November 3, 1975

TO: Senator John Huber, Chairman
Special Committee on Taxation and Revenue

FROM: Franklin D. Fleeks *[Signature]*
Committee Tax Counsel

SUBJECT: Severance Taxes -- Legal Analysis

INTRODUCTION

Review of data available to the staff revealed that everyone is familiar with the concept of severance taxes. However, no one has done a legal analysis of just what severance taxes are for the use of the working legislator. It is the purpose of this memorandum to provide the members of the subcommittee with a concise legal analysis predicated on the use of the severance tax to derive substantial revenues from the state's renewable and nonrenewable resources.

There is confusion in the use of the term severance tax. It should be understood from the outset that gross production tax and severance tax are the same. These taxes come under the general heading of privilege or occupation taxes. These taxes are excise taxes: " . . . taxes imposed

by public authority for the purpose of raising revenue on the performance of an act, the enjoyment of a privilege, or the engaging in an occupation . . ." 33 C.J.S. 110-111.

The severance tax is not a tax levied directly on persons or property and is clearly distinguishable from ad valorem property taxes and income taxes. The Supreme Court of Montana in ruling on the validity of a license tax imposed on the privilege of engaging in mining, the tax being based on production stated:

"The state in effect says to producers: Your operations deplete the natural resources of the state, and to the extent that you remove from the earth the natural wealth which nature has provided it, and to that extent impoverish it, you are required to pay a license tax for the use and benefit of the state, for the privilege of extracting such natural wealth. The tax provided is not, therefore, on metals, minerals, or mine products, but rather upon the business of producing metals or precious stones, based on annual production." State ex rel Snidone v. State Board of Equalization, 17 P.2d 68, 72 (1932)

The United States Supreme Court in distinguishing between a property tax and an excise tax imposed upon a product of a working corporate mine stated: ". . . [It] is not a tax upon property as such because of its ownership, but a true excise levied on the results at the business of carrying on mining operations . . . " Stanton v. Baltic Mining Co., 240 U.S. 103, 114 (1916). Because of this

difference, any constitutional requirement relating to imposition of property taxes does not affect the levying of severance taxes. 103 A.L.R. 18, 20.

At present, the State of Alaska levies a gross production tax/severance tax on oil and gas under AS 43.75. The meaning of gross production tax and severance tax as used in the memorandum is as follows:

Gross Production Tax -- A severance tax levied as an occupation tax. The tax is usually imposed at a certain sum per unit of mineral removed. Williams and Meyers, Manual of Oil and Gas Terms, 208.

Severance Tax -- A tax imposed on persons engaged in severing from the soil natural resources, such as timber, oil, natural gas, ore, or the like, based on the quantity or value of the product. 32 A.L.R. 827.

LEGAL ATTACKS ON AND
LEGAL DEFENSE OF SEVERANCE TAXES

There is no doubt that the state has the right to levy severance taxes. Much of the litigation is based on the premise that the severance tax is invalid because by imposing a tax on quantity or value of the product, that imposition was arbitrary discrimination which violated both the due process and equal protection clauses of the constitution.

Attempts have been made to convert the severance tax into a property or income tax, in order to bring the severance tax within those taxes constitutional provisions of equality. Also in this vein, allegations have been made that severance was an incidental step in a general manufacturing process and not subject to a privilege or occupation tax.

The courts have generally struck down the arguments advanced above. The United States Supreme Court in ruling on a Louisiana severance tax law based on the taxation of crude oil by its gravity weight laid down the general rules, which are still in effect:

"The states have a wide discretion in the imposition of taxes. When dealing with their proper domestic concerns, and not trenching upon the prerogatives of the national government or violating the guaranties of the Federal Constitution the states have the attribute of sovereign powers in devising their fiscal systems to insure revenue and foster their local interest. The states in the exercise of their taxing power, as with the exertion of other powers, are subject to the requirements of the due process and the equal protection clauses of the 14th Amendment, but that amendment imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to schemes of taxation. The state may tax real and personal property in a different manner. It may grant exemptions. The state is not limited to ad valorem taxation. It may impose different specific taxes upon different trades and professions and may vary the rates of excise upon various products. In levying such taxes, the state is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference

to composition, use, or value. To hold otherwise would be to subject the essential taxing power of the state to an intolerable supervision, hostile to the basic principles of our government and wholly beyond the protection which the general clause of the 14th Amendment was intended to assure" Ohio Oil Company v. Conway, 281 U.S. 146, 159, 74 L.Ed. 775, 782 (1930).

If the severance tax is alleged not to be a privilege or occupation tax, the "Tennessee Doctrine" comes into effect. That doctrine states that ". . . a privilege is whatever the legislature declares to be a privilege and taxes as such" Burke v. Memphis, 94 Tenn. 692, 30 S.W. 742.

LIMITATIONS ON LEGISLATIVE POWERS

The wide discretion that the legislature has in imposing taxes are subject to limitations. While the state may classify broadly the subjects of taxation, Ohio Oil Co., supra, in doing so it must proceed on a rational basis. The general rule was stated by the United States Supreme Court in Royster Guano Co. v. Virginia, 253 U.S. 412, 415, 64 L.Ed. 989, 40 S. Ct. 560. The rule is: ". . . The state must proceed upon a rational basis and may not resort to a classification that is palpably arbitrary. The rule often has been stated to be that the classification must rest upon some ground of difference having a fair and substantial object of the legislation" The general rule on

classification has recently been upheld by the U.S. Supreme Court in a Florida case. The Florida law under attack exempted widows from property tax but not widowers. In upholding the classification Justice Douglas stated for the majority that:

" . . . We have long held that where taxation is concerned and no specific federal right, apart from equal protection, is imperiled, the states have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 35 L.Ed. 2d 351, 93 S. Ct. 1001. " A state tax law is not arbitrary although it 'discriminates in favor of a certain class . . . if the discrimination is founded upon a reasonable distinction, or difference in state policy,' not in conflict with the Federal Constitution. Allied Stores v. Bowers, 358 U.S. 522, 3 L.Ed. 2d 480, 79 S. Ct. 437. This principle has weathered nearly a century of Supreme Court adjudication, and it applies here as well . . ." Kahn v. Shevin, 416 U.S. 351, 40 L.Ed. 2d 189, 94 S. Ct. 1734 (1974)

Even though classification imposes limitations on the legislature, that limitation will not invalidate a properly drawn law. The state can classify as long as classification is rational, not arbitrary, and all taxpayers occupying the same status or falling into the same class are treated alike.

LEGAL JUSTIFICATION FOR
INCREASED RATE OF SEVERANCE TAX

If a high rate of severance tax is imposed by the legislature, the opponerts to the levy are sure to attack it on the basis that the tax is unreasonable, arbitrary,

prohibitory and confiscatory. This line of attack on "excessive taxation" through due process has uniformly met the response:

" . . . where a statute is in every other respect a valid exercise of the taxing power, the judiciary has no power to declare the statute unconstitutional, even though the tax completely destroys a legitimate and useful business"

Morganti, 14th Amendment, Due Process, The Taxing Power, Case Note, 52 Journal of Urban Law, 620 (1974).

The U. S. Supreme Court, beginning with McCulloch v. Maryland, 17 U.S. (4 Wheat) 316, 428 (1819) and continuing up to the present in City of Pittsburgh v. Alco Parking Corp. et al., 417 U.S. 369, 41 L.Ed. 2d 132, 94 S. Ct. 2291 (1974) have held to this view. In an 1869 case involving a federal statute increasing a tax upon circulating notes of state banks the Supreme Court said:

" . . . The judicial cannot prescribe to the legislative departments of the government limitations upon the exercise of its acknowledged powers. The power to tax may be exercised oppressively upon persons, but the responsibility of the legislature is not to the courts, but to the people by whom its members are elected. So if a particular tax bears heavily upon a corporation, or a class of corporations, it cannot for that reason only, be pronounced contrary to the Constitution. . . . "

Veazie Bank v. Fenno, 75 U.S. (8 Wall) 533.

The Alaskan legislature imposed a license tax upon the manufacture of fish oil and fertilizer. The grounds used to

attack the tax was that it would destroy the plaintiff's business, taking the plaintiff's property without just compensation. The U. S. Supreme Court upheld the tax:

" . . . Even if the tax should destroy a business, it would not be made invalid or require compensation upon that ground alone. Those who enter upon a business take that risk . . . We know of no objection to exacting a discouraging rate as the alternative to giving up a business, when the legislature has the full power of taxation . . . "
Alaska Fish Salting and Products Co. v. Smith, 255 U.S. 44, 65 L.Ed. 489, 41 S. Ct. 219 (1921).

The most current case dealing with this question is City of Pittsburg v. Alco Parking Corp. et al., supra. Here the city passed an ordinance placing a 20 percent gross receipts tax on private commercial operators of parking facilities. The tax was responsible for nine out of fourteen private commercial operators not being able to conduct business at a profit. In a unanimous decision validating the ordinance, the U. S. Supreme Court held:

" . . . The claim that a particular tax is so unreasonably high and unduly burdensome as to deny due process is both familiar and recurring, but the Court has consistently refused either to undertake the task of passing on the 'reasonableness' of a tax that otherwise is within the power of Congress or of state legislative authorities, or to hold that a tax is unconstitutional because it renders a business unprofitable . . . "

Article IX, Section 1, of the Alaska Constitution, gives to the State the power of taxation. It is, without doubt, within the power of this legislature to impose a new severance tax. The rate of the severance tax, whether high or low, is within the discretion of the legislative body.

CONCLUSION

It is within the power of the legislature to levy a gross production/severance tax. The subject of the severance tax can be a broad classification. The severance tax cannot be based on an arbitrary classification and the classification must proceed on a rational basis. The courts of the several states and the U. S. Supreme Court have consistently upheld high rates of taxation even though the rate will materially affect legitimate and useful business. A carefully drawn statute with high rates will withstand legal attacks from the affected industry.

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Alaska State Legislature

SPECIAL COMMITTEE ON TAXATION AND REVENUE

POUCH V
JUNEAU, ALASKA 99811
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Senate

SENATORS
JOHN HUBER, CH.
JOE ORSINI
PAT RODEY

January 9, 1976

The Honorable Genie Chance
Alaska State Senator
Chairwoman
Legislative Council

Dear Senator Chance:

The Committee staff was assembled and on board by September 16, 1975. Their initial instructions were to review all current and proposed taxation and revenue statutes. The review was to see which statutes would lend themselves to change. After the initial review, the following topics were assigned to the staff for research: (a) Multistate Tax Compact; (b) Value-added tax; (c) Short-term Land Tax; (d) Oil and Gas Taxation; and (e) Wholesale Liquor Industry. Enclosed in your binders are the staff's reports on each of these areas.

There is continuing work to be done on all of the above but as the reports show, the basic data has been obtained or is in the process of being obtained. Major emphasis was placed on oil and gas taxation. In addition to proposing a raise in the severance tax rates, two additional new statutes are proposed. Explanation of the working drafts of the bills will give you the information needed for your deliberations.

The future projects that we hope to begin studying within the month are: (1) Review of Fisheries Operations with Emphasis on Processing, (2) Gas Pipeline Impact on Taxation and Revenue, (3) Oil and Gas Pipeline Income Taxation, (4) other Minerals Taxation, (5) Analysis of State Leasing Policy and other subject areas assigned to the Committee. As in the past these future projects will be handled on a task force basis. The staff members work as a team reinforcing each other's abilities.

I invite you to read these reports and will welcome any comment.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "John Huber".

Senator John Huber
Chairman
Interim Committee on Taxation
and Revenue

AGO 529642 +

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2/76

OIL AND GAS TAXATION REPORT

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INTRODUCTION

The drafting of any bill is difficult but when the bill is in the field of taxation that difficulty increases. In arriving at conclusions we have used all the available data we could find. This included but was not limited to American Petroleum Institute statistics, information in prospectus, federal government reports, reports from various state agencies, and various other publications dealing with the oil and gas industry.

Introduction to Bills

The Committee's staff has used as a guide the following principles:

- (a) The economic activity must be vigorous enough to provide a sustained flow of tax revenues without impairing the activity itself.
- (b) The tax revenue to be collected must be collected at a reasonable cost.
- (c) The statute must be easy to administer in a fair and even handed manner, under straight forward rules that are easy for the taxpayers to understand.

One of the goals of any tax is obviously to produce state revenues. There exists a point where the state tax burden on any given taxpayer or industry will affect its competitive position.

At that point the taxpayer or industry will curtail its operations or shut down entirely. The proposed bills, though increasing the state tax do not reach that point. The increases in the tax are warranted because of the increase in profitability of the companies, caused by the increase in world oil prices.

The economic analysis prepared by Ed Sterner of the Committee's staff is also attached. His report and analysis show the economic impact of the proposed bills. The proposed bills are based on this analysis and are included in this report.

Oil and Gas Taxation at Present

Currently, the State of Alaska levies four taxes on oil and gas. The statutes are:

- (1) AS 43.55 Oil and Gas Properties Production Tax
- (2) AS 43.56 Oil and Gas Exploration, Production and Pipeline Transportation Property Taxes
- (3) AS 43.57 Oil and Gas Regulation and Conservation Tax
- (4) AS 43.58 Oil and Gas Reserves Ad Valorem Tax

The first three statutes were amended or adopted in the First Special Session of 1973. The last bill was adopted during the 1975 Regular Session. The intent of AS 43.58 was to be a stopgap measure passed to take care of state's shortfall in revenue until oil production begins on the Prudhoe Bay field.

The Committee staff recommends that no changes be made to AS 43.56 and AS 43.57. The statutes, in their present form, adequately serve the purpose for which they were passed.

Proposed Statutes

Production Tax

It is proposed that the rates of AS 43.55, Oil and Gas Properties Production Tax, be raised. It is also proposed that the tax per barrel of oil also be increased. Because the producer is required to pay the higher of the two tax schedules, the cents per barrel tax provides a floor to the tax revenue which the state will receive for each barrel.

Since the 1973 Special Session, world events have raised the price of oil. This has been translated into increased profits by the producing companies. In order for the State of Alaska to procure its fair share of these profits, the tax rates must be raised. As the economic analysis shows, even this increase allows a fair return to the producers.

Net Proceeds Tax

In addition to the proposed raise in oil and gas production tax a new tax statute is submitted. The statute proposed is a "net proceeds" tax. This type of tax is currently being assessed, with local variations, in the following states: Colorado, Idaho, Montana, Nevada, and New Mexico.

The "net proceeds" tax is a net-income related, rather than a property or production related tax. It is an ad valorem tax. The proposed tax seeks to avoid the problems involved in valuing

reserves by equating the value of reserves to the value of oil and gas extracted in a calendar year. The producing oil and gas wells are the properties that are taxed, and not the net or gross proceeds, the latter being only the means of valuating the oil and gas wells for tax purposes.

From studies done by the staff, the current corporate income tax law does not reach the net profits of the out-of-state producing companies. The Multistate Tax Compact with its allocation formula is inadequate for production of revenue from resource companies. The allocation formula based on sales, property, and payroll does short change the State of Alaska. The major components of sales, property, and payroll are located outside of the state.

It is recommended that a tax be levied on income to the property. This is a net proceeds approach to resource taxation. The procedure begins with the gross proceeds from the sale of the product, deducting all allowable expenses. The allowable expenses are specifically set forth in the statute. Sales will be determined at the shipping point when the resource is shipped from Alaska. Administratively, the sales figure will be determined by the sale of the state's royalty oil on the open market and/or other indices as determined by the Department of Revenue.

The recommended tax would be in lieu of the state's corporate income tax.

Other Matters

It is projected that the recommended changes will bring to the State of Alaska tax revenues of \$10 to 20 billion over a

twenty-year period from Prudhoe Bay alone. This represents a \$5 to 15 billion increase over what current taxes would bring.

It is the staff's recommendation that a portion of these funds be dedicated to the future generations of Alaskans. At present this cannot be done because of the constitutional limitations on dedicated funds set out in Article IX, section 7 of the Alaska Constitution.

It is proposed that a constitutional amendment be drafted and submitted to the people of Alaska setting up a dedicated fund from oil and gas revenues.

A Review of Possible Oil Taxation Proposals

- I. The Current Tax Situation
- II. An Oil Tax Base
- III. Tax Proposal One: A Basic Profitability Tax on
Producing Properties, "Oil and Gas Properties Net Proceeds
Tax"
- IV. Tax Proposal Two: An "Excess" Value Approach,
"Excess Value Surtax"
- V. Conclusion

I. The Current Tax Situation

In addition to the non-tax royalty income from oil or gas, the state receives tax revenue from the petroleum industry from gross severance taxes, property taxes on capital improvements (both state and local), corporate net income taxes, and the "temporary" ad valorem taxes on petroleum reserves. In the past, fairly stable prices and costs have allowed the state to use gross severance and property taxes to tax the petroleum industry at rates acceptable to both the industry and the state. Such stability has not recently characterized the petroleum industry and the future is far from clear.

While the gross severance tax and property taxes perform the function of providing a basic floor for the taxation of the petroleum industry, they do not have the flexibility needed to react and compensate for the rapid changes in the petroleum industry situation. The corporate net income tax at the national

level provides the basis for a flexible national tax structure. However, Alaska's state experience has been that the income tax is a relatively ineffective means of attaining the oil corporations' profitability in the state.

Thus, what appears to be needed in Alaska is a substitute for the net income tax which will provide the flexibility needed to supplement the gross severance and property taxes. The following presents a proposed tax base and two proposals of how that base should be taxed. Each proposal is followed by a series of comments and questions. These are meant to encourage discussion of the proposals, not to limit the discussion. All observations and comments will be appreciated.

II. An Oil Tax Base

Due to the legal and enforcement problems connected with the income tax, the tax should be based upon the value of production as determined by the state, with the assistance of required returns from the companies. The deductions allowed would cover most expenses currently allowed under the net income tax; however, the deductions will be limited by statute.

As a starting point for discussion, the following base is proposed:

1. FOB price - AK Border or other convenient point
MINUS
2. Transportation costs - from wellhead to FOB point
MINUS

3. Direct production costs - wages and fringes of workers at field, maintenance, etc.

MINUS

4. Depreciation - of capital improvements

MINUS

5. Royalty payments to state

MINUS

6. Gross severance taxes, property taxes, conservation taxes

EQUALS

7. Adjusted value of production

Questions and Comments:

A. Should exploration and development costs be:

(1) Allowed as an operating expense?

*(2) Considered a capital expense and be depreciated?

(3) Left as an option to each company?

(4) Not allowed at all?

*A(2) It is felt that the capitalization approach may be the best alternative. Allowing exploration costs to be charged as part of current expenses only assists those with current income to charge against them. The capitalization approach would treat both current operators in Alaska and new entrants equally.

The option approach, A(3) might be a reasonable compromise which could encourage more exploration by current operators and

yet allow some benefit for new entrants. The total disallowance of exploration costs would be economically unfair and should only be used if the deduction proves to be a "fatal loophole."

B. Should indirect administrative costs:

- (1) Be disallowed as above?
- (2) Be allowed for by a statutory deduction (e.g. \$0.10/bbl)?
- *(3) Be allowed only if directly spent in Alaska (e.g., salaries and fringes of administrative personnel subject to Alaska withholding tax)?

*B(3) If past performance is any indicator, only administrative costs actually incurred in Alaska should be allowed. This should cover the major part of the marginal costs of operating in Alaska while avoiding a "fatal loophole" of the net income tax.

A statutory deduction such as suggested by B(2) might be included to compensate for out-of-state costs; however, in view of the dominance of capital, direct operating, and other costs, it does not seem necessary. Comment H also suggests a reason why full allowance of indirect expenses may not be necessary.

C. Should the "Adjusted Value of Production" be computed:

- (1) By field?
- *(2) By company?

*C(2) The inclusion of administrative costs, exploration costs, or any other costs which cannot be directly allocated to any specific field makes the calculation by company almost a

necessity. The companies might be required to report direct expenses by field and report other expenses separately. This would give the state the indicators of the marginal profitability of various sizes and locations of fields which might assist the state in future lease sales. It would also show when one company's "overhead" appears to be out of line when compared to other companies' overhead.

D. Should accelerated depreciation be:

- * (1) Permitted (within limits)?
- (2) Required?
- (3) Prohibited?

*D(1) Due to the nature of the industry, flexibility in depreciation rates is desirable. A flat requirement or prohibition of accelerated depreciation would not be appropriate unless the flexibility is abused. New entrants into the Alaska petroleum producing industry will not have much use for accelerated depreciation. Those companies currently operating in the state may use it to defer taxes, thus lowering the effective tax rate until the capital costs are recovered. Minimum and maximum rates such as five and ten percent might be set, with exceptions being subject to review by the Department of Revenue. The alternative would be to link all depreciation to the probable life of the property as Nevada does, "The probable life of the property represented by the original cost shall be considered in computing the depreciation charge." (NRS 362.120(g)).

E. Should "losses" due to accelerated depreciation or immediate deduction of exploration expenses, if allowed or required, be applicable:

(1) Only against current income (no carry forward provision)?

*(2) Against profits from other Alaska fields or future years?

*E(2) It is possible that new entrants to Alaska (or those without Prudhoe Bay interests) may appear to have "losses" after special tax concessions. It would seem that if concessions are made, they should be equally available to all in the industry. To treat all companies equitably, such carry forwards must be allowed.

F. Should bonus bids be:

(1) Allowed as amortized deductions against the company's state-wide production?

*(2) Allowed as amortized deductions against profits of the fields to which they apply?

(3) Not allowed as deductions?

*F(2) Although it may seem most equitable to allow all bonus bids to be written off against future profits, this approach would place current producers, especially major Prudhoe Bay interests, at an unfair advantage. Knowing in advance that they will have sufficient income to write the bids off, they might be

willing to over-bid potential new entrants into Alaska. This point may become moot if the state turns to royalty or participation bidding for its leases.

G. Should interest payments on debt:

- (1) Be allowed as an expense?
- (2) Be partially allowed as an expense (e.g., a percent)?
- (3) Not be allowed?

No position is taken on this issue. There are persuasive arguments on all sides. Typically, interest "foregone" by equity investment is not deductible, while interest payments on debt financing are deductible. In general, this tends to bias investors in favor of debt financing, especially if they can borrow at lower rates than they can loan due to their credit position. In particular, this tends to foster debt financing in areas with effective tax programs since the exemption of interest payments, in effect, exempts the profits up to the interest rates on the debt from taxes. The interest payments are made to lenders who are hopefully in a position or a jurisdiction where effective taxation can be minimized. Furthermore, this debt financing releases equity capital which can also be invested in jurisdictions with less effective tax programs.

On the other hand, not allowing the deduction of interest charges can result in a form of double taxation; first by taxing the interest payments as part of the borrower's profit, and second as part of the lender's income. Furthermore, should profit

margins fall, the taxpayer can be placed in the position of paying taxes while not having enough income after other costs to pay the interest on the debt.

Perhaps the fairest approach would be to allow deductions for both interest payments on debt and interest "foregone" on equity investment. This would lead into an administrative and accounting quagmire that would likely provide the "fatal loop-hole" which is to be avoided. Not allowing deductions for either interest payments or interest "foregone" also avoids causing biases in investment decisions. This does not seem "fair" in view of the position in which debt financed enterprises are placed. At fairly low tax rates, the no exemption route may be the approach to take to close a sometimes abused loophole. The case is clearly open to debate.

H. It should be noted that the "Adjusted Value of Production" does not include the short-term interest which can be earned from the cash flows generated by the petroleum production. Thus, the true value of the production is actually understated. This is paralleled by the understatement of expenses, since all indirect costs are not allowed. To some degree, these sources of income and expense offset each other and help minimize any inequities inherent in the tax.

I. For the purposes of this tax, should the "adjusted value" of all petroleum production, including both gas and oil be:

(1) Calculated and taxed separately?

*(2) Calculated and taxed jointly?

*I(2) Many of the costs of oil and gas production, both direct and indirect, cannot be accurately separated. Any allocation of the costs would often be arbitrary, and such a requirement would be difficult to administer.

J. Should activities other than production, such as refining, if pursued in Alaska be:

(1) Included in this tax approach?

*(2) Excluded from this tax and be taxed under the income tax?

*J(2) This tax is designed to tax the value of petroleum producing properties, not the profitability of refining and marketing operations. The more complex pricing structure of refined products, research, development capital, and operating costs of such "down stream" operations require a more complex tax approach to be equitable. Any attempt to modify the proposed tax and apply it to such operations would likely result in the opening of administrative and accounting problems which would result in an ineffective tax.

K. Should royalty payments to interests other than the state be:

(1) Exempted from taxation as are state royalties?

(2) Subject to tax like other production?

* (3) Subject to tax, with the tax paid on the royalty interest being allowed as an adjustment to the royalty holder's income tax?

*K(3) Royalty payments are a legitimate expense for producers. The object is to tax the royalty owner's oil income in the same manner as the producer's income, without harming the operator. The first alternative, K(1), would allow the operator to indicate his royalty costs, but would remove the royalty oil and gas from the tax base for this tax. This would mean that the value of the royalty oil and gas would only be subject to income taxes. This tax has been found to be less effective for multistate organizations than for domestic corporations. The second alternative, K(2), would keep royalty production under this tax but would be unfair to both the producer and the royalty interest holder. Its inclusion with other production value would make the producer's adjusted value of production appear too high and would subject royalty values to both this tax and net income taxes paid by the royalty owner. The third alternative, K(3), would retain royalties under this adjusted value tax approach and would avoid double taxation. As an example, the producer reports the gross value of production minus the deductions allowed by statute, including all royalties, and pays the appropriate tax. The producer also reports the gross value of the royalty production, minus allowable costs to be paid by the royalty owner, such as transportation, and pays the

appropriate tax. The tax paid on the royalty portion would be considered as part of the royalty payment and as an adjustment to the royalty interest's income tax due to crude oil and gas production activities.

Conclusion

The above issues must be settled before the final form of the tax can be determined. The preliminary revenue estimates found in the appendix use the asterisk marked alternatives and allow no deductions for interest payments. The various alternatives can have significant impact on how soon and how much revenue will be received by the state. The goal is to develop a tax approach that is basically fair to both the petroleum producers and the state.

III. Tax Proposal One: A Basic Profitability Tax on Producing Properties, "Oil and Gas Properties Net Proceeds Tax"

Once the tax base is determined, this tax will be applied to the "adjusted value of production." Since this tax is designed to tax the profitability of properties which the net income tax does not tax, the income tax rate of 9.4 percent would be appropriate. This would treat the profitability of the taxed properties in basically the same way as the current state income tax treats other corporate profits. The preliminary revenue estimates are based on the use of the 9.4 percent rate.

IV. Tax Proposal Two: An "Excess" Value Approach

There is a basic feeling among many people that profits from non-reproducible property, be they from real estate "speculation" or crude oil production, can be in some sense "too high" or "excessive." Such an excessive income is often expressed in terms of too high a return on capital investment. At first glance this seems fairly straight forward. However, there are two basic problems with this approach, the first of which kept the excess profits taxes of the Korean War in litigation into 1974.

First, one must determine just what the capital base is. Does the base include only equity capital or all capital? Are exploration costs part of the capital base? Is capital valued at original value or replacement value? These and other problems with the estimation of the capital base make such an approach a legal, administrative and enforcement nightmare.

Second, even if the capital base could be defined, a determination of just what is a "reasonable profit" is most difficult at best. Return rates vary from industry to industry and even within sectors of industries.

In hearings before the U. S. Senate Committee on Finance, January 22 and 23, 1974, a unanimous criticism (a rare event among Washington "experts") of such a tax was heard. Sheldon S. Cohen, former Chief Counsel, Treasury Dept., Charles W. Davis, former Commissioner of Internal Revenue Service, and William E. Simon, Secretary of Treasury, all concluded that an excess profits tax

based on historical profits or "reasonable profits" is basically unadministrable (pages 97, 105, and 63-4 respectively). For a more extensive discussion of determining the capital base and profit rate of return, please refer to Measurement of Corporate Profits, prepared by J. W. Allen, Economics Division, Library of Congress for the Senate Committee on Interior and Insular Affairs, March 1974 (Govt. Documents No. Y4. In. 8/13:93-39). There is fortunately another means to determine at least approximately when excess profits begin. It does not appear as straight forward as the returns to capital approach, but it avoids the litigation problems of the capital approach.

The alternative approach is a "long term price approach." The extensive back-up research for the Project Independence Report, issued November 1974 (Govt. Document FE 1:2:In 2/3 back-ups FE1:18 series), consistently indicates that a wide variety of energy resources can draw sufficient capital and compete with oil that is priced at a world level of \$7.00/bbl (FOB New York City). In other words, any price for a barrel of oil or its energy equivalent of more than \$7.00/bbl will yield profits in excess of those needed to develop the nation's energy resources. Inflation, since the report was issued, has probably increased this price to approximately \$7.50 to \$8.00/bbl. In its recent estimates of United States recoverable oil reserves, the American Petroleum Institute used a price of seven dollars per barrel (Oil and Gas Journal, 4/7/75, p. 45).

William L. Henry, vice president, Gulf Oil Corporation, in testimony before the Senate Committee on Finance (Feb. 13-14, 1975, also available as API reprint), also seems to accept as reasonable the administration's proposal to recognize a \$7.00 price in 1977 (page 50 of reprint). Secretary Simon stated on Jan. 22, 1975, "We have made an estimate -- a judgment -- as to the 'long-term supply price,' i.e., the minimum price to producers that will be sufficient to induce an increase in our supplies of oil sufficient to make us energy independent by 1985. Our judgment is that the price required for this is around \$7 to \$8 at today's price levels, assuming the continuation of percentage depletion." (House Ways and Means Comm. Hearing, 1/22/75, H782-2, p. 83) At the European Common Market Summit, Dec. 1 and 2, 1975, in preparation for the Dec. 16 energy negotiations, Common Market leaders agreed upon a \$7 per barrel price support. The Organization for Economic Cooperation and Development in its 240 page report suggests that oil can in general be obtained from offshore depths of 300-400 meters for \$4/bbl, from depths of 400-2,000 meters for \$5-8/bbl, and shale oil can be obtained for \$4-7/bbl. The report also suggests that by 1980, landed costs for both North Sea and Alaskan (Prudhoe Bay) oil may be between \$1.25 and \$1.50 per barrel at 1973 prices (The Economist, 3/1/75, pp. 75-76). The OECD proposed a price floor of \$4-6 per barrel. From industry, government, and independent sources, comes

the strong indication that the long term price of energy is probably around \$7/bbl of oil or its energy equivalent, and even that may have to be artificially supported just as current oil prices are artificially supported by OPEC.

Faced with the possibility of falling energy prices, at least in real purchasing terms, an investor will look to investment which will yield an acceptable rate of return at the expected lower price. Investments will only be made in projects which require a higher than long term price if the investor thinks the capital can be recovered and a profit made before the price falls to the long term level. This may explain in part the low level of exploratory drilling in Alaska as compared to other parts of the nation. In Alaska, the lead time for bringing a new field into commercial production is often years. In Oklahoma or Texas the lead time may be months, not years, and profits are assured before any possible fall in energy prices. For a short term Alaska investment, accelerated depreciation could sometimes be allowed to enable faster, tax-free recovery of capital investment.

Thus, profits due to prices above the long term price are "excess" in the sense that they may enrich the investor, but they will not cause him to increase his investment in areas that will not earn an acceptable rate of return at the long term price.

Specifically, if Alaska oil investment cannot yield an acceptable rate of return given a \$7 or \$8 California price for oil, then only short term oil investment will be made in Alaska.

The state's royalty, its gross severance tax, and state and local property taxes, being costs of production, and even the state's net income tax or a substitute for it, on income due to the long term price, all help determine whether or not Alaska oil development at a \$7 price is worthwhile. If royalties, severance taxes, property taxes, and net worth taxes were all zero, the capital investment and operating costs could be much higher than they are now and still be competitive. However, there is a tax which does not have a bearing on whether oil development at the long term price is worthwhile -- a tax on income due to a price above the long term level. In this case, it is a tax on income due to a price of more than \$7-8/bbl of oil or its energy equivalent in gas. Thus, in addition to the increase in severance tax rates, and the net property tax, it is proposed that an "excess value surtax" also be instituted.

Excess Value Surtax:

1. FOB price(s) at Alaska border or other convenient point times quantity
- MINUS
2. Long term price of oil or gas equivalent times quantity produced and sold at the long term price or greater, plus any other quantities of oil or gas sold at less than the long term price times their respective prices. The prices are determined at same FOB point as item 1.
- EQUALS
3. "Excess Value"

MINUS

4. Gross severance taxes or royalties to which the excess value is subject

EQUALS

5. "Excess Value" subject to surtax
- 5a. Royalties reported under 4, are also subject to Excess Value Surtax.

or if it can be shown that
for a specific field:

1. The long term price at FOB point times quantity produced

MINUS

2. Costs directly attributable to the field as determined under items 2 through 6 of the net properties tax, not including indirect administrative costs, even if incurred in Alaska, or royalty payments or gross severance tax payments due to a value higher than the long term price

EQUALS

3. Less than \$1.00 per barrel of producer's equity (non-royalty) oil or gas equivalent produced from the field

THEN

4. "Excess Value" equals the quantity produced by the field and sold at a price equal to or greater than the price needed to yield net proceeds of \$1.00 per barrel of producer's equity oil or gas equivalent times the actual price(s) at FOB point.

MINUS

5. The long term price plus the amount needed to yield net proceeds of \$1.00 per barrel of producer's equity oil or gas equivalent times the quantity sold at a price equal to or greater than such a price.

MINUS

6. Gross severance taxes or royalties to which the excess value, as calculated under items 4 and 5, is subject.

EQUALS

7. "Excess Value" subject to surtax.

NOTE: The tax on the royalty share sold at more than the long term price would almost certainly be based on the first method, since costs charged to royalty interests, such as transportation, would not reach the \$6.00/bbl mark.

COMMENTS

The excess value tax, as suggested, strives to tax only the income which does not have a direct impact upon the investor's long term plans. The alternative calculation is offered to provide for any short term investments which may be made in spite of their higher costs. The indirect administration or exploration costs allowed under the Oil and Gas Properties Net Proceeds Tax are not allowed under the surtax because this special alternative is aimed

at the extraordinary capital and direct operating costs of marginal fields. This alternative assures producers that the first dollar per barrel of profit on marginal fields will be taxed only at the net property value tax level, not the higher excess value level(s).

Should a producer find that his overall costs are greater than the long term price, it is unlikely that he will continue to explore in Alaska. It is next to impossible for the producer's operating costs to exceed the long term price. For a producer in the worst position of having direct costs for every field greater than the revenues which the long term price will yield, the tax would still exempt the first dollar per barrel of net worth from extraordinary taxation. Even if indirect administrative costs are as high as ten cents per barrel, this tax still exempts ninety cents. Furthermore, since even the higher excess value tax rates will leave a substantial part of the profit for the producer, he will still be able to recover other indirect costs such as unsuccessful exploration. These will be recovered after, rather than before, taxes are paid.

Possible Excess Value Surtax Rates

The Federal Administration proposal suggests rates for the "windfall" income which quickly rise to approximately 85-90 percent (House Comm. on Ways and Means, hearings Jan. 22, 1975, p. 46). Indonesia has imposed an excess profits tax on prices in excess of \$5.83/bbl of 85 to 95 percent (Oil and Gas Journal, Jan. 20, 1975, p. 45).

It is apparent that other governments feel that very high tax rates can be sustained by the industry. Since the base upon which this tax would be calculated is not a true net income base, it is felt that the state rates should be at lower levels.

The calculations in the appendix are based on a 41 percent rate, in addition to the nine percent net property value tax, produces a total tax rate of 50 percent. Even this rate would not be too heavy, since the tax may be written off against the Federal income tax at a rate of 48 percent. In the appendix, the 41 percent rate is levied on value due to a price of more than \$7.00 per barrel, or the net value greater than \$1.00/bbl if costs are greater than \$6.00/bbl. It would be possible to have graduated rates with a 20 percent surtax on the first dollar, or part of a dollar, of excess value per barrel, 30 percent on the second dollar, on up to 60 percent on the fifth dollar or part of a dollar or more. This would give some recognition to the fact that the long term price is an estimate.

The graduated rates would add some administrative complexity if oil and gas prices change frequently or multi-tiered price systems are maintained. The graduated system would make it in the state's interest not to have prices averaged and would require the Department of Revenue to have the operators report their production by each quantity and price level. For example, if two barrels of oil are sold at seven and thirteen dollars under the graduated tax, the first barrel has no excess tax, the second \$2.60. If these

prices are averaged at \$10/bbl, then the tax due on each barrel is \$.90 or a total of \$1.80. Under the flat 41 percent tax, both methods would yield \$2.46 and it makes no difference (41 percent of \$6.00 excess value).

Based on a \$7.00 base and a \$12.00 sales price the two approaches would be comparable:

	<u>41 Percent Tax</u>	<u>Graduated Tax</u>	
\$7-8.00 (1st Dollar)	0.41	20%	0.20
8-9.00	0.41	30%	0.30
9-10.00	0.41	40%	0.40
10-11.00	0.41	50%	0.50
11-12.00	0.41	60%	<u>0.60</u>
Total	2.05		2.00

At eleven dollars per barrel the 41 percent and graduated taxes would yield \$1.64 and \$1.40 per barrel respectively and at thirteen dollars, \$2.46 and \$2.60 respectively.

An Example of the Surtax Alternatives
Given the 41 Percent Rate

A producer sells twenty five barrels of Alaskan oil or gas equivalent in California, five barrels for \$12 each, five barrels for \$9 each, five for \$7.50 each, five for \$7 each, and five for \$5 each. Royalty interests own 12.5 percent of production and no severance tax is shown to simplify the example. Whenever oil or

gas is sold at less than the long term price, or under the alternatives, at a price not subject to the excess value tax, it is dropped from the calculation. This is indicated by a dash in the example. They are dropped so that oil or gas which is sold due to contracts or controls at a price lower than the long term price may not be averaged with higher priced oil or gas to reduce the excess value tax owed on production sold at higher than the long term price.

<u>Quantity</u>	<u>Price</u>	<u>Gross Value</u>	<u>Long Term Value(7xQ)</u>	<u>Excess Value</u>	<u>Producer Equity</u>	<u>Producer Excess Value</u>
5	12	60	35	25	.875	21.875
5	9	45	35	10	.875	8.75
5	7.50	37.50	35	2.5	.875	2.187
5	7	35	35	0	.875	0
5	5	25	35	--	--	--
Total						32.81

If the cost of production and shipping to California totaled more than \$6 per barrel, the alternate formula would be used. In this case, \$7 costs are used.

<u>Price</u>	<u>Gross Value</u>	<u>Costs/bbl + \$1.00</u>	<u>Excess Value</u>	<u>Producer Equity</u>	<u>Producer Excess Val.</u>
12	60	40	20	.875	17.50
9	45	40	5	.875	4.375
7.50	37.50	40	--	--	--
7	35	40	--	--	--
5	25	40	--	--	--
TOTAL					21.88

Tax owed by the producer equals 21.88 times .41 = 8.97

The royalty owner would be subject to the first alternative in both cases since he only incurs transportation costs, which should not equal the long term price by themselves. Taking the total excess value from the first alternative, 37.5, times the royalty interest, .125, equals the royalty holder's excess value of 4.69. This value times the tax rate, .41, equals the royalty holder's surtax liability of \$1.92.

Under the first alternative a total of \$15.37 is paid on an excess value of \$37.50. Under the second alternative, a total of \$10.89 is paid on an excess value of \$25.00.

It should continually be recognized that the excess value surtax is based on an estimate of the long term price of energy. Thus, the tax should have a provision for periodic correction and inflation adjustments of the long term price base. It is tentatively proposed that the Department of Revenue be empowered to make adjustments, up or down, in the base price each year. The proposed adjustments must be proposed along with the Administration's annual budget proposals and, unless disapproved or reduced by the Legislature, would automatically become effective within the next fiscal year. In no event, could the adjustment exceed the total increase in the national wholesale price index since the tax went into effect, minus any previous adjustment. Such a correction provision should cause the tax to disappear as the "windfall" disappears. Note that

the correction is not tied to the oil wholesale price index since oil prices can be manipulated by government or the OPEC cartel. This would probably bear less relation to the true long term price than the admittedly approximate correction based on the general wholesale price index.

V. Conclusion

This review presents the basic considerations behind the proposed oil taxation legislation. The basic "Oil and Gas Properties Net Proceeds Tax" is designed to allow producers to recover their costs before being taxed above the floor set by the severance tax, while avoiding the fatal loopholes of state net income taxation. The second tax, the "Excess Value Surtax," is designed to tax those profits not needed to cause long-term investment in Alaska at a higher rate.

If prices and costs were to stabilize, perhaps the gross severance tax could be made equitable enough to remain the sole major source of petroleum tax revenue. Even a matrix system of severance tax rates related to both prices and quantities produced might be used. No gross tax, however, can reflect the significant difference between the development costs, operation costs, and commercial lives of various fields. Only some form of net value tax can reflect such variations.

In the near future, the State of Alaska will very likely be receiving one to two billion dollars in petroleum royalties and tax

revenues annually. This comes to \$2,500 to \$5,000 for every man, woman, and child in the state, putting Alaska in the ranks with Saudi Arabia and Libya and surpassed only by Kuwait and Abu Dhabi.

If Alaska is to avoid the ire of the rest of the nation (which could react by fixing Alaska petroleum prices separately), it must be able to show that its revenue is fairly obtained and does not have significant impacts upon national energy prices or supplies.

The proposed package of increased severance taxes, the "Oil and Gas Properties Net Proceeds Tax," and the "Excess Value Surtax" should be defensible and acceptable to the nation; defensible and reluctantly acceptable to private oil interests and most importantly fair to the people of Alaska and its future citizens, who must bear the impact of petroleum production in the state.

PLEASE NOTE: THE PRECEDING PAGES WERE TREATED
AS A UNIT IN THE ORIGINAL DOCUMENT.

ALASKA
STATE LEGISLATURE

MEMORANDUM

December 22, 1975

TO: Senator John Huber
FROM: Franklin D. Fleeks
Tax Counsel
SUBJECT: Committee Staff Review of the Wholesale Liquor Industry

Submitted for your review and approval are the findings of the staff in regards to the wholesale liquor industry. The basic research was done by Janis C. Gull. I have prepared a synopsis of the findings. Since there is one important missing link, how the manufacturing distillers deal with the wholesale dealers, you will find our recommendations qualified.

FDF/kab

AGO 529674 +

State of Alaska
Legislative Council
Subcommittee on Taxation and Revenue
Chairman, Senator John Huber

Members:

Senator Joe Orsini
Senator Pat Rodey
Representative Nels A. Anderson, Jr.
Representative Steve Cowper
Representative Jim Duncan
Representative Clark Gruening

This study is in response to the directive of the Legislative Council to perform taxation and revenue studies in conjunction with the Senate Special Committee on Taxation and Revenue as charged by Senate President Chancy Croft, in a January 24, 1975 letter to Governor Hammond.

Approved:

Taxation and Revenue Report #1
Wholesale Liquor Industry

By: Franklin D. Fleeks, committee tax
counsel; and Janis C. Gull, committee
researcher

AGO 529675 +

December, 1975

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Attachments

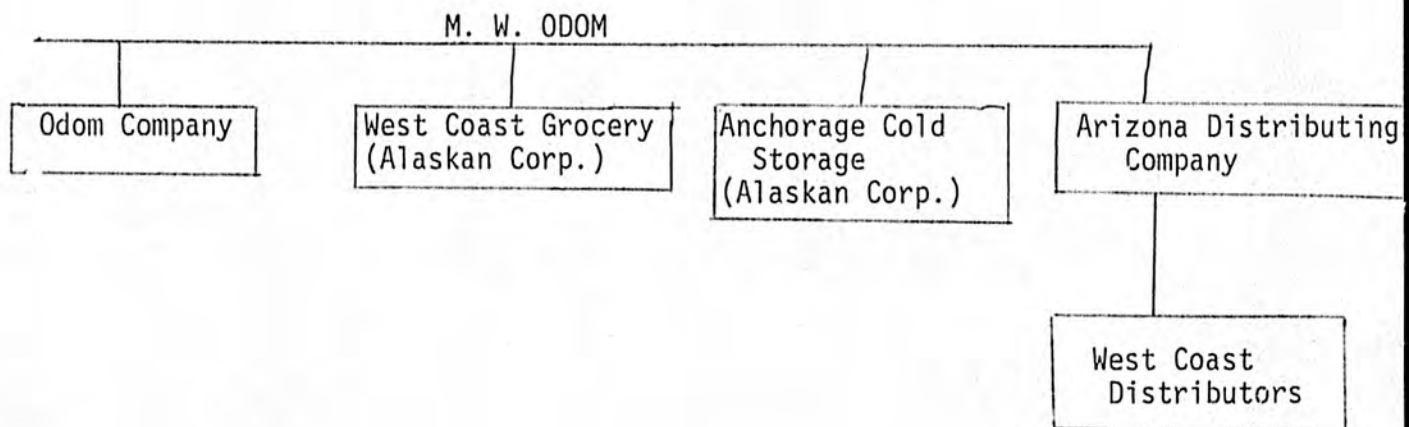
1. Memorandum from P. A. Wall, Director, Administrative Services Division, Department of Revenue, dated May 15, 1975
2. Copy of CSHB 246 am
3. Copy of HB 309

Introduction

The wholesale liquor industry in Alaska is dominated by three firms. Their percentage of the market based on FY 1975 gross receipts from the sale of liquor is as follows:

<u>NAME</u>	<u>GROSS RECEIPTS</u>	<u>PERCENTAGE</u>
K & L Distributors	\$15,643,982	38.00
Alaska Distributors	10,042,458	24.40
Odom Corporation	15,251,651	37.05
All others	244,651	.55
	<u>\$41,162,932</u>	<u>100.00</u>

One of the unique characteristics of the three major groups is outside ownership and control even though some of the corporate members are Alaskan corporations. K & L Distributors is controlled by the Levine Family of Bellevue, Washington, Alaska Distributors is controlled by Alex Shulman of Seattle, Washington, and the Odom Group is controlled by M. W. Odom of Seattle, Washington. The most complex structure is the Odom Group. Its structure is as follows:



There are currently twenty-two (22) wholesale liquor licenses issued. Under current Alaska law, AS 04.10.110, a general wholesale license is required for each distributing point. As shown below, the three major firms have more than one (1) distributing point and are thus multiple licensees.

The taxes and license fees collected by the Department of Revenue for the five past years are as follows:

<u>Fiscal Year</u>	<u>Gross Income</u>	<u>License Fees</u>	<u>Excise Tax</u>	<u>*Income Tax</u>
1975	\$41,162,932	\$81,850	\$6,598,213	\$72,834
1974	33,607,680	81,500	5,690,909	42,195
1973	31,426,323	80,200	5,234,678	52,042
1972	31,379,627	80,350	4,871,156	78,862
1971	30,816,351	80,600	4,936,399	46,045

* Furnished by the Department of Revenue based on 4 companies. Identities of the companies were not furnished

CORPORATE STRUCTURES

Alaska Bay Corp. and Aregah

These two entities hold general wholesale licenses and each has a warehouse. Their operations are located in Anchorage. Their respective gross incomes for 1974 were \$49,430 and \$20,997.

Mosesian Vinters

This wholesaler is owned in full by a religious order. It distills and distributes milk wine from its distillery in Palmer. Its gross receipts for 1974 were \$32,514.

Service Transfer

The base of operations for this company is Sitka. They are the sole distributors of Olympia beer within the Sitka area. The corporation's gross receipts were \$121,990 for 1974.

K & L Distributors

This is a family owned corporation dealing exclusively in alcoholic beverages. The corporation holds five wholesale liquor licenses.

The five distribution points are: Bellevue, Anchorage, Fairbanks, Juneau and Soldotna. Its gross income including some Washington transactions was \$15,643,892.

Alaska Distributors Co.

The corporation maintains three distribution points and hold three licenses. The distribution points are: Seattle, Anchorage and Fairbanks. This is a Washington-based corporation. Its gross income for 1974 was \$10,042,458.

Odom Company

This corporation along with its related corporations, Anchorage Cold Storage, West Coast Distributors, and West Coast Groceries hold the remainder of the Alaskan wholesale licenses. Odom Co. has four distribution points located at: Seattle, Fairbanks, Juneau and Ketchikan. Its gross income for 1974 was \$6,000,022.

West Coast Grocery

This Odom company handles beer and wine in the Ketchikan area. Its gross income for 1974 was \$279,023.

West Coast Distributors

This Odom company has four distribution points located at Seattle, Anchorage, Fairbanks and Juneau. Its gross income for 1974 was \$4,953,451.

Anchorage Cold Storage

This Odom company does its principal business in the Anchorage area. For 1974 its liquor sales were \$3,819,155.

The following chart summarizes the above information. I have combined the Odom Group below for informational purposes.

<u>Name</u>	<u>Location</u>	Wholesale Malt Beverage and Wine			General Wholesale		
		<u>Gross</u>	<u>Excess Fee</u>	<u>License Fee</u>	<u>Gross</u>	<u>Excess Fee</u>	<u>License Fee</u>
Anchorage Cold Storage	Anchorage				3,819,155	\$5,000	\$500
Odom	Seattle				4,308,540	5,000	500
Odom	Fairbanks				1,739,937	5,000	500
Odom	Juneau	83,853	1,000	100			
Odom	Ketchikan	57,692	1,000	100			
West Coast Groceries	Ketchikan	279,023	3,000	100			
West Coast Dist.	Seattle				1,863,310	5,000	500
West Coast Dist.	Anchorage				2,245,975	5,000	500
West Coast Dist.	Fairbanks				833,074	5,000	500
West Coast Dist.	Juneau	15,092	150	100			
Subtotals		445,660	5,150	400	14,805,991	15,000	1,500
Add Malt Bev. and Wine					<u>445,660</u>	<u>5,150</u>	<u>400</u>
TOTAL					15,251,651	20,150	1,900

1974 EXCESS FEES AND LICENSE FEES PAID BY WHOLESALERS

<u>Company</u>	<u>Location</u>	<u>Wholesale Malt Beverage and Wine</u>			<u>General Wholesale</u>		
		<u>Gross</u>	<u>Excess Fee</u>	<u>License Fee</u>	<u>Gross</u>	<u>Excess Fee</u>	<u>License Fee</u>
Alaska Bay	Anchorage				49,430.00	none	500.00
Alaska Dist.	Seattle				2,727,177.03	5,000.00	500.00
Alaska Dist.	Fairbanks				2,327,399.82	5,000.00	500.00
Alaska Dist.	Anchorage				4,987,881.47	5,000.00	500.00
Alaska Dist.	Juneau		no 1974 license				
Anch. Cold Stor.	Anchorage				3,819,154.72	5,000.00	500.00
Aregah	Anchorage				20,996.99	none	500.00
K & L	Bellevue				3,397,189.00	5,000.00	500.00
K & L	Anchorage				8,132,905.00	5,000.00	500.00
K & L	Fairbanks				3,116,862.00	5,000.00	500.00
K & L	Juneau	123,241.00	1,500.00	100.00			
K & L	Soldotna				873,695.00	5,000.00	500.00
Mosesian	Anchorage	32,514.31	500.00	100.00			
Odom	Seattle				4,308,539.59	5,000.00	500.00
Odom	Fairbanks				1,739,936.71	5,000.00	500.00
Odom	Juneau	83,853.49	1,000.00	100.00			
Odom	Ketchikan	67,692.40	1,000.00	100.00			
Service Trans.	Sitka	121,990.10	1,500.00	100.00			
West Coast Dist.	Seattle				1,863,309.73	5,000.00	500.00
West Coast Dist.	Anchorage				2,241,974.84	5,000.00	500.00
West Coast Dist.	Fairbanks				833,074.34	5,000.00	500.00
West Coast Dist.	Juneau	15,091.90	150.00	100.00			
West Coast Gro.	Ketchikan	279,023.00	3,000.00	100.00			
		\$723,406.20	\$8,650.00	\$700.00	\$40,439,526.24	\$65,000.00	\$7,500.00

AGU 529682

CURRENT STATUTES

In the field of taxation and revenue the wholesale liquor industry is covered specifically by the following:

- (a) AS 04.10.110 Wholesale License
- (b) AS 43.60 Excise Tax on Intoxicating Liquor

The wholesale license fee is asserted on two categories: (a) the general license which covers hard liquor and (b) the wholesale malt beverage and wine license. The license fees are based on a sliding scale with the general license ranging from a minimum of \$500 to a maximum of \$5,000 and the wholesale liquor license ranging from a minimum of \$100 to a maximum of \$5,000.

Excise tax rates are based on gallonage. The rates are as follows:

- (a) Malt beverages - 25 cents a gallon or fraction of a gallon.
- (b) Wine or other liquor of 21 percent alcohol by volume or less -- 60 cents a gallon or fraction of a gallon.
- (c) Other liquors having a content of more than 21 percent alcohol by volume - \$4 a gallon.

Factors Favoring an Increase

In a memo dated May 15, 1975, a copy of which is attached, Mr. Wall of the Department of Revenue made an analysis of the liquor licenses and fees. He noted the last change in licenses and fees was in 1959. Since that time the industry under the general license has increased its total business volume from \$15,490,169 to \$40,439,526; a 161.07 percent increase.

Licenses and fees for the general license have gone from \$66,500 in 1959 to \$73,500 in 1974, an increase of \$7,000 or 10.53 percent. It should also be noted that the last excise tax rate increase took place in 1961.

Gross income in the industry from 1971 - 1974 increased at a rate of one percent (1%). With the increase in population and income during the 1974 - 1975 periods, gross income increased twenty two percent (22%). Revenue received by the State from license fees increased less than one percent. Revenue from the excise tax increased by sixteen percent (16%). No judgment can be made in regards to the income tax because of not knowing if the four companies used were the major ones in the industry.

All economic indicators point to growth for Alaska in the years ahead. The wholesale liquor industry, in all certainty, will share in this growth. Each segment of the Alaskan economy should contribute its fair share of tax. Because of the nature of its products, the wholesale liquor industry creates a burdensome monetary and social cost to the State. An increase in rates will insure that the industry is contributing its fair share to the State revenues.

CONCLUSION

At present there are two bills in the legislative hopper, CSHB 246 am and HB 309, which will increase the State revenues. If the rates of excise tax proposed by HB 309 had been in effect for FY 1975, an additional \$2,798,187 in revenue would have been yielded.

Comparison of Old Rates and Proposed Rates:
Base Year FY 1975

Item	Taxable Gallons	Present Rate	Proposed Rate	Tax at Present Rate	Tax At Proposed Rate	Increase
Distilled Spirits	1,122,016	\$4.00	\$4.50	4,488,064	5,049,072	561,008
Wine	766,351	0.60	1.00	459,811	766,351	306,540
Beer	7,702,555	0.25	0.50	<u>1,925,639</u>	<u>3,851,278</u>	<u>1,925,639</u>
				<u>6,873,514</u>	<u>9,666,701</u>	<u>2,793,187</u>

If SCHB 246 am had been in effect, an approximate addition of \$330,000 would have been yielded.

The present system of policing the industry is working reasonably well, administratively. Further efforts by the Department of Revenue should be effected to make sure that the State's return under the Multistate Tax Compact is maximum yield. There is one major question remaining to be answered at the time of this report. The question pertains to the transactions between the manufacturing distiller and the wholesale distributors. During December, our staff will be looking into this question.

The staff recommends that the present bills be supported with the caveat, that if our further investigations reveal improprieties, a new or amended bill will be submitted.

ALASKA
STATE LEGISLATURE /

MEMORANDUM

December 18, 1975

TO: Senator Huber and
Franklin D. Fleeks, tax counsel

FROM: Janis C. Gull

SUBJECT: Wholesale Liquor Industry

On November 18 I received a memorandum containing your Outline of Research Needed for Analysis of Liquor Tax. The following is a copy of that outline and my report on the research and findings of fact that were the direct results of said outline.

The three items indicated in RED are not included in this report as I was not able to obtain conclusive information and statistics relating to them.

I am currently at your disposal to discuss the context of this report and to supply any and all raw data entailed within.

JCG/kb

Janis C. Gull

State of Alaska
Legislative Council
Subcommittee on Taxation and Revenue
Chairman, Senator John Huber

Members:

Senator Joe Orsini
Senator Pat Rodey
Representative Nels A. Anderson, Jr.
Representative Steve Cowper
Representative Jim Duncan
Representative Clark Gruening

This study is in response to the directive of the Legislative Council to perform taxation and revenue studies in conjunction with the Senate Special Committee on Taxation and Revenue as charged by Senate President Chancy Croft, in a January 24, 1975 letter to Governor Hammond.

Taxation and Revenue Report #1
Wholesale Liquor Industry

By: Janis C. Gull, committee researcher

Approved:

December, 1975

ALASKA
STATE LEGISLATURE

9K
JFH 11-18-75
MEMORANDUM

TO : Senator John Huber
FROM : Franklin D. Fleeks, Tax Counsel
SUBJECT: Outline of Research Needed for Analysis of
Liquor Tax

Nov. 18, 1975

The following outline is submitted for your approval. The information sought will give a detailed picture of the wholesale liquor industry in Alaska. The study is limited to the wholesale distributors, most of whom are out of state corporations.

A partial listing of sources to be contacted for information is as follows:

- a. Dept. of Revenue - Excise Tax Division
- b. Dept. of Revenue - Income Tax Division, Multi-state Tax Compact
- c. Dept. of Revenue - Statistics on amount of tax collected
- d. Alcohol Beverage Control Board
- e. Bill McGuire - Adm. Asst. to Sen. Chancy Croft
- f. Tapes of legislative hearings on last sessions bill
- g. Lobbyist for distributors for their position
- h. Washington State Liquor Control Board for comparison of wholesale prices
- i. Transcript of anti-trust suit against the wholesale distributors.

OUTLINE

- I. Identification of the Taxpayers
 - a. Who are the wholesale distributors who operate in Alaska?
 - b. Are they domestic (Alaskan) corporations, subsidiaries of out of state corporations, or completely out of state corporations?
 - c. Where are their major warehouses located; In Alaska or outside of Alaska?
- II. Identification of the Problem
 - a. How long since the rates have been changed?
 - b. What are the present rates of taxation?
 - c. How do Alaska's rates of taxation of the wholesale liquor industry compare to other states?
 - d. What were the total amount of wholesale liquor sales in Alaska for the past five years?
 - e. How many Alaskan employees are there?
- III. Operations of the Wholesalers
 - a. How is the wholesale price of liquor determined?
 - b. Does the out of state corporation raise the wholesale price of liquor sold to its wholly owned Alaskan subsidiary in order to reduce the profit of the subsidiary?
 - c. Is the wholesale price of liquor purchased by the distributors the same as their Seattle price less transportation costs to Alaska?
- IV. Identification of the Type and Amount of Taxes Being Currently Received by the State
 - a. How much was collected from the excise tax on liquor in the past 5 years?
 - b. Are the distributors paying any income tax?
 - c. Does the Multistate Tax Compact reach the distributors net profits from sales in Alaska?
- V. Miscellaneous
 - a. Should the tax be based on gallonage or the wholesale price?
 - b. If the Multistate Tax Compact is not reaching the distributors, is there another way to collect the revenue?
 - c. Should reform of the tax structure be tied to Alcoholic Rehabilitation?
 - d. What increase in the rate of excise tax is recommended?

I. Identification of the Taxpayers

- a. Who are the wholesale distributors who operate in Alaska?
- b. Are they domestic (Alaskan) corporations, subsidiaries of out of state corporations, or completely out of state corporations?
- c. Where are their major warehouses located; in Alaska or outside of Alaska?

The following is a complete list of all wholesalers presently doing business in the State of Alaska.

Alaska Bay Corporation
505 Ocean Dock Road
Anchorage, Alaska
Mail: Box 1872
Fairbanks, Alaska 99701

Mosesian Vinters
Ray N. Mosesian
Mail: Star Route A, Box 217-A
Anchorage, Alaska 99502

Alaska Distributors Company
4601 Sixth Avenue South
Seattle, Washington 98108

Odom Company
1258 First Avenue South
Seattle, Washington 98134

Alaska Distributors Company
P. O. Box 549
Fairbanks, Alaska 99701

Odom Company
Alaska Railroad Industrial Area
Fairbanks, Alaska 99701

Alaska Distributors Company
Box 4-1598
Anchorage, Alaska 99509

Odom Company
Box 410
Juneau, Alaska 99801

Anchorage Cold Storage, Co., Inc.
P. O. Box 39
Anchorage, Alaska 99501

Odom Company
619 Stedman Street
Ketchikan, Alaska 99901

Aregah Corporation
Box 3454
Anchorage, Alaska 99501

Service Transfer, Inc.
Box 178
Sitka, Alaska 99835

K & L Distributors, Inc.
300 120th Avenue, N. E.
Bellevue, Washington 98004

West Coast Distributors, Inc.
1258 First Avenue South
Seattle, Washington 98134

K & L Distributors, Inc.
4504 Lois Drive
Anchorage, Alaska 99503

K & L Distributors, Inc.
17 Adak Street
Fairbanks, Alaska 99701

K & L Distributors, Inc.
490 South Franklin Street
Juneau, Alaska 99801

K & L Distributors, Inc.
P. O. Box 337
Soldotna, Alaska 99669

West Coast Distributors, Inc.
Box 942
Anchorage, Alaska 99510

West Coast Distributors, Inc.
P. O. Box 732
Fairbanks, Alaska 99701

West Coast Distributors, Inc.
490 South Franklin Street
Juneau, Alaska 99801

West Coast Grocery Company
P. O. Box 118
Ketchikan, Alaska 99901

Of the preceding wholesale entities only four are totally Alaskan owned: 1) Alaska Bay Corporation; 2) Aregah; 3) Mosesian Vinters; and 4) Service Transfer. Of these, Alaska Bay Corporation and Aregah hold general wholesale licenses. Each corporation has one only warehouse, both of which are physically located in Anchorage. Their total combined gross income for 1974 was only \$70,426.99. They also paid the minimum in licensing and excess taxes - \$500 each.

Mosesian Vinters distills and distributes milk wine from its distillery in Palmer. They hold a malt- beverage and wine license and are owned in full by a religious order. Their total gross income for 1974 was \$32,541.31.

Service Transfer has only one warehouse located in Sitka. They also hold a malt -beverage and wine license and distribute Olympia Beer solely in Sitka. To my knowledge they do not sell any other beverage. Their total gross 1974 income was \$121,990.10.

The combined gross income for the two domestic malt liquor distributors for 1974 is \$154,504.41. They also paid a total of \$2,000 in excess fees and \$200 in license fees.

Considering the remaining eighteen wholesalers licensed to do business within the State of Alaska I have found that they are all subsidiaries of three larger Washington State corporate entities. The only exception to this might be considered to be the K & L distribution point in Bellevue, Washington. This particular location is the parent corporation to its four separate distribution points in Alaska.

Alaska Distributors Co.
4501 6th Ave. So.
Seattle, Washington

Owner: Alex Shulman

This corporation is based in Seattle, Washington. It maintains three Alaska licensed warehouses -- Seattle, Anchorage, and Fairbanks. Each pays license fees of \$500 and the maximum of \$5,000 in excess fees.

The corporation also has eight other distribution points in Alaska. However, these eight are all run by "commissioned sales persons", none of which have licensed warehouses or pay any withholding taxes. They order the exact quantity their customers require and deliver it immediately.

Alaska Distributors as a whole paid a total of \$16,500 in licensing fees in 1974. Their total gross income for the same period was \$10,042,458.32. Because their income tax returns are confidential, I could not find out the exact percentage of their gross or net income that actually went to the State of Alaska.

K & L Distributors, Inc.
300 120th N. E.
P. O. Box 1969
Bellevue, Washington 98004

Owners: The Levine family

K & L Distributors is a family owned corporation with its physical base located in Bellevue, Washington. It has five Alaska licensed warehouses: 1) Bellevue, 2) Anchorage, 3) Fairbanks, 4) Juneau, and 5) Soldotna. The Soldotna distribution point holds a malt-beverage and wine license only. All of the others hold general licenses. K & L pays a total of \$2,100 in license fees as well as \$21,500 in excess fees for these warehouses.

This corporation has set up a series of "sales representatives" to cover the outlying areas. As with Alaska Distributors, K & L's "reps" are "commissioned sales persons." There are eight separate "area" locations for these reps, but the quantitative number of personnel changes monthly.

All K & L products are shipped via the Bellevue warehouse to Alaska. They are not distributed elsewhere. The Bellevue distribution point does do a representative volume of business in Washington. This can be largely attributed to the fact that they are the exclusive distributor of both Budweiser and Olympia beer -- the number 1 and number 2 best sellers respectfully.

The Levine family is not involved in other business endeavors but is solely a liquor distributor. Their basic corporate structure is rather simple and appears to function very well.

ODOM
1258 First Avenue South
Seattle, Washington 98124

Owner: Mr. M. W. Odom

NOTE: M. W. Odom is the owner and president of a corporate conglomerate. He has set up and/or purchased an extensive series of separate corporations -- all of which have separate managerial staff and policies and tax structures. The end net proceeds of each entity is directed to the parent corporation. This creates a steady cash flow both within each corporation as well as the ability to extend monies to other internal corporations.

The following report entails his liquor interests within the State of Alaska and extends only to the "parent" warehouses in Seattle.

West Coast Grocery
P. O. Box 118
Ketchikan, Alaska 99901

President: M. W. Odom

This corporation distributes alcoholic beverages and general groceries in the Ketchikan area. It also does a healthy mail order grocery and liquor business. Hard liquor is handled by "commissioned sales persons" in this area and thusly the Ketchikan warehouse maintains a wholesale malt-beverage and wine license. It pays \$100 in license fees and \$3,000 in excess fees. The total gross income was \$279,023 for 1974.

Anchorage Cold Storage
P. O. Box 39
240 First Avenue
Anchorage, Alaska 99501

President: M. W. Odom

This Odom entity has a standing staff of 185 persons. It handles produce, frozen meats and liquor. They hold one general wholesale license for their Anchorage location and pay the standing \$500 as well as the \$5,000 in excess fees. As indicated by the above address, this particular company was incorporated in the State of Alaska and is a domestic corporation. The total gross liquor sales for 1974 was \$3,819,154.72.

Odom Company
1258 First Avenue South
Seattle, Washington 98134

President: M .W. Odom

This company is what I call Odom with a small "o". It is considered to be a separate corporation, as are the rest of his entities. It is not the parent corporation in Seattle. It appears that M. W. merely wanted to hang his name on it in lieu of Mucktuck Distributors or something else.

The company has four large warehouses. Both the Seattle and Fairbanks locations hold general wholesale licenses and pay the maximum in excess taxes (\$500 - \$5,000 each.) The Juneau and Ketchikan warehouses are malt-beverage and wine distribution points and pay the maximum licensing of \$100 and \$1,000 each. Odom's total 1974 gross income for all four warehouses was \$6,200,022.19. The total licensing fee was \$12,000 excess and \$1,200 licenses. The management also maintains four "commissioned sales persons" in various small communities.

West Coast Distributors
1258 First Avenue South
Seattle, Washington 98134

President: M. W. Odom

This corporate structure is much the same as with the other Odom enterprises. They have four warehouses: Seattle, Anchorage, Fairbanks and Juneau, with the latter being a malt-beverage distribution point. West Coast pays \$1,600 in license fees and \$16,500 in excess fees. The total gross income was \$1,953,450.81. They also distribute groceries, and sundries.

NOTE: Anchorage Cold Storage, West Coast Groceries, Coca-Cola, and West Coast Distributors are all housed in the same structural complex in Anchorage. This appears to facilitate each individual company in that they can and do "share" trucks, secretarial facilities (i.e., MTST, switchboard, etc.) and warehousing footage. The same procedure is used in Fairbanks and Seattle; however, there is a juggling of who is where (i.e., Anchorage Cold Storage is not in Fairbanks, and Odom Co. is not in Anchorage).

It is interesting to note that even though these corporations are located in the same complex, each company has: 1) its own managerial hierarchy; 2) different offices; 3) different phones; and 4) different mailing addresses. But in the process of "combining," during any given day a driver in an Odom truck can deliver Odom beer, Anchorage Cold Storage meat and West Coast sundries and liquor. The only difference is found in the invoices and billing.

ODOM (Big "O") corporation is by far the most complex of all of the distributors. The system does function rather well, and combined they compiled the following available statistics for the year 1974:

TOTAL GROSS SALES INCOME

General Wholesale	\$14,805,989.95
Wholesale Malt and Wine	445,660.79

LICENSE AND FEES

General Wholesale	3,000.00
Excess fee	30,000.00
Malt Beer and Wine	400.00
Excess Fee	5,150.00
Total Licensing and Fees	\$ 38,555.00

Fiscal Year 7-1-74
Through 6-30-75

Beer	1,807,803.7 gallons
Wine	259,456.8 gallons
Liquor	443,187.3 gallons

II. Identification of the Problem.

- a. How long since the rates have been changed?
- b. What are the present rates of taxation?
- c. How do Alaska's rates of taxation of the wholesale liquor industry compare to other states?
- d. What was the total amount of wholesale liquor sales in Alaska for the past five years?

Alaskan Statute 43.60.010 in regards to the liquor industry was instituted in 1961. There have been no changes made since its inception. The taxation rates established in 1961 are: wine: \$0.60 per gallon; malt-beverages: \$0.25 per gallon; hard liquor: \$4.00 per gallon.

Please note that on 3/18/75 House Bill 309 was introduced by the Rules Committee by Request of the Governor and it was referred to the House Finance Committee. At the present time it is still held by Finance.

This new bill (309) would increase the current tax rates as follows: (1) malt beverages at a rate of \$0.50 a gallon, (from \$0.25); (2) wine or other liquor at a rate of \$1.00 per gallon, (from \$0.60); and (3) hard liquors at a rate of \$4.50 a gallon (from \$4.00).

In addition to HB 309, House Bill 246 am was introduced. CS for #246 was introduced by Community and Regional Affairs. It was referred to the Judiciary which in turn produced CSHB 246 am which was passed by the House and sent to Senate Commerce and Finance. The bill is currently held in this committee. CSHB 246 am is designed to change the wholesale license fees.

The current statute allows for general wholesale licenses of \$500 per year and a maximum of \$5,000 in excess fees on an income of \$500,000 or over.

Also currently allowed is the malt-beverage and wine license fees of \$100 with \$1,000 maximum in excess fees on an income of \$100,000 or over.

The new bill CSHB 246 am requests the same tax and excess structure and in addition thereto, a sum equal to one percent of the business transacted during the year for which the license is issued on the business transacted during any year. This bill has currently passed the House and is in the Senate Finance Committee.

In answer to question c, how do Alaska's rates of taxation of the wholesale liquor industry compare to other states, the following chart has been compiled:

- 13 -

**Excise Tax Rates on Specified Alcoholic Beverages Levied by
31 License States and the District of Columbia Ranked According to Magnitude,
and by the Federal Government***

As of January-14, 1975

(11-24-75)

Distilled Spirits		Table Wine		Dessert Wine		Beer	
State	Rate Per Gallon	State	Rate Per Gallon	State	Rate Per Gallon	State	Rate Per Gallon
1	2	3	4	5	6	7	8
Minn.	\$4.39	Ga.	\$1.50	Ga.	\$2.50	S. Car.	.768
Alaska	4.00 ②	Fla.	1.15	Fla.	1.60	Ga.	.322
Okla.	4.00	Tenn.	1.10	Tenn.	1.10	La.	.322
Tenn.	4.00	S. Car.	1.08	S. Car.	1.08	Okla.	.322
Fla.	3.75	Ark.	.75	Okla.	1.00	Fla.	.320
Ga.	3.75	Neb.	.75	S. Dak.	.95	S. Dak.	.267
Mass.	3.36	Alaska ⑦	.60	Minn.	.79	Alaska ⑦	.250
N. Y.	3.25	Ky.	.50	Ark.	.75	Ark.	.234
S. Dak.	3.05	N. Dak.	.50	Neb.	.75	Texas	.165
N. J.	2.80	Okla.	.50	Alaska ⑩	.60	N. Dak.	.160
S. Car.	2.72	Mass.	.46	Ill.	.60	Kansas	.150
Wisc.	2.60	Ind.	.45	N. Dak.	.60	Minn.	.129
Ariz.	2.50	Ariz.	.42	Kans.	.50	Tenn.	.110
Ark.	2.50	Del.	.40	Ky.	.50	Neb.	.100
Conn.	2.50	Md.	.40	Nev.	.50	Ind.	.095
L.	2.50	N. Mex.	.40	Mass.	.46	Md.	.090
N. Dak.	2.50	R. I.	.40	Ind.	.45	Mass.	.088
R. I.	2.50	Mo.	.30	Ariz.	.42	Conn.	.081
Ind.	2.28	Nev.	.30	Del.	.40	Ky.	.081
Del.	2.25	N. J.	.30	Md.	.40	Ariz.	.080
Calif.	2.00	S. Dak.	.30	N. Mex.	.40	N. Mex.	.080
D. C.	2.00	Minn.	.27	R. I.	.40	D. C.	.073
Ill.	2.00	Conn.	.25	Wisc.	.39	Ill.	.070
Mo.	2.00	Ill.	.23	Texas	.34	Del.	.065
Neb.	2.00	Colo.	.20	D. C.	.33	R. I.	.065
Texas	2.00	Kans.	.20	Colo.	.30	Wisc.	.065
Ky.	1.92	Wisc.	.195	Mo.	.30	Colo.	.060
Nev.	1.90	Texas	.17	N. J.	.30	Mo.	.060
Colo.	1.80	D. C.	.15	Conn.	.25	Nev.	.060
Kansas	1.50	La.	.11	La.	.21	N. Y.	.044
Md.	1.50	N. Y.	.10	N. Y.	.10	Calif.	.040
N. Mex.	1.50	Calif.	.01	Calif.	.02	N. J.	.033
Median of State Taxes	2.50		.40		.455		.089
Average of State Taxes	2.60		.51		.60		.152
Fed. Tax	10.50**		.17		.67		.29***

*Hawaii, the only other license state, levies an excise tax on alcoholic beverages of 20 percent of the wholesale price.

**Per proof gallon if withdrawn from bond at over 100° proof and per wine gallon if withdrawn from bond at not over 100° proof.

***Actual rate is \$9.00 per 31 gallon barrel.

Source: Commerce Clearing House, State Tax Guide: All States

AGO 5297 00

As the chart indicates, Alaska ranks second in rates per gallon of distilled spirits, seventh in rates per gallon of table wine, tenth in rates per gallon for dessert wine and seventh in rates per gallon for beer.

Unlike most corporations in Alaska with only one or two "commissioned sales persons," the three large liquor distributors have a fairly large standing staff of them. None of these persons pay withholding taxes through the business. They are not listed as "employees" and their quantitative number varies from month to month. As of December 15, 1975, there appears to be at least 44 "commissioned persons" working in the state. The total number of Alaskans currently paying withholding taxes as full or part time employees is 382 persons, of these approximately 200 work in other capacities besides handling or dealing with liquor.

III. Operations of the Wholesalers

- a. How is the wholesale price of liquor determined?
- b. Does the out of state corporation raise the wholesale price of liquor sold to its Alaskan subsidiary in order to reduce the profit of the subsidiary?
- c. Is the wholesale price of liquor purchased by the distributors the same as their Seattle price less transportation costs to Alaska?

As was indicated at the outset of this report I have not received conclusive information at this time about questions a and b.

Theoretically the wholesale price of liquor sold by distributors is exactly the same between Seattle and Alaska. The higher prices are incurred due to freight and extra handling as well as high overhead.

The Alaska Beverage Analyst (November, 1975) quotes both the Seattle and Anchorage prices as well as the Fairbanks price. On the surface it seems quite fair. However, if price gouging is taking place it appears to be on the true wholesale level. That is to say that the prices listed in the Alaska Beverage Analyst have already been hiked before the magazine was printed.

IV. Identification of the Type and Amount of Taxes being currently
Received by the State

- a. How much was collected from the excise tax on liquor in the
past 5 years?
- b. Are the distributors paying any income tax?
- c. Does the Multistate Tax Compact reach the distributors net
profits from sales in Alaska?

Excise tax received by the State of Alaska from the wholesale
liquor industry is as follows:

EXCISE ALCOHOL TAX

<u>Fiscal Year Ended</u>	<u>Net Collections</u>	<u>Dollar Increase over prior fiscal year</u>	<u>Percent Increase over prior fiscal year</u>
6/30/75	\$6,598,213.24	\$907,304.59	15.94
6/30/74	5,690,908.65	456,230.55	8.72
6/30/73	5,234,678.10	363,521.68	7.46
6/30/72	4,871,156.42	(65,242.42)	(1.32)
6/30/71	4,936,398.84	511,479.26	11.56
6/30/70	4,424,919.58	481,813.95	12.22
6/30/69	3,943,105.63	Base Year	Base Year

The distributors are most definitely paying income tax. However, it is to be noted that for the year of 1974 the top four companies in the industry paid a total of \$72,834.00 in income taxes based on a \$36,839,823.32 gross income. All of the other companies' combined gross income total is so inconsequential as to be unmentioned at this point. As indicated before, I do not have the statistics on their corporate incomes. Therefore, I do not know what their net income was.

The wholesale liquor industry also paid out a total of \$8,200.00 in license fees as well as an additional \$73,650.00 in excess license fees.

Concerning the Multistate Tax Compact I have received the following information. The liquor industry is influenced by the Multistate Tax Compact. In the last year the effect of the Compact has been that an additional \$3,222.00 was received from the industry. This figure can be directly attributed to the Multistate. The audit of the separate companies is generally felt to be more effective on the retail level.

Before the Multistate Tax Compact can rationally be considered it first has to be made more effective. I do believe that one of the methods to facilitate this change would be to utilize the thesis I will expand upon in Section Five. This method would be established on a percentage rate based on the wholesale price. I feel this would bring in far more income than the Multistate Compact.

Just recently (November 16) I received information about serious troubles with the liquor industry in Washington State. It seems that they have not been acting in accordance with the Washington laws and

with the Washington State Liquor Board Regulations. If indeed this is the case, then it necessitates a deeper investigation into the wholesale liquor distributors industry in relationship to, among other things, the Multistate Tax Compact.

V. Miscellaneous

- a. Should the tax be based on gallonage or the wholesale price?
- b. If the Multistate Tax Compact is not reaching the distributors, is there another way to collect the revenue?
- c. Should reform of the tax structure be tied to Alcoholic Rehabilitation?
- d. What increase in the rate of excise tax is recommended?

The first question of this section deals with a very interesting aspect. After researching, discussing with "experts," analyzing and much consideration, I'm of the opinion that the tax should be based on the original 1961 gallonage structure and/or the slightly higher tax recommended in HB 309 (1975). And that above that there should be a tax based on the wholesale price with a sliding scale toward the higher priced items.

Concerning the Multistate Tax Compact I feel that the above-mentioned system of a sliding scale based on the wholesale price would definitely be another viable way to collect revenue.

Alcoholic rehabilitation cannot be tied to the tax structure in the State of Alaska. The state constitution forbids any allocation or dedications of any revenue funds to one given entity.

Appendix

Definitions

There are two different classifications for wholesale licenses in the State of Alaska, 1) general wholesale licenses and 2) wholesale malt beverage and wine licenses. They are defined as follows:

(1) The holder of a general wholesale license may sell intoxicating liquors in the original package, and wine in bulk, in quantities of not less than five wine gallons to holders of licenses. A general wholesale license shall be required for each distributing point. The general wholesale license fee schedule is based upon the total amount of business transacted during any year and is \$500 as a minimum license fee and is in payment for the first \$50,000 of business transacted, and in addition, thereto, a rising scale up to but not over \$5,000 in excess fees may be charged based on gross sales.

(2) The holder of a wholesale malt beverage and wine license may sell malt beverages and wine in the original packages and malt beverages and wine in bulk in quantities of not less than five wine gallons to holders of licenses. The malt beverages and wine license fee schedule is based on the total amount of business transacted in any year and is \$100 as a minimum license fee, and based on the first \$10,000 of business. Excess fees on a rising scale extend to \$2,000 but not over and are attached to a \$200,000 figure.

It is to be noted that both of these licenses are restricted by law in that they may not sell to a consumer.

Appendix

The following people were contacted and have contributed their expertise to this report:

The Department of Revenue

Commissioner Sterling Gallagher - income tax
Mr. Bob Stevenson - excise tax
Ms. Eddie Price - income tax
Mr. Bob Mitchell - multistate compact
Mr. Fred Boetsch - excise tax

Alcohol Beverage Control Board

Ms. Linda Brown - ABC director

Legislative Affairs - Anchorage

Mr. Bill McGuire - source material

Senate Finance Committee

Copies of Legislative hearings

Federal Court System

U. S. Attorney - antitrust suit in 1973

Anchorage Cold Storage

Mr. Bob Winslow - manager

K & L Distributor, Inc.

Ms. Winifred Nordquist exec. sec.

Alaska Distributors, Inc.

Mr. Jim Reckie - manager

The following is the total gross income for wholesale liquor sales in Alaska for the past ten years. The column on the right is dollars per year, and the left column is gallonage:

	<u>Taxable Gallons</u>	<u>Total Gross Income</u>
1974	8,839,890.46	\$40,439,526.24
1973	7,532,690.60	32,919,173.66
1972	7,013,539.09	30,783,714.55
1971	not available	30,730,250.25
1970	5,995,406.16	30,141,016.99
1969	5,351,761.27	26,658,756.88
1968	4,769,086.71	23,500,115.31
1967	4,506,210.52	21,616,597.71
1966	4,149,523.00	18,771,534.47
1965	3,982,346.93	15,914,811.61

GENERAL WHOLESALE LICENSE FOR 1975

Locations of Warehouses

	Seattle	Anchorage	Fairbanks	Soldotna
(O/S Wash) Alaska Distributors	x	x	x	
(O/S Wash) K & L Distributors	x	x	x	x
(O/S Wash O) Anchorage Cold Storage		x		
(O/S Wash O) Odom	x		x	
(O/S Wash O) West Coast Distributors	x	x	x	

Malt-Beverage

	Juneau	Sitka	Ketchikan	Palmer
(O/S Wash) K & L Distributors	x			
(O/S Wash O) Odom	x		x	
(O/S Wash O) West Coast Distributors	x			
(O/S Wash O) West Coast Grocery			x	

	Anchorage	Sitka	Palmer	
Domestic Alaska Bay Corp.	x			General
Domestic Aregah	x			General
Domestic Mosesian Vinters			x	Malt
Domestic Service Transfer		x		Malt (Oly)

MEMORANDUM

State of Alaska

TO: R. D. Stevenson
-Special Assistant
Department of Revenue

DATE : May 15, 1975

FROM: P. A. Wall
Director
Administrative Services Division
Department of Revenue

SUBJECT: CS for House Bill No. 246 am

CS for House Bill No. 246 am passed the House and has been referred to the Senate Commerce and Finance Committees.

The Committee Substitute relates to liquor licenses, fees, and municipal regulation of the sale of intoxicating liquor.

With relation to the amendment concerning liquor licenses and fees, this office has recently received the 1974 reports concerning the gross volume of business transacted by all wholesalers in Alaska for the calendar year 1974.

In order to up-date the statistics and provide the Legislature with a projection of increases in revenue that would be obtained by passage of the bill, the following information is submitted:

It is to be noted from AS 04.10.110 (a) concerning general wholesale licenses that the minimum license fee is \$500 and is in payment for the first \$50,000 of business transacted for one distributing point. Effective rate of the initial fee is 1% (\$50,000 X .01 equals \$500). The schedule then provides various brackets of gross receipts with increasing fees until the top amount of \$500,000 is reached where the present additional fee is \$5,000 or again an effective rate of 1% (\$500,000 X .01 equals \$5,000). There is presently no additional fee for receipts received in amounts over \$500,000 for one distributing point.

Reference is now made to the attached schedule, prepared from statistics contained in reports furnished yearly to the Alcoholic Beverage Control Board of holders of General Wholesale Licenses and by holders of Wholesale Malt Beverage and Wine Licenses.

It is to be noted on the subject schedule that for 1959 all holders of General Wholesale Licenses paid initial fees in total amount of \$7,000 and excess fees dependent upon the present schedule in total amount of \$59,500 for grand total of fees in amount of \$66,500 to pay all fees due on gross receipts at various distributing points totaling \$15,490,169.50.

MEMORANDUM

#2

State of Alaska

TO: Γ

DATE :

FROM:

SUBJECT:

Some 15 years later in 1974, all holders of General Wholesale Licenses paid initial fees of \$7,500 and excess fees dependent upon the present schedule in total amount of \$66,000 for a grand total of fees in amount of \$73,500 to pay all fees due on gross receipts at various distributing points totalling \$40,439,525.74.

In comparison 15 years apart, the holders of General Wholesale Licenses were, under the prevailing fee schedule, able to increase their total volume of business from \$15,490,169.50 to \$40,439,525.74, an increase of \$24,949,356.24 or 161.07% increase, and yet pay in effect only \$7,000 more fees, an increase of 10.53% in total fees. This is due to the top fee schedule being set at \$5,000 for gross business of over \$500,000 at each distributing point.

The present fee schedule is described in 35-4-21 (h) ACLA 1949 amended by Chapter 131, SLA 1957 and Chapter 197, SLA 1959. There have been no further amendments or changes to date on the fee schedule so described.

From the present fee schedule, a wholesaler who had business transacted, for example, at some distributing point under the present fee schedule of \$4,000,000 would not pay more than the wholesaler who did total business at one distributing point of \$510,000. Each under the present fee schedule would pay the top additional fee of \$5,000.

During 1974 statistics available from the Alcoholic Beverage Control Board disclose that 13 holders of General Wholesale Licenses at various distributing points reported gross receipts in excess of \$500,000.

The present schedule for the General Wholesale License fees is in essence a fee of 1% of the total amount of business transactions each year at each distributing point up to a total of \$500,000. After that point no additional fees are incurred for gross receipts above \$500,000.

You will note from AS 04.10.110 (b) concerning Wholesale Malt Beverage and Wine licenses that the minimum fee is \$100 and is in payment for the first \$10,000 of business transacted for one distributing point. Effective rate of the initial fee is 1% (\$10,000 X .01 equals \$100,000). The schedule then provides various brackets of gross receipts with increasing fees until the top amount of \$400,000 is reached where the present additional fee is \$5,000.

MEMORANDUM

#3

State of Alaska

TO: Γ

FROM:

DATE :

SUBJECT:

With respect the seven holders during 1974 of Wholesale Malt Beverage and Wine Licenses, only one holder did in excess of \$200,000 in gross receipts at one distributing point; accordingly, the top bracket in the present schedule was not reached.

Based on the 1974 receipts of all wholesale licenses of firms doing business within the State, as reported to the Alcoholic Beverage Control Board, the provisions concerning the excess fee schedule that are incorporated in CS for House Bill No. 246 am would provide increased license fee revenues as follows:

GENERAL WHOLESALE

15 initial fees @ \$500 (covering first \$50,000 of gross receipts)		\$ 7,500.00
Total Gross Receipts	\$40,439,525.74	
Less: Gross Receipts covered by initial fee (15 X \$50,000)	750,000.00	
Balance of gross receipts subject to 1% fee	<u>\$39,689,525.74</u>	<u>396,895.25</u>
Total proposed fees (based on 1974 sales)		\$404,395.25
Total fees under present schedule (based on 1974 sales)		<u>73,500.00</u>
Net increase in revenue on general wholesale licenses		<u>\$330,895.25</u>

WHOLESALE MALT BEVERAGE AND WINE LICENSES:

7 initial fees @ \$100 (covering first \$10,000 of gross receipts)		\$ 700.00
Total Gross Receipts	\$ 723,405.70	
Less: Gross Receipts covered by initial fee (7 @ \$10,000)	70,000.00	
Balance of gross receipts subject to 1% fee	<u>653,405.70</u>	<u>6,534.05</u>
Total proposed fees (based on 1974 sales)		\$ 7,234.05
Total fees under present schedule (based on 1974 sales)		<u>9,200.00</u>
Net decrease in revenue on wholesale malt beverage and wine licenses		<u>\$ 1,965.95</u>

MEMORANDUM

#4

State of Alaska

TO: F

DATE :

FROM:

SUBJECT:

Summarizing the effect of the changes on both types of wholesale license fees is as follows:

Net increase in revenue on general wholesale license fees as compared to present fee schedules	\$330,895.25
Net decrease in revenue on wholesale malt beverage and wine license fees as compared to present fee schedules	<u>1,965.95</u>
Net additional revenue pursuant to CSHB 246 am	<u>\$328,929.30</u>

The new additional revenue based on 1974 sales would amount to \$328,929.30.
For your information the 1975-76 budget request for the Alcoholic
Beverage Control Board was in amount of \$275,200.

AGO 529714

Original sponsor: Guy and Itta

Offered: 4/21/75
Referred: Judiciary

1 IN THE HOUSE

BY THE COMMUNITY AND
REGIONAL AFFAIRS COMMITTEE

2 CS FOR HOUSE BILL NO. 246 am

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 NINTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to liquor licenses, fees, and municipal
7 regulation of the sale of intoxicating liquor."

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

9 * Section 1. AS 04.10.110 is amended to read:

10 Sec. 04.10.110. WHOLESALE LICENSE. (a) The holder of a general
11 wholesale license may sell intoxicating liquors in the original package,
12 and wine in bulk, in quantities of not less than five wine gallons to
13 holders of licenses. The holder of a general wholesale license may not
14 sell to a consumer. Liquor requiring internal revenue strip stamps
15 shall have the stamps intact on the package. A general wholesale li-
16 cense shall be required for each distributing point. The general
17 wholesale license fee schedule is based upon the total amount of busi-
18 ness transacted during any year and is \$500 as a minimum license fee,
19 to accompany the application, and in payment of the fee for the first
20 \$50,000 of business transacted, and, in addition thereto, a sum equal
21 to one percent of the business transacted during the year for which
22 the license is issued. [ON THE BUSINESS TRANSACTED DURING ANY YEAR,

23	ABOVE \$50,000 AND NOT OVER \$75,000	A FEE OF \$ 250
24	ABOVE \$75,000 AND NOT OVER \$100,000	A FEE OF \$ 500
25	ABOVE \$100,000 AND NOT OVER \$125,000	A FEE OF \$ 750
26	ABOVE \$125,000 AND NOT OVER \$150,000	A FEE OF \$1000
27	ABOVE \$150,000 AND NOT OVER \$175,000	A FEE OF \$1250
28	ABOVE \$175,000 AND NOT OVER \$200,000	A FEE OF \$1500
29	ABOVE \$200,000 AND NOT OVER \$250,000	A FEE OF \$2000

1 ABOVE \$250,000 AND NOT OVER \$300,000 A FEE OF \$2500
 2 ABOVE \$300,000 AND NOT OVER \$350,000 A FEE OF \$3000
 3 ABOVE \$350,000 AND NOT OVER \$400,000 A FEE OF \$3500
 4 ABOVE \$400,000 AND NOT OVER \$500,000 A FEE OF \$4500
 5 ABOVE \$500,000 A FEE OF \$5000]

6 (b) The holder of a wholesale malt beverage and wine license may
 7 sell malt beverages and wine in the original packages and malt beverages
 8 and wine in bulk in quantities of not less than five wine gallons to
 9 holders of licenses. The holder of a wholesale malt beverage and wine
 10 license may not sell to a consumer. The malt beverages and wine license
 11 fee schedule is based on the total amount of business transacted in any
 12 year and is \$100 as a minimum license fee, to accompany the application,
 13 and in payment of the fee for the first \$10,000 of business transacted,
 14 and, in addition, a sum equal to one per cent of the business transacted
 15 during the year for which the license is issued. [ON THE BUSINESS
 16 TRANSACTED DURING ANY YEAR,

17 ABOVE \$10,000 AND NOT OVER \$25,000 A FEE OF \$ 150
 18 ABOVE \$25,000 AND NOT OVER \$50,000 A FEE OF \$ 500
 19 ABOVE \$50,000 AND NOT OVER \$75,000 A FEE OF \$ 750
 20 ABOVE \$75,000 AND NOT OVER \$100,000 A FEE OF \$1000
 21 ABOVE \$100,000 AND NOT OVER \$150,000 A FEE OF \$1500
 22 ABOVE \$150,000 AND NOT OVER \$200,000 A FEE OF \$2000
 23 ABOVE \$200,000 AND NOT OVER \$300,000 A FEE OF \$3000
 24 ABOVE \$300,000 AND NOT OVER \$400,000 A FEE OF \$4000
 25 ABOVE \$400,000 A FEE OF \$5000]

26 * Sec. 2. AS 04.10.200 is repealed and re-enacted to read:

27 Sec. 04.10.200. PUBLIC NOTICE. The board shall provide by regu-
 28 lation for adequate notice to inform the public of a proposed issuance
 29 of a new license or reissuance, renewal or transfer of an existing

1 license. The notice shall be bilingual when necessary. Notice shall
2 be given by posting at the location of the premises, at the nearest post
3 office, and at one other conspicuous location in the area for a period
4 of at least 10 days a true copy of the application and by published
5 notice by newspaper, radio and television. Where published notice is
6 not feasible the board may make such exemptions from the requirement of
7 publication as required.

8 * Sec. 3. AS 04.10.300 is repealed and re-enacted to read:

9 Sec. 04.10.300. PROTEST IN AREAS OUTSIDE MUNICIPALITIES. (a) An
10 adult resident in an area outside a municipality who desires to protest
11 the issuance, reissuance, renewal or transfer of any and all licenses
12 for an establishment or establishments within two miles of his permanent
13 place of abode or within the established village in which his permanent
14 place of abode is located shall serve upon the applicant and the board a
15 written statement of the reasons for his protest. Upon the receipt of
16 the protest, the board may give notice and hold a hearing in the area
17 in which the protestant resides, at which all persons interested may
18 be heard.

19 (b) If the protest is made in writing to the board by at least 35
20 per cent of the adult residents having a permanent place of abode within
21 the established village where the licensed premises is situated or is to
22 be situated and within two miles of the established village, a special
23 election conducted by the Department of Community and Regional Affairs
24 held within the village is mandatory. If at the election the majority
25 of the adult residents having a permanent place of abode within the
26 established village and within two miles of the established village
27 object to issuance, reissuance, renewal or transfer, the board may not
28 issue, reissue, renew or transfer any licenses in, or within two miles
29 of, the established village.

1 (c) If the licensed premises is situated or is to be situated
2 outside a municipality or established village and at the hearing the
3 majority of the adult residents having a permanent place of abode within
4 two miles of the premises object to issuance, reissuance, renewal or
5 transfer, the board may, if in its opinion the public interest will be
6 served by the refusal or if other grounds for refusal exist by law,
7 refuse to issue, reissue or transfer the license.

8 (d) For purposes of this section, an "established village" means
9 an unincorporated area where at least 25 people reside as a social unit,
10 as determined by the Department of Community and Regional Affairs.

11 * Sec. 4. AS 04.10.350(a) is amended to read:

12 (a) A license issued under this chapter is renewable automatically
13 if the fee is paid in accordance with secs. 40 - 140 of this chapter,
14 except as provided in sec. 300 of this chapter or except in the case of
15 conviction of the licensee under AS 04.15.100, pending the outcome of a
16 board hearing or judicial determination as to the legality of issuing
17 the license, or in the case of a lawful revocation in which event the
18 license is renewable only as provided by law and regulation.

19 * Sec. 5. AS 04.15.070(a) is amended to read:

20 (a) A municipality may by ordinance provide rules and regulations
21 governing the barter, sale and possession of intoxicating liquor within
22 the municipality necessary to the orderly conduct of the business of
23 selling intoxicating liquor. When, under a local option election, the
24 city clerk finds the majority of the voters are against the sale of
25 intoxicating liquor, the municipality, by ordinance, may make the sale
26 of intoxicating liquor within the municipality a misdemeanor whether
27 the sale is made pursuant to license or otherwise. The ordinance may
28 not be inconsistent with this title or the rules and regulations pro-
29 mulgated under this title. No municipality may impose taxes other than

1 property taxes on liquor inventories and sales taxes on liquor sales
2 when these taxes are levied on other property and sales within the
3 municipality.
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AGO 529719

HB 309

Introduced: 3/18/75
Referred: State Affairs and
Finance 4-2-75

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

1 IN THE HOUSE

2 HOUSE BILL NO. 309

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 NINTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the excise tax on intoxicating
7 liquors; and providing for an effective date."

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

9 * Section 1. AS 43.60.010(a) is amended to read:

10 (a) Every brewer, distiller, bottler, jobber, retailer, whole-
11 saler, or manufacturer who sells intoxicating liquors in the state or
12 who consigns shipments of intoxicating liquors into the state, whether
13 or not the liquors are brewed, distilled, bottled, or manufactured in
14 the state, shall pay on all malt beverages (alcoholic content of one
15 per cent or more by volume), wines, and hard or distilled liquors, the
16 following taxes: (1) malt beverages at the rate of 50 [25] cents a
17 gallon or fraction of a gallon; (2) wine or other liquor of 21 per
18 cent alcohol by volume or less at the rate of \$1.00 [60 CENTS] a
19 gallon or fraction of a gallon; and (3) other liquors having a content
20 of more than 21 per cent alcohol by volume at the rate of \$4.50 [\$4.00]
21 a gallon.

22 * Sec. 2. This Act takes effect July 1, 1975.
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ALASKA STATE LEGISLATURE

MEMORANDUM

TO : Senator John Huber Nov. 19, 1975
FROM : Franklin D. Fleecks, Tax Counsel
SUBJECT: Draft of Letter to Dept. of Revenue

This draft letter is submitted for your comments and approval.

Sterling Gallagher, Commissioner
Department of Revenue
Pouch S
Juneau, Alaska 99811

Dear Commissioner:

This letter is submitted in the interest of saving time for both the Dept. of Revenue's staff and the staff of the Subcommittee on Revenue and Taxation. In reviewing the various tax statutes and their effect the questions listed below came up. We have listed the questions under topic headings in the order of their relationship. ^{we would} ~~It will be appreciated that~~ If a question cannot be answered because the data is not available, ~~that~~ this fact be spelled out.

MULTISTATE TAX COMPACT

The Committee's legislative members have asked this

basic question: Does the Compact generate sufficient tax revenues on income earned in the State of Alaska? At present, we do not have the data to give them an informative, rational answer. We have broken down our inquiry into industry classification because of your statutory limitation that specific companies cannot be named.

Your memorandum to our Committee, dated Nov. 4, 1975, covered your activity in the enforcement of the Compact in regards to the oil industry. Using the second paragraph of the memorandum as a guide, the following questions are submitted for the wholesale liquor industry and canneries operated by out of state corporations.

1. What were the total income taxes paid by both industries for the period 1970-1975 on a yearly basis?

2. Are the excise taxes paid by both industries subject to provisions of the Compact?

3. Can you ascribe any rise in revenue during the 1970-1975 period as directly attributable to the operation of the Compact?

4. As a comparison, what effect has the Compact had on the collection of income tax from multistate retail operations, i.e. J. C. Penney, Safeway, Pay n Save, N. C. Co./Nordstroms etc. The legislators feel that in this classification, retail sales, the allocation formula of the Compact should work best.

5. Have the new Multistate Tax Compact regulations been issued in final form?

MISCELLANEOUS OIL INDUSTRY QUESTIONS

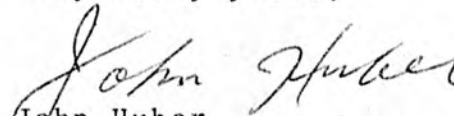
1. Does the Dept. of Revenue keep any statistics or other data on the exploration and drilling expenses of the major oil producers in Alaska?
2. If the calculation of a tax on the oil industry required knowledge of the total capital and/or equity capital, could the Dept. of Revenue secure the information to administer the tax?

MISCELLANEOUS QUESTIONS

1. After your hearings on the Mineral Severance Tax has the Dept. of Revenue formulated a new position?
2. Does the Dept. of Revenue have a position on the raising of the excise tax on liquor?
3. Does the Dept. of Revenue have a position on taxation of profits made by real estate transactions?
4. When does the Dept. of Revenue contemplate the completion and publication of its corporate statistical study?

Thank you for your cooperation.

Very truly yours,


John Huber
Chairman

November 20, 1975

Sterling Gallagher, Commissioner
Department of Revenue
Pouch S
Juneau, Alaska 99811

Dear Commissioner:

This letter is submitted in the interest of saving time for both the Department of Revenue's staff and the staff of the Subcommittee on Taxation and Revenue. In reviewing the various tax statutes and their effect the questions listed below came up. We have listed the questions under topic headings in the order of their relationship. If a question cannot be answered because the data is not available, we would appreciate that this fact be spelled out.

MULTISTATE TAX COMPACT

The Committee's legislative members have asked this basis question: Does the Compact generate sufficient tax revenues on income earned in the State of Alaska? At present, we do not have the data to give them an informative, rational answer. We have broken down our inquiry into industry classification because of your statutory limitation that specific companies cannot be named.

Your memorandum to our Committee, dated November 4, 1975, covered your activity in the enforcement of the Compact in regards to the oil industry. Using the second paragraph of the memorandum as a guide, the following questions are submitted for the wholesale liquor industry and canneries operated by out of state corporations.

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- 2) Are the excise taxes paid by both industries subject to provisions of the Compact?
- 3) Can you ascribe any rise in revenue during the 1970-1975 period as directly attributable to the operation of the Compact?
- 4) As a comparison, what effect has the Compact had on the collection of income tax from multistate retail operations, i.e. J.C. Penney, Safeway, Pay n Save, N.C. Company/Nordstroms etc. The legislators feel that in this classification, retail sales, the allocation formula of the Compact should work best.
- 5) Have the new Multistate Tax Compact regulations been issued in final form?

AGO 529724

MISCELLANEOUS OIL INDUSTRY QUESTIONS

- 1) Does the Department of Revenue keep any statistics or other data on the exploration and drilling expenses of the major oil producers in Alaska?
- 2) If the calculation of a tax on the oil industry required knowledge of the total capital and/or equity capital, could the Department of Revenue secure the information to administer the tax?

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- 1) After your hearings on the Mineral Severance Tax has the Department of Revenue formulated a new position?
- 2) Does the Department of Revenue have a position on the raising of the excise tax on liquor?
- 3) Does the Department of Revenue have a position on taxation of profits made by real estate transactions?
- 4) When does the Department of Revenue contemplate the completion and publication of its corporate statistical study?

Thank you for your cooperation.

Very truly yours,

John Huber

JH:smm

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STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

JAY S. HAMMOND, GOVERNOR

POUCH S - JUNEAU 99811

December 5, 1975

The Honorable John Huber
Alaska State Legislature
Chairman, Special Committee on
Taxation and Revenue
Pouch V
Juneau, Alaska 99811

Dear Senator Huber:

Thank you for your letter expressing interest in the Multistate Tax Compact and several other aspects of our tax program. I have had my staff dig into the industries involved in order to determine the facts to answer your questions.

The following table answers your first question on the income taxes paid by the wholesale liquor industry and the canneries operated by out of state corporations.

Liquor Industry

Number of companies identified: 4

Income tax per originally filed returns for the group identified:

1970	\$46,045
1971	78,862
1972	52,042
1973	42,195
1974	72,834

Canneries

Number of companies identified: 21

Income tax per originally filed returns for the group identified:

1970	(figures not available)
1971	\$206,673
1972	711,530
1973	330,579
1974	306,872

December 5, 1975

The answer to question two is that excise taxes are not subject to the provisions of Multistate Tax Compact since the Compact applies only to income and sales taxes. The income tax provisions allow for apportionment of income where income is earned in more than one state. Excise taxes are based on activity conducted directly in a particular state.

In answer to your third question, I have to really divide my remarks into two areas. The direct assessments made as a result of field audits conducted of multistate taxpayers and applying the Compact approach has resulted in assessments of \$6,923,000 between June of 1973, when our multistate field audit program became active, through the end of October, 1975; a twenty-seven month period. I should note however, that much of the early phases of that period were devoted to developing the audit programs and scheduling audits. Now that the program is off and running and we are doing audits on a regular basis, the rate of revenue production should increase.

In addition, there is the indirect effect of enforcing the provisions of the Compact upon compliance by multistate corporate taxpayers. The fact that we are conducting such audits and enforcing such provisions will cause many taxpayers to file on a Multistate Compact basis voluntarily and that will, of course, bring in additional revenues, since the result of filing on a Compact basis will be to increase the tax liability of the corporation so filing. With respect to the two industries mentioned above, additional taxes of \$3,222 were collected from the wholesale liquor industry and \$76,223 was collected from the canneries industry as a result of the enforcement of the Multistate Tax Compact.

With respect to retail operations, most of the multistate retail stores operating in Alaska have filed apportioned returns under the Compact approach. The main result of auditing some of these corporations has been to combine their finance subsidiaries (who actually own the credit card operation and the accounts receivable and receive the finance charges) with the retail unit itself. Since a big share of the combined operations' profit comes from the finance charges, this area has been fruitful as well. One recent audit which has not yet been finalized indicates that a firm which paid in approximately \$30,000 in corporate income taxes will owe an additional \$80,000 by combining the finance company with the retail operation. In other words, it appears that the tax would almost quadruple by using this approach. We, of course, intend to apply the same rule to other multinational retailers with finance affiliates.

The new multistate regulations have not yet been issued in final form, but a hearing was held on their adoption on November 20. As soon as they have been reviewed by the Department of Law and approved they will be forwarded to the Lieutenant Governor's Office for adoption and will become effective 30 days thereafter. We expect this to take place in mid January.

AGO 529727

The Department of Revenue does not have any statistics on exploration and drilling expenses of the major oil producers to the extent such expenses are incurred in Alaska. Of course, the corporate tax returns do indicate the intangible drilling expense deductions on a worldwide basis.

The calculation of a tax based on total capital of an oil company, to the extent it is employed in Alaska, might be possible since much of this information is available from our property tax records - although this is not necessarily the case since the property tax is based on current market value and capital investment would be indicated on corporate books at cost less depreciation. I think however, that it would be possible for the Department to secure the information to administer such a tax. Tax based on equity capital would be almost impossible to administer since the equity of the corporations is actually on a consolidated worldwide basis and the equity investment in a particular subsidiary or affiliate doing business in Alaska might not be the same as the equity of the total business operation. In addition, if that subsidiary or affiliate were in itself a multistate corporation then the equity would have to be apportioned in some manner. I think it would be very difficult to identify how much equity investment there might be in an oil company's operations in Alaska.

The hearings that were held on the Mineral Severance Tax on November 6 and 7 were extremely helpful to the Department of Revenue in that they supplied us with a lot of economic information and analyses that had not been previously available. As a result, we came to a consensus with the members of the mining industry, that basically a mineral severance tax is not appropriate at this time, but that there were changes needed in the present Mining License Act in order to clear up some of the ambiguities in that Act and make it more easily administerable and more equitable in its application. The mining industry was interested in providing tax incentives but the Department is not inclined at this time to recommend anymore incentives than presently exist in the mining license and income tax statutes.

The Department of Revenue is interested in raising the excise taxes on liquor and to that end recommended to the Governor the introduction of HB 309 last year which does raise the excise tax on distilled spirits from \$4.00 to \$4.50 per gallon; on wines from 60¢ to \$1.00 and on beer from 25¢ to 50¢. We continue to support these increases.

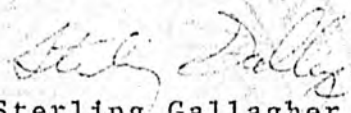
I am not really sure I understand the question regarding the taxation of profits made by real estate transactions. Presently, such transactions are taxable through the Net Income Tax Act. A dealer in real estate pays the regular tax rate on any profits made in the sale of real estate just as any other businessman does. A casual investor in real property or an individual who sells his house is taxable on any profits at capital gains rates.

December 5, 1975

The corporate data base study is presently in the key punch stage and we are key punching information from 1973 and 1974 returns. We anticipate that this will be finished by the end of December and we will be able to publish some preliminary statistics in January. However, the key punching of audit adjustments covering years 1973 and 1974 has not been done and the programs have yet to be written to incorporate those adjustments in the corporate data base. As soon as those programs are ready we will begin capturing the data from audit adjustments and posting those to the data files. As 1975 income tax returns come in and machine time is available, data will be pulled from those returns and entered into the data base as well. You can, therefore, expect some time in January to receive some preliminary statistical reports for 1973 and 1974 based on returns as they were filed and not including any audit adjustments that may have been made.

We appreciate your interest in tax matters and as you know, are happy to see that the formation of the Special Committee on Taxation and Revenue and the establishment of a staff to conduct tax research on behalf of the legislature. We have met with your staff on several occasions and feel that the addition of this professional input into the legislative process will be very helpful in achieving a common goal of an equitable and easily administerable tax system which will provide the necessary revenues to fund state government.

Sincerely,


Sterling Gallagher
Commissioner

PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED
AS A UNIT IN THE ORIGINAL DOCUMENT.

STATE OF ALASKA
LEGISLATIVE COUNCIL
Subcommittee on Taxation and Revenue
Chairman, Senator John Huber

REVIEW OF THE WHOLESALE LIQUOR INDUSTRY

Prepared by: Janis C. Gull
Staff Researcher

Franklin D. Fleeks
Tax Counsel

**ALASKA
STATE LEGISLATURE**

MEMORANDUM

TO: Senator John Huber
FROM: Franklin D. Fleeks 
Tax Counsel
SUBJECT: Committee staff review of the wholesale
liquor industry

Submitted for your review and approval are the findings of the staff in regard to the wholesale liquor industry. The basic research was done was Janis C. Gull. A prepared synopsis of the findings follows. Since there is one important missing link: how the manufacturing distillers deal with the wholesale dealers, you will find our recommendations qualified.

CURRENT STATUTES

In the field of taxation and revenue the wholesale liquor industry is covered specifically by the following:

- (a) AS 04.10.110 Wholesale License
- (b) AS 43.60 Excise Tax on Intoxicating Liquor

The wholesale license fee is asserted on two categories: (a) the general license which covers hard liquor and (b) the wholesale malt beverage and wine license. The license fees are based on a sliding scale with the general license ranging from a minimum of \$500 to a maximum of \$5,000 and the wholesale liquor license ranging from a minimum of \$100 to a maximum of \$5,000.

Excise tax rates are based on gallonage. The rates are as follows:

- (a) Malt beverages - 25 cents a gallon or fraction of a gallon.
- (b) Wine or other liquor of 21 percent alcohol by volume or less - 60 cents a gallon or fraction of a gallon.
- (c) Other liquors having a content of more than 21 percent alcohol by volume - \$4 a gallon.

FACTORS FAVORING AN INCREASE

In a memo dated May 15, 1975, a copy of which is attached, Mr. Wall of the Department of Revenue made an analysis of the liquor licenses and fees. He noted the last change in licenses and fees was in 1959. Since that time the industry, under the general license, has increased its total business volume from \$15,490,169 to \$40,439,526; a 161.07 percent increase.

Licenses and fees for the general license have gone from \$66,500 in 1959 to \$73,500 in 1974, an increase of \$7,000 or 10.53 percent. It should also be noted that the last excise tax rate increase took place in 1961.

Gross income in the industry from 1971-1974 increased at a rate of one percent (1%). With the increase in population and income during the 1974-1975 periods, gross income increased twenty-two percent (22%). Revenue received by the state from license fees increased less than one percent (1%). Revenue from the excise tax increased by sixteen percent (16%). No judgment can be made in regard to the income tax because of not knowing if the four companies used were the major ones in the industry.

All economic indicators point to growth for Alaska in the years ahead. The wholesale liquor industry, in all certainty, will share in this growth. Each segment of the Alaskan economy should contribute its fair share of tax. Because of the nature of its products, the wholesale liquor industry creates a burdensome monetary and social cost to the state. An increase in rates will insure that the industry is contributing its fair share to the state revenues.

UNFINISHED ITEMS AND RECOMMENDATIONS

Review of the attached report and its underlying data revealed the following areas of concern.

Wholesale Price Determinations

Nothing was found indicating that the price charged to Alaskan subsidiaries was out of line. However, the staff has not received

data on the price charged by the distillers to the wholesalers. Inquiries have been made to the Alcohol, Tobacco, Firearms Division of the U. S. Treasury, the Washington State Liquor Control Board, and the National Alcohol Beverage Control Association. On receipt of the data a comparison will be made between the price charged by the distiller to the wholesaler and the price charged by the wholesaler to its Alaskan subsidiary. This comparison should provide answers on pricing policies of the major wholesalers. Work is continuing on this item.

AS 43.60.010(b) - Warehousing

This subsection was passed during the 1971 session, becoming effective July 1, 1971. This section provides that if consigned shipments of intoxicating liquors into Alaska are to warehouses in the state no tax is imposed until the liquor is removed from the warehouse for sale or consignment to retailers. The effect of this subsection is that at any one time the warehouses can contain both intoxicating liquors that have been taxed at the FOB point-Seattle and intoxicating liquors not taxed because of consignments to Alaskan warehouses.

Before passage of this amendment all liquor was taxed FOB point-Seattle. In enforcing the tax the Department of Revenue had a simple audit tool. After reviewing the wholesaler's books the department could cross-check the bills of lading of the shipper to verify the accuracy of the wholesaler's books.

The amendment eliminated this tool. Because the liquor in the warehouse can be taxed or nontaxed, the current system lends itself

to manipulation. The current system also puts an intolerable administrative burden on the Department of Revenue as they do not have sufficient personnel to adequately examine the industry.

Any tax that is imposed should have as its criteria equity, ease of administration, and be free from manipulative influences. The current law has none of these. In fact, it is a loophole that needs closing. It is the recommendation of the staff that AS 43.60.010(b) be repealed.

CONCLUSION

Because of the continuing research needed in establishing wholesale prices this conclusion is qualified. It is the staff's recommendation that subject to the above qualification, the bills, CSHB246am and HB 309, currently in the House Finance Committee, be supported and that AS 43.60.010(B) be repealed.

**ALASKA
STATE LEGISLATURE**

MEMORANDUM

TO: Senator Huber and
Franklin D. Fleeks, tax counsel

FROM: Janis C. Gull

SUBJECT: Wholesale Liquor Industry

On November 18 I received a memorandum containing your Outline of Research Needed for Analysis of Liquor Tax. The following is a copy of that outline and my report on the research and findings of fact that were the direct results of said outline.

I am currently at your disposal to discuss the context of this report and to supply any and all raw data entailed within.

ALASKA STATE LEGISLATURE

9K
JAH 11-18-75

MEMORANDUM

TO : Senator John Huber Nov. 18, 1975
FROM : Franklin D. Fleeks, Tax Counsel
SUBJECT: Outline of Research Needed for Analysis of
Liquor Tax

The following outline is submitted for your approval. The information sought will give a detailed picture of the wholesale liquor industry in Alaska. The study is limited to the wholesale distributors, most of whom are out of state corporations.

A partial listing of sources to be contacted for information is as follows:

- a. Dept. of Revenue - Excise Tax Division
- b. Dept. of Revenue - Income Tax Division, Multi-state Tax Compact
- c. Dept. of Revenue - Statistics on amount of tax collected
- d. Alcohol Beverage Control Board
- e. Bill McGuire - Adm. Asst. to Sen. Chancy Croft
- f. Tapes of legislative hearings on last sessions bill
- g. Lobbyist for distributors for their position
- h. Washington State Liquor Control Board for comparison of wholesale prices
- i. Transcript of anti-trust suit against the wholesale distributors.

OUTLINE

- I. Identification of the Taxpayers
 - a. Who are the wholesale distributors who operate in Alaska?
 - b. Are they domestic (Alaskan) corporations, subsidiaries of out of state corporations, or completely out of state corporations?
 - c. Where are their major warehouses located; In Alaska or outside of Alaska?
- II. Identification of the Problem
 - a. How long since the rates have been changed?
 - b. What are the present rates of taxation?
 - c. How do Alaska's rates of taxation of the wholesale liquor industry compare to other states?
 - d. What were the total amount of wholesale liquor sales in Alaska for the past five years?
 - e. How many Alaskan employees are there?
- III. Operations of the Wholesalers
 - a. How is the wholesale price of liquor determined?
 - b. Does the out of state corporation raise the wholesale price of liquor sold to its wholly owned Alaskan subsidiary in order to reduce the profit of the subsidiary?
 - c. Is the wholesale price of liquor purchased by the distributors the same as their Seattle price less transportation costs to Alaska?
- IV. Identification of the Type and Amount of Taxes Being Currently Received by the State
 - a. How much was collected from the excise tax on liquor in the past 5 years?
 - b. Are the distributors paying any income tax?
 - c. Does the Multistate Tax Compact reach the distributors net profits from sales in Alaska?
- V. Miscellaneous
 - a. Should the tax be based on gallonage or the wholesale price?
 - b. If the Multistate Tax Compact is not reaching the distributors, is there another way to collect the revenue?
 - c. Should reform of the tax structure be tied to Alcoholic Rehabilitation?
 - d. What increase in the rate of excise tax is recommended?

I. Identification of the Taxpayers

- a. Who are the wholesale distributors who operate in Alaska?
- b. Are they domestic (Alaskan) corporations, subsidiaries of out-of-state corporations, or completely out-of-state corporations?
- c. Where are their major warehouses located; in Alaska or outside of Alaska?

The following is a complete list of all wholesalers presently doing business in the State of Alaska.

Alaska Bay Corporation
505 Ocean Dock Road
Anchorage, Alaska
Mail: Box 1872
Fairbanks, Alaska 99701

Alaska Distributors Company
4601 Sixth Avenue South
Seattle, Washington 98108

Alaska Distributors Company
P. O. Box 549
Fairbanks, Alaska 99701

Alaska Distributors Company
Box 4-1598
Anchorage, Alaska 99509

Anchorage Cold Storage, Co., Inc.
P. O. Box 39
Anchorage, Alaska 99501

Aregah Corporation
Box 3454
Anchorage, Alaska 99501

Mosesian Vinters
Ray N. Mosesian
Mail: Star Route A, Box 217-A
Anchorage, Alaska 99502

Odom Company
1258 First Avenue South
Seattle, Washington 98134

Odom Company
Alaska Railroad Industrial Area
Fairbanks, Alaska 99701

Odom Company
Box 410
Juneau, Alaska 99801

Odom Company
619 Stedman Street
Ketchikan, Alaska 99901

Service Transfer, Inc.
Box 178
Sitka, Alaska 99835

K & L Distributors, Inc.
300 120th Avenue, N. E.
Bellevue, Washington 98004

K & L Distributors, Inc.
4504 Lois Drive
Anchorage, Alaska 99503

K & L Distributors, Inc.
17 Adak Street
Fairbanks, Alaska 99701

K & L Distributors, Inc.
490 South Franklin Street
Juneau, Alaska 99801

K & L Distributors, Inc.
P. O. Box 337
Soldotna, Alaska 99669

West Coast Distributors, Inc.
1258 First Avenue South
Seattle, Washington 98134

West Coast Distributors, Inc.
Box 942
Anchorage, Alaska 99510

West Coast Distributors, Inc.
P. O. Box 732
Fairbanks, Alaska 99701

West Coast Distributors, Inc.
490 South Franklin Street
Juneau, Alaska 99801

West Coast Grocery Company
P. O. Box 118
Ketchikan, Alaska 99901

Of the preceding wholesale entities only four are totally Alaskan owned: 1) Alaska Bay Corporation; 2) Aregah; 3) Mosesian Vinters; and 4) Service Transfer. Of these, Alaska Bay Corporation and Aregah hold general wholesale licenses. Each corporation has one only warehouse, both of which are physically located in Anchorage.

Mosesian Vinters distills and distributes milk wine from its distillery in Palmer. It holds a malt-beverage and wine license and is owned in full by a religious order.

Service Transfer has only one warehouse located in Sitka. It also holds a malt -beverage and wine license and distributes Olympia Beer solely in Sitka.

Considering the remaining eighteen wholesalers licensed to do business within the State of Alaska I have found that they are all subsidiaries of four larger Washington State corporate entities. The only exception to this might be considered to be the K & L distribution

point in Bellevue, Washington. This particular location is the parent corporation to its four separate distribution points in Alaska.

Alaska Distributors Co.
4601 6th Ave. So.
Seattle, Washington

Owner: Alex Shulman

This corporation is based in Seattle, Washington. It maintains three Alaska licensed warehouses -- Seattle, Anchorage, and Fairbanks. The corporation also has eight other distribution points in Alaska. These eight are all run by "commissioned sales persons", none of whom utilize licensed warehouses. It also appears that only a minimum amount of withholding taxes is being paid. They order the exact quantity their customers require and deliver it immediately. Because its income tax returns are confidential, I could not find out the exact percentage of the gross or net income that actually went to the State of Alaska.

It has been found that Alaska Distributors pays excise taxes in accordance with AS 43.60.010(b) which states that excise taxes imposed shall not be levied until the goods are sold and removed from the warehouse for sale as consignment to retailers.

K & L Distributors, Inc.
300 120th N.E.
P. O. Box 1969
Bellevue, Washington 98004

Owners: The Levine family

K & L Distributors is a family-owned corporation with its physical base in Bellevue, Washington. It has five Alaska licensed warehouses:

1) Bellevue, 2) Anchorage, 3) Fairbanks, 4) Juneau, and 5) Soldotna.

The Soldotna distribution point holds a malt-beverage and wine license only. All of the others hold general licenses.

This corporation has set up a series of "sales representatives" to cover the outlying areas. As with Alaska Distributors, K & L's "reps" are "commissioned sales persons." There are eight separate "area" locations for these reps, but the quantitative number of personnel changes monthly.

All K & L products are shipped from the Bellevue warehouse to Alaska. They are not distributed elsewhere. The Bellevue distribution point does do a representative volume of business in Washington. This can be largely attributed to the fact that they are the exclusive distributor of both Budweiser and Olympia beer -- the number 1 and number 2 best sellers respectively.

The Levine family is not involved in other business endeavors but is solely a liquor distributor. Its basic corporate structure is rather simple and appears to function very well. As with Alaska Distributors, K & L also pays its excise taxes under As 43.60.010(b).

West Coast Grocery
P. O. Box 118
Ketchikan, Alaska 99901

President: Charles H. Hyde

This corporation distributes alcoholic beverages and general groceries in the Ketchikan area. It also does a healthy mail order

grocery and liquor business. Hard liquor is handled by "commissioned sales persons" in this area, and thus the Ketchikan warehouse maintains a wholesale malt-beverage and wine license.

West Coast Grocery - Ketchikan is a division of West Coast Grocery Company of Tacoma, Washington. It maintains a number of locations on the west coast. It appears that this corporation is also basically owned and operated by one family. Charles H. Hyde is the president, with William B. Hyde as vice president.

At this point in time I have not found out whether they are paying the excise taxes upon shipment from Tacoma or are utilizing AS 43.60.010.

ODOM
1258 First Avenue South
Seattle, Washington 98124

Owner: Mr. M. W. Odom

NOTE: M. W. Odom is the owner and president of a corporate conglomerate. He has set up and/or purchased an extensive series of separate corporations -- all of which have separate managerial staff, policies and tax structures. The end net proceeds of each entity is directed to the parent corporation. This creates a steady cash flow both within each corporation as well as the ability to extend monies to other internal corporations.

The following report entails his liquor interests within the State of Alaska and extends only to the "parent" warehouses in Seattle.

Anchorage Cold Storage
P. O. Box 39
240 First Avenue
Anchorage, Alaska 99501

President: M. W. Odom

This Odom entity has a full-time staff of 185 persons. It handles produce, frozen meats and liquor. It holds one general wholesale license for the Anchorage location. As indicated by the above address, this particular company was incorporated in the State of Alaska and is a domestic corporation.

Anchorage Cold Storage pays all of its excise taxes in Washington. It does not utilize AS 43.60.010(b). This is due to the fact that the company is actually purchasing the goods from Odom in Seattle and is then shipping them to Alaska. This procedure excludes it from section 2(b) of the statute because it only allows the wholesalers to withhold payment of excise taxes until such time as the liquor is sold. In the case of Odom - Anchorage Cold Storage, Odom is selling all liquor and malt beverages to that company in Seattle.

Anchorage Cold Storage merged with the parent Odom Company on April 18, 1974.

Odom Company
1258 First Avenue South
Seattle, Washington 98134

President: M. W. Odom

This company is what I call Odom with a small "o." It is considered to be a separate corporation, as are the rest of his entities.

It is not the parent corporation in Seattle. It appears that M. W. merely wanted to hang his name on it in lieu of Mucktuck Distributors or something else.

The company has four large warehouses. Both the Seattle and Fairbanks locations hold general wholesale licenses. The Juneau and Ketchikan warehouses are malt-beverage and wine distribution points. The management also maintains four "commissioned sales persons" in various small communities.

West Coast Distributors
1250 First Avenue South
Seattle, Washington 98134

President: M. W. Odom

This corporate structure is much the same as with other Odom enterprises. It has four warehouses, Seattle, Anchorage, Fairbanks and Juneau, with the latter being a malt-beverage distribution point. West Coast Distributors like Anchorage Cold Storage merged with Odom on April 18, 1974.

II. Identification of the Problem

- a. How long since the rates have been changed?
- b. What are the present rates of taxation?
- c. How do Alaska's rates of taxation of the wholesale liquor industry compare to other states?
- d. What was the total amount of wholesale liquor sales in Alaska for the past five years?

Alaskan Statute 43.60.010 was instituted in 1961. There have been no rate changes made since its inception. The taxation rates established in 1961 are wine: \$0.60 per gallon; malt-beverages: \$0.25 per gallon; hard liquor: \$4.00 per gallon.

On 3/18/75 House Bill 309 (Appendix No. II) was introduced by the Rules Committee by Request of the Governor and it was referred to the House Finance Committee. At the present time it is still in that Committee.

This new bill (309) would increase the current tax rates as follows 1) malt beverages at a rate of \$0.50 a gallon, (from \$0.25); 2) wine or other liquor at a rate of \$1.00 per gallon, (from \$0.60); and 3) hard liquors at a rate of \$4.50 a gallon (from \$4.00).

In addition to HB 309, House Bill 246 am (Appendix No. III) was introduced. CS for #246 was introduced by Community and Regional Affairs. It was referred to the Judiciary which in turn produced CSHB 246 am which was passed by the House and sent to Senate Commerce and Finance. The bill is currently in this Committee. CSHB 246 am is designed to change the wholesale license fees.

The current statute allows for general wholesale license of \$500 per year and a maximum of \$5,000 in excess fees on an income of \$500,000 or over.

Also currently allowed is the malt-beverage and wine license fees of \$100 with \$1,000 maximum in excess fees on an income of \$100,000 or more.

The new bill, CSHB 246 am, requests the same tax and excess structure and in addition thereto, a sum equal to one percent of the business transacted during the year for which the license is issued on the business transacted during any year. This bill has passed the House and is in the Senate Finance Committee. A letter from Mr. P. A. Wall to R. D. Stevenson regarding the potential value of this bill is enclosed Appendix No. I.

In answer to question c, how do Alaska's rates of taxation of the wholesale liquor industry compare to other states, the following chart has been compiled:

As the chart indicates, Alaska ranks second in rates per gallon of distilled spirits, seventh in rates per gallon of table wine, tenth in rates per gallon for dessert wine and seventh in rates per gallon for beer.

Unlike many corporations in Alaska with only one or two "commissioned sales persons," the three large liquor distributors employ a fairly large standing staff of these "specialized" persons. None of them have to pay withholding taxes through the business. They are not listed as "employees" and their quantitative number varies from month to month. As of December 15, 1975, there appears to be at least 44 "commissioned persons" working in the state. The total number of Alaskans currently paying withholding taxes as full or part-time employees is 382 persons. Approximately 200 of these people work in other capacities besides handling or dealing with liquor.

III. Operations of the Wholesalers

- a. How is the wholesale price of liquor determined?
- b. Does the out-of-state corporation raise the wholesale price of liquor sold to its Alaskan subsidiary in order to reduce the profit of the subsidiary?
- c. Is the wholesale price of liquor purchased by the distributors the same as their Seattle price less transportation costs to Alaska?

The wholesale price of liquor is determined by adding the distilling price to operating expenses, plus freight costs to the wholesaler (i.e., FOB Seattle), plus federal taxes and then net profit. This figure is then equated by gallons to exact a wholesale price per product.

I was not able to find conclusive evidence that the out-of-state corporations are raising the wholesale price of liquor to their Alaskan subsidiaries. There have been antitrust suits levied against the different wholesalers. However, it should be noted that all of the separate suits were settled out of court.

Theoretically the wholesale price of liquor sold by distributors is exactly the same between Seattle and Alaska. The higher prices are incurred due to freight and extra handling as well as high overhead.

The Alaska Beverage Analyst (November, 1975) quotes both the Seattle and Anchorage prices as well as the Fairbanks price. On the surface it seems quite fair. However, if price gouging is taking place it appears to be on the true wholesale level. That is to say that the prices listed in the Alaska Beverage Analyst have already been hiked before the magazine was printed.

IV. Identification of the Type and Amount of Taxes being currently
Received by the State

- a. How much was collected from the excise tax on liquor in the
past 5 years?
- b. Are the distributors paying any income tax?
- c. Does the Multistate Tax Compact reach the distributors net
profits from sales in Alaska?

Excise tax received by the State of Alaska from the wholesale
liquor industry is as follows:

EXCISE ALCOHOL TAX

Fiscal Year Ended	Net Collections	Dollar Increase over prior fiscal year	Percent Increase over prior fiscal year
6/30/75	\$6,598,213.24	\$907,304.59	15.94
6/30/74	5,690,908.65	456,230.55	8.72
6/30/73	5,234,678.10	363,521.68	7.46
6/30/72	4,871,156.42	(65,242.42)	(1.32)
6/30/71	4,936,398.84	511,479.26	11.56
6/30/70	4,424,919.58	481,813.95	12.22
6/30/69	3,943,105.63	Base Year	Base Year

The distributors are definitely paying income tax. However, it is to be noted that for the year of 1974 the top four companies in the industry paid a total of \$72,834.00 in income taxes to the state based on a \$36,839,823.32 gross income. All of the other companies' combined gross income total is so inconsequential as to be unmentioned at this point. As indicated before, I do not have the statistics on their corporate incomes. Therefore, I do not know what their net income was.

The wholesale liquor industry also paid out a total of \$8,200.00 in license fees as well as an additional \$73,650.00 in excess license fees.

Concerning the Multistate Tax Compact I have received the following information. The liquor industry is influenced by the Multistate Tax Compact. In the last year the effect of the Compact has been that an additional \$3,222.00 was received from the industry. This figure can be directly attributed to the Compact. However, the audit of separate companies is generally felt to be more effective on the retail level.

Before the Multistate Tax Compact can rationally be considered it first has to be made more effective. I do believe that one of the methods to facilitate this change would be to utilize the thesis I will expand upon in Section Five. This method would be established on a percentage rate based on the wholesale price. I feel this would bring in far more income than the Multistate Compact.

V. Miscellaneous

- a. Should the tax be based on gallonage or the wholesale price?
- b. If the Multistate Tax Compact is not reaching the distributors, is there another way to collect the revenue?
- c. Should reform of the tax structure be tied to Alcoholic Rehabilitation?
- d. What increase in the rate of excise tax is recommended?

The first question of this section deals with a very interesting aspect. After researching, discussing with "experts," analyzing and much consideration, I am of the opinion that the tax should be based on the gallonage structure currently recommended in HB 309 (1975) Appendix No. II. And that above this rate there should be a tax based on the wholesale price with a sliding scale toward the higher priced items.

Concerning the Multistate Tax Compact I feel that the above-mentioned system of a sliding scale based on the wholesale price would definitely be another viable way to collect revenue.

Alcoholic rehabilitation cannot be tied to the tax structure in the State of Alaska. The state constitution forbids any allocation or dedications of any revenue funds to one given entity.

Concerning a rate increase for liquor excise taxes, the 1975 Legislature has a bill pending in the House Finance Committee (House Bill No. 309). It was introduced by the request of the Governor.

Through my research I feel that at this point in time the new rates proposed will be adequate and that they are justified.

APPENDICES

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HB 246 am	III
Locations of warehouses	IV
Definitions	V
Persons contacted	VI

MEMORANDUM

State of Alaska

APPENDIX No. I

TO: R. D. Stevenson
Special Assistant
Department of Revenue

DATE: May 15, 1975

FROM: P. A. Wall
Director
Administrative Services Division
Department of Revenue

SUBJECT: CS for House Bill No. 246 am
P. 1

CS for House Bill No. 246 am passed the House and has been referred to the Senate Commerce and Finance Committees.

The Committee Substitute relates to liquor licenses, fees, and municipal regulation of the sale of intoxicating liquor.

With relation to the amendment concerning liquor licenses and fees, this office has recently received the 1974 reports concerning the gross volume of business transacted by all wholesalers in Alaska for the calendar year 1974.

In order to up-date the statistics and provide the Legislature with a projection of increases in revenue that would be obtained by passage of the bill, the following information is submitted:

It is to be noted from AS 04.10.110 (a) concerning general wholesale licenses that the minimum license fee is \$500 and is in payment for the first \$50,000 of business transacted for one distributing point. Effective rate of the initial fee is 1% (\$50,000 X .01 equals \$500). The schedule then provides various brackets of gross receipts with increasing fees until the top amount of \$500,000 is reached where the present additional fee is \$5,000 or again an effective rate of 1% (\$500,000 X .01 equals \$5,000). There is presently no additional fee for receipts received in amounts over \$500,000 for one distributing point.

Reference is now made to the attached schedule, prepared from statistics contained in reports furnished yearly to the Alcoholic Beverage Control Board by holders of General Wholesale Licenses and by holders of Wholesale Malt Beverage and Wine Licenses.

It is to be noted on the subject schedule that for 1959 all holders of General Wholesale Licenses paid initial fees in total amount of \$7,000 and excess fees dependent upon the present schedule in total amount of \$59,500 for a grand total of fees in amount of \$66,500 to pay all fees due on gross receipts at various distributing points totaling \$15,490,169.50.

MEMORANDUM

State of Alaska

TO: F

DATE :

FROM:

SUBJECT: P. 2

Some 15 years later, in 1974, all holders of General Wholesale Licenses paid initial fees of \$7,500 and excess fees dependent upon the present schedule in total amount of \$66,000 for a grand total of fees in amount of \$73,500 to pay all fees due on gross receipts at various distributing points totaling \$40,439,525.74.

In comparison 15 years apart, the holders of General Wholesale Licenses were, under the prevailing fee schedule, able to increase their total volume of business from \$15,490,169.50 to \$40,439,525.74, an increase of \$24,949,356.24 or 161.07% increase, and yet pay in effect only \$7,000 more fees, an increase of 10.53% in total fees. This is due to the top fee schedule being set at \$5,000 for gross business of over \$500,000 at each distributing point.

The present fee schedule is described in 35-4-21 (H) ACLA 1949 amended by Chapter 131, SLA 1957 and Chapter 197, SLA 1959. There have been no further amendments or changes to date on the fee schedule so described.

From the present fee schedule, a wholesaler who had business transacted, for example, at some distributing point under the present fee schedule of \$4,000,000 would not pay more than the wholesaler who did total business at one distributing point of \$510,000. Each under the present fee schedule would pay the top additional fee of \$5,000.

During 1974 statistics available from the Alcoholic Beverage Control Board disclose that 13 holders of General Wholesale Licenses at various distributing points reported gross receipts in excess of \$500,000.

The present schedule for the General Wholesale License fees is in essence a fee of 1% of the total amount of business transactions each year at each distributing point up to a total of \$500,000. After that point no additional fees are incurred for gross receipts above \$500,000.

You will note from AS 04.10.110 (b) concerning Wholesale Malt Beverage and Wine Licenses that the minimum fee is \$100 and is in payment for the first \$10,000 of business transacted for one distributing point. Effective rate of the initial fee is 1% (\$10,000 X .01 equals \$100.00). The schedule then provides various brackets of gross receipts with increasing fees until the top amount of \$400,000 is reached where the present additional fee is \$5,000.

MEMORANDUM

State of Alaska

TO: F

APPENDIX

DATE :

FROM:

SUBJECT: P. 3

With respect the seven holders during 1974 of Wholesale Malt Beverage and Wine Licenses, only one holder did in excess of \$200,000 in gross receipts at one distributing point; accordingly, the top bracket in the present schedule was not reached.

Based on the 1974 receipts of all wholesale licenses of firms doing business within the State, as reported to the Alcoholic Beverage Control Board, the provisions concerning the excess fee schedule that are incorporated in CS for House Bill No. 246 am would provide increased license fee revenues as follows:

GENERAL WHOLESALE:

15 initial fees @ \$500 (covering first \$50,000 of gross receipts)		\$ 7,500.00
Total Gross Receipts	\$40,439,525.74	
Less: Gross Receipts covered by initial fee (15 x \$50,000)	750,000.00	
Balance of gross receipts subject to 1% fee	<u>\$39,689,525.74</u>	396,895.25
Total proposed fees (based on 1974 sales)		\$404,395.25
Total fees under present schedule (based on 1974 sales)		<u>73,500.00</u>
Net increase in revenue on general wholesale licenses		<u>\$330,895.25</u>

WHOLESALE MALT BEVERAGE AND WINE LICENSES:

7 initial fees @ \$100 (covering first \$10,000 of gross receipts)		\$ 700.00
Total Gross Receipts	\$ 723,405.70	
Less: Gross Receipts covered by initial fee (7 @ \$10,000)	70,000.00	
Balance of gross receipts subject to 1% fee	<u>\$ 653,405.70</u>	6,534.05
Total proposed fees (based on 1974 sales)		\$ 7,234.05
Total fees under present schedule (based on 1974 sales)		<u>9,200.00</u>
Net decrease in revenue on wholesale malt beverage and wine licenses		<u>\$ 1,965.95</u>

MEMORANDUM

State of Alaska

TO: F

APPENDIX

DATE :

FROM:

SUBJECT: P. 4

Summarizing the effect of the changes on both types of wholesale license fees is as follows:

Net increase in revenue on general wholesale license fees as compared to present fee schedules	\$330,895.25
Net decrease in revenue on wholesale malt beverage and wine license fees as compared to present fee schedules	1,965.95
Net additional revenue pursuant to CSHB 246 am	<u>\$328,929.30</u>

The new additional revenue based on 1974 sales would amount to \$328,929.30. For your information the 1975-76 budget request for the Alcoholic Beverage Control Board was in amount of \$275,200.

APPENDIX No. II

Introduced: 3/16/75
Referred: State Affairs and
Finance

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

1 IN THE HOUSE

2 HOUSE BILL NO. 309

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 NINTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the excise tax on intoxicating
7 liquors; and providing for an effective date."

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

9 * Section 1. AS 43.60.010(a) is amended to read:

10 (a) Every brewer, distiller, bottler, jobber, retailer, whole-
11 saler, or manufacturer who sells intoxicating liquors in the state or
12 who consigns shipments of intoxicating liquors into the state, whether
13 or not the liquors are brewed, distilled, bottled, or manufactured in
14 the state, shall pay on all malt beverages (alcoholic content of one
15 per cent or more by volume), wines, and hard or distilled liquors, the
16 following taxes: (1) malt beverages at the rate of 50 [25] cents a
17 gallon or fraction of a gallon; (2) wine or other liquor of 21 per
18 cent alcohol by volume or less at the rate of \$1.00 [60 CENTS] a
19 gallon or fraction of a gallon; and (3) other liquors having a content
20 of more than 21 per cent alcohol by volume at the rate of \$4.50 [\$4.00]
21 a gallon.

22 * Sec. 2. This Act takes effect July 1, 1975.
23
24
25
26
27
28
29

APPENDIX No. III

Original sponsor: Guy and Itta

Offered: 4/21/75
Referred: Judiciary

IN THE HOUSE

BY THE COMMUNITY AND
REGIONAL AFFAIRS COMMITTEE

CS FOR HOUSE BILL NO. 246 am

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to liquor licenses, fees, and municipal
regulation of the sale of intoxicating liquor."

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

* Section 1. AS 04.10.110 is amended to read:

Sec. 04.10.110. WHOLESALE LICENSE. (a) The holder of a general
wholesale license may sell intoxicating liquors in the original package,
and wine in bulk, in quantities of not less than five wine gallons to
holders of licenses. The holder of a general wholesale license may not
sell to a consumer. Liquor requiring internal revenue strip stamps
shall have the stamps intact on the package. A general wholesale li-
cense shall be required for each distributing point. The general
wholesale license fee schedule is based upon the total amount of busi-
ness transacted during any year and is \$500 as a minimum license fee,
to accompany the application, and in payment of the fee for the first
\$50,000 of business transacted, and, in addition thereto, a sum equal
to one percent of the business transacted during the year for which
the license is issued. [ON THE BUSINESS TRANSACTED DURING ANY YEAR,

ABOVE \$50,000 AND NOT OVER \$75,000	A FEE OF \$ 250
ABOVE \$75,000 AND NOT OVER \$100,000	A FEE OF \$ 500
ABOVE \$100,000 AND NOT OVER \$125,000	A FEE OF \$ 750
ABOVE \$125,000 AND NOT OVER \$150,000	A FEE OF \$1000
ABOVE \$150,000 AND NOT OVER \$175,000	A FEE OF \$1250
ABOVE \$175,000 AND NOT OVER \$200,000	A FEE OF \$1500
ABOVE \$200,000 AND NOT OVER \$250,000	A FEE OF \$2000

1 ABOVE \$250,000 AND NOT OVER \$300,000 A FEE OF \$2500
 2 ABOVE \$300,000 AND NOT OVER \$350,000 A FEE OF \$3000
 3 ABOVE \$350,000 AND NOT OVER \$400,000 A FEE OF \$3500
 4 ABOVE \$400,000 AND NOT OVER \$500,000 A FEE OF \$4500
 5 ABOVE \$500,000 A FEE OF \$5000]

6 (b) The holder of a wholesale malt beverage and wine license may
 7 sell malt beverages and wine in the original packages and malt beverages
 8 and wine in bulk in quantities of not less than five wine gallons to
 9 holders of licenses. The holder of a wholesale malt beverage and wine
 10 license may not sell to a consumer. The malt beverages and wine license
 11 fee schedule is based on the total amount of business transacted in any
 12 year and is \$100 as a minimum license fee, to accompany the application,
 13 and in payment of the fee for the first \$10,000 of business transacted,
 14 and, in addition, a sum equal to one per cent of the business transacted
 15 during the year for which the license is issued. [ON THE BUSINESS

16 TRANSACTED DURING ANY YEAR,

17 ABOVE \$10,000 AND NOT OVER \$25,000 A FEE OF \$ 150
 18 ABOVE \$25,000 AND NOT OVER \$50,000 A FEE OF \$ 500
 19 ABOVE \$50,000 AND NOT OVER \$75,000 A FEE OF \$ 750
 20 ABOVE \$75,000 AND NOT OVER \$100,000 A FEE OF \$1000
 21 ABOVE \$100,000 AND NOT OVER \$150,000 A FEE OF \$1500
 22 ABOVE \$150,000 AND NOT OVER \$200,000 A FEE OF \$2000
 23 ABOVE \$200,000 AND NOT OVER \$300,000 A FEE OF \$3000
 24 ABOVE \$300,000 AND NOT OVER \$400,000 A FEE OF \$4000
 25 ABOVE \$400,000 A FEE OF \$5000]

26 * Sec. 2. AS 04.10.200 is repealed and re-enacted to read:

27 Sec. 04.10.200. PUBLIC NOTICE. The board shall provide by regu-
 28 lation for adequate notice to inform the public of a proposed issuance
 29 of a new license or reissuance, renewal or transfer of an existing

1 license. The notice shall be bilingual when necessary. Notice shall
2 be given by posting at the location of the premises, at the nearest post
3 office, and at one other conspicuous location in the area for a period
4 of at least 10 days a true copy of the application and by published
5 notice by newspaper, radio and television. Where published notice is
6 not feasible the board may make such exemptions from the requirement of
7 publication as required.

8 * Sec. 3. AS 04.10.300 is repealed and re-enacted to read:

9 Sec. 04.10.300. PROTEST IN AREAS OUTSIDE MUNICIPALITIES. (a) An
10 adult resident in an area outside a municipality who desires to protest
11 the issuance, reissuance, renewal or transfer of any and all licenses
12 for an establishment or establishments within two miles of his permanent
13 place of abode or within the established village in which his permanent
14 place of abode is located shall serve upon the applicant and the board a
15 written statement of the reasons for his protest. Upon the receipt of
16 the protest, the board may give notice and hold a hearing in the area
17 in which the protestant resides, at which all persons interested may
18 be heard.

19 (b) If the protest is made in writing to the board by at least 35
20 per cent of the adult residents having a permanent place of abode within
21 the established village where the licensed premises is situated or is to
22 be situated and within two miles of the established village, a special
23 election conducted by the Department of Community and Regional Affairs
24 held within the village is mandatory. If at the election the majority
25 of the adult residents having a permanent place of abode within the
26 established village and within two miles of the established village
27 object to issuance, reissuance, renewal or transfer, the board may not
28 issue, reissue, renew or transfer any licenses in, or within two miles
29 of, the established village.

1 (c) If the licensed premises is situated or is to be situated
2 outside a municipality or established village and at the hearing the
3 majority of the adult residents having a permanent place of abode within
4 two miles of the premises object to issuance, reissuance, renewal or
5 transfer, the board may, if in its opinion the public interest will be
6 served by the refusal or if other grounds for refusal exist by law,
7 refuse to issue, reissue or transfer the license.

8 (d) For purposes of this section, an "established village" means
9 an unincorporated area where at least 25 people reside as a social unit,
10 as determined by the Department of Community and Regional Affairs.

11 * Sec. 4. AS 04.10.350(a) is amended to read:

12 (a) A license issued under this chapter is renewable automatically
13 if the fee is paid in accordance with secs. 40 - 140 of this chapter,
14 except as provided in sec. 300 of this chapter or except in the case of
15 conviction of the licensee under AS 04.15.100, pending the outcome of a
16 board hearing or judicial determination as to the legality of issuing
17 the license, or in the case of a lawful revocation in which event the
18 license is renewable only as provided by law and regulation.

19 * Sec. 5. AS 04.15.070(a) is amended to read:

20 (a) A municipality may by ordinance provide rules and regulations
21 governing the barter, sale and possession of intoxicating liquor within
22 the municipality necessary to the orderly conduct of the business of
23 selling intoxicating liquor. When, under a local option election, the
24 city clerk finds the majority of the voters are against the sale of
25 intoxicating liquor, the municipality, by ordinance, may make the sale
26 of intoxicating liquor within the municipality a misdemeanor whether
27 the sale is made pursuant to license or otherwise. The ordinance may
28 not be inconsistent with this title or the rules and regulations pro-
29 mulgated under this title. No municipality may impose taxes other than

property taxes on liquor inventories and sales taxes on liquor sales
when these taxes are levied on other property and sales within the
municipality.

APPENDIX No. IV

GENERAL WHOLESALE LICENSE FOR 1975

Locations of Warehouses

	Seattle	Anchorage	Fairbanks	Soldotna
(O/S Wash) Alaska Distributors	x	x	x	
(O/S Wash) K & L Distributors	x	x	x	x
(O/S Wash O) Anchorage Cold Storage		x		
(O/S Wash O) Odom			x	
(O/S Wash O) West Coast Distributors	x	x	x	

Malt-Beverage

	Juneau	Sitka	Ketchikan
(O/S Wash) K & L Distributors	x		
(O/S Wash O) Odom	x		x
(O/S Wash O) West Coast Distributors	x		
(O/S Wash O) West Coast Grocery			x

	Anchorage	Sitka	Palmer	
Domestic Alaska Bay Corp.	x			General
Domestic Aregah	x			General
Domestic Mosesian Vinters			x	Malt
Domestic Service Transfer		x		Malt (Oly)

Definitions

There are two different classifications for wholesale licenses in the State of Alaska, 1) general wholesale licenses and 2) wholesale malt beverage and wine licenses. They are defined as follows:

(1) The holder of a general wholesale license may sell intoxicating liquors in the original package, and wine in bulk, in quantities of not less than five wine gallons to holders of licenses. A general wholesale license shall be required for each distributing point. The general wholesale license fee schedule is based upon the total amount of business transacted during any year and is \$500 as a minimum license fee and is in payment for the first \$50,000 of business transacted, and in addition, thereto, a rising scale up to but not over \$5,000 in excess fees may be charged based on gross sales.

(2) The holder of a wholesale malt beverage and wine license may sell malt beverages and wine in the original packages and malt beverages and wine in bulk in quantities of not less than five wine gallons to holders of licenses. The malt beverages and wine license fee schedule is based on the total amount of business transacted in any year and is \$100 as a minimum license fee, and based on the first \$10,000 of business. Excess fees on a rising scale extend to \$2,000 but not over and are attached to a \$200,000 figure.

It is to be noted that both of these licenses are restricted by law in that they, the licensees, may not sell to a consumer.

APPENDIX No. VI

The following people were contacted and have contributed their expertise to this report:

The Department of Revenue

Commissioner Sterling Gallagher - income tax
Mr. Bob Stevenson - excise tax
Ms. Eddie Price - income tax
Mr. Bob Mitchell - multistate compact
Mr. Fred Boetsch - excise tax

Alcohol Beverage Control Board

Ms. Linda Brown - ABC director

Legislative Affairs - Anchorage

Mr. Bill McGuire - source material

Senate Finance Committee

Copies of Legislative hearings

Federal Court System

U. S. Attorney - antitrust suit in 1973

Anchorage Cold Storage

Mr. Bob Winslow - manager

K & L Distributor, Inc.

Ms. Winifred Nordquist - exec. sec.

Alaska Distributors, Inc.

Mr. Jim Reckie - manager

Alaska Department of Revenue - Seattle Division

Mr. Albert Huntz - Manager, Seattle Field Office
Mr. Bob Loe - C. P. A. Revenue Field Auditor II

Washington State Liquor Control Board

Mr. Abraham Garcia - Warehouse Superintendent
Mr. James E. Hoing - Accounting Division, Controller

Odom Corporation in Seattle

Mr. Brooks Hanford - Lobbyist

PLEASE NOTE: THE PRECEDING PAGES WERE TREATED
AS A UNIT IN THE ORIGINAL DOCUMENT.

**ALASKA
STATE LEGISLATURE**

MEMORANDUM

January 8, 1976

TO: Senator John Huber
Chairman, Interim Committee on Taxation and Revenue

FROM: Franklin D. Fleeks
Committee Tax Counsel

SUBJECT: Staff Analysis of Possibility of Taxing Short
Term Land Gains

This staff analysis is submitted for the Committee's information and guidance in this area. It is hoped that it will serve as a working document and that the Committee members will inform the staff if further efforts should be expended in this area.

AGO 529768 +

Introduction

With the advent of the Transalaska Pipeline momentous changes have taken place in the Alaskan real estate market. Around each area impacted by the pipeline there have been huge increases in the price of land. Filing of plats for new subdivisions within the commuting areas of the major Alaskan population centers has also increased. We have also noted the large purchases of land in the Matanuska, Kenai, Homer and Fairbanks areas by so-called investors for purely speculative purposes.

This activity has caused increased social costs to the cities and boroughs and hampered rational land use development. It has also resulted in the reaping of large windfall profits through the rapid turnover of the land. In order to reach these windfall profits the staff has researched what other states and countries have been doing. The initial investigations were done by staff member Terry Berman. Contacts were initiated with Jonathon Rowe of the Public Citizen Tax Reform Research Group, and Jamie Love of Alaska Public Interest Research Group, and the Ontario Ministry of Treasury Economics and Intergovernmental Affairs. This staff analysis is submitted for your information and guidance in this area.

Policy Arguments

Uncontrolled land speculation is associated with increases in the price of land, depletion of open space, premature and unplanned development, and windfall profits. These factors present the state and its

local communities with problems in the social, economic and environmental spheres. One policy argument was stated succinctly in an article in the Washington Law Review which said:

"In a speculative land market, land profits often include an unearned increment - an increase in value not attributable to the seller's efforts but to events outside his control . . . A major goal of land value increment taxation . . . is to minimize this unearned increment or recapture it so that it may inure to the benefit of society generally rather than solely to individuals . . . " ¹

The unearned increment referred to above usually translates into windfall profits for the speculator. One definition of windfall profits is that it is ". . . gain which exceeds what prevailing standards of economic morality suggest is a fair return from a particular investment or activity . . ." ² It is not enough to define windfall profits, criteria must be set to analyze them. The same author states:

". . . windfall gain is judged excessive by reference to two criteria: the amount of capital or labor expended in the investment or activity, and the social benefit arising from that activity. By the first criteria, a gain is unjustified when it is unearned; by the second, it is unjustified when it is realized without corresponding public benefit, or perhaps at the public expense . . ." ³

Another policy argument is regulatory in nature. The tax would limit profits from speculation discouraging rapid turnover of land. This would enhance the ability of the governmental units to foster better land use development.

Review of Current Statutes

Only one state, Vermont, currently has a comprehensive statute covering this area. Connecticut has a generalized statute which attempts to curtail some speculative activity. Other comparable legal systems having real estate gains taxes are the United Kingdom, Ontario (Canada), Australia and New Zealand. Only Vermont will be discussed here. In the appendix is an excerpt from an article which gives a synopsis of the others, and also a copy of a letter from Ontario.⁴ It should also be noted that Montana and Washington also had this type of bill introduced in their 1975 sessions.

The Vermont "Tax on Gains from the Sale or Exchange of Land" is based on progressive rates that range from 60 percent, if land is held for less than a year, down to 10 percent if land is held five years but less than six years. After six years there is no tax. The tax only applies to land. Allocation must be made on gains from sales of land containing buildings and other structures. A maximum residential exemption of five acres is also provided. There is no allowance for losses to be offset against the gains.

Conclusion

Due to the accelerated growth of Alaska, windfall profits are being made from short term speculation in Alaska lands. This speculation

Land Gains Tax
January 8, 1976
Page 5

9
burdens the state and its instrumentalities with social costs attributable to that speculation. A tax modeled on the Vermont tax can serve to regulate this use of Alaskan land by limiting profits which will discourage rapid turnover and also serve as a revenue producing device to help pay for the social cost. If you believe further research should be done in this area, please inform the staff.

AGO 529772

Footnotes

1. M. M. Teachout, State Taxation - Use of Taxing Power to Achieve Environmental Goals: Taxes Gains Realized From the Sale or Exchange of Land Held Less Than Six Years, 49 Wash. L. Rev. 1159.
2. Teachout, supra.
3. Teachout, supra.
4. R. Lisle Baker, Controlling Land Uses and Prices by Using Special Gain Taxation to Intervene in the Land Market: The Vermont Experiment, 4 Environmental Affairs, 427.

Appendix

<u>Item</u>	<u>Number</u>
Vermont Statute, Tax on Gains from the Sale or Exchange of Land	I
Excerpt of other comparable legal systems	II
Letter from Ministry of Treasury, Economics and Intergovernmental Affairs	III
Report of staff member, Terry Berman	IV

Chapter 236. Tax on Gains From the Sale or Exchange of Land

SECTION

- 10001. Tax imposed.
- 10002. Land.
- 10003. Rate of tax.
- 10004. Sale or exchange.
- 10005. Basis, gain and holding period.
- 10006. Liability for tax.
- 10007. Withholding at source; payment.
- 10008. Installment sales.
- 10009. Administration of tax.
- 10010. Criminal penalties.

§ 10001. Tax imposed

There is imposed, in addition to all other taxes imposed by this title, a tax on the gains from the sale or exchange of land in Vermont.—Added 1973, No. 81, § 8, eff. May 1, 1973.

§ 10002. Land and residences

(a) "Land" means all land, whether or not improved, but does not include land, not exceeding five acres, necessary for the use of a dwelling used by the taxpayer as his principal residence. Buildings or other structures are not included in this definition of land.

(b)(1) Also excluded from the definition of land of subsection (a) of this section is the land, not exceeding five acres, necessary for the use of a dwelling which is to be used as the purchaser's principal residence. As used in this section "purchaser's principal residence" means the principal dwelling of a person whose domicile is or will be established in the state of Vermont. This exclusion from the definition of land shall not apply unless the purchaser first executes, upon a form supplied by the commissioner of taxes, a certification that he is domiciled in Vermont or will be within sixty days, that the dwelling to be purchased will be used as his principal residence, and that he understands that as a Vermont domiciliary all of his income is subject to the jurisdiction of Vermont income tax laws.

(2) Additionally, where there is not on the land a dwelling completed and fit for occupancy as the purchaser's principal residence at the time of the transfer of title to the land so excluded from the definition of land:

(A) The purchaser shall certify that the dwelling shall commence to be constructed within one year of the date of transfer of title to the land and that it will be completed and occupied within two years from the date of such transfer.

(B) The deed or other transfer instrument shall state that the amount of the tax of which the transferor has been relieved by virtue of the purchaser's certifications is a lien running with the land in favor of the state of Vermont until either the amount of such tax has been paid or the purchaser has filed with the commissioner a statement under the penalties of perjury that the dwelling was constructed and occupied within the terms and conditions previously certified.

(3) In cases where the commissioner determines that any of such certifications were untrue, he shall collect from the buyer the tax upon the profit allocable to the wrongfully excluded land.

(c) If zoning or similar laws or regulations require a minimum of more than five acres for residential property, that number of acres, instead of five acres, shall be excluded from the definition of land under subsections (a) and (b) of this section, except that not more than ten acres shall be so excluded.

(d) Also excluded from the definition of land of subsection (a) of this section is the land owned by a development corporation or local development corporation as defined in Title 10, section 252(4) and section 302(4).—Added 1973, No. 81, § 8, eff. May 1, 1973; amended 1973, No. 209 (Adj. Sess.), eff. July 1, 1974.

1973 (Adj. Sess.) amendment. Amended section generally to adjust acreage surrounding a principal dwelling to reflect local zoning requirements; and to clarify transactions under which no gain is recognized.

§ 10003. Rate of tax

The tax imposed by section 10001 of this title shall be based upon the years held at the following rates on the gain, as gain is determined under section 10005 of this title:

Years land held by transferor	*Gain, as a percentage of basis (tax cost)		
	0-99%	100-199%	200% or more
Less than 1 year	30%	45%	60%
1 year, but less than 2	25%	37.5%	50%
2 years, but less than 3	20%	30%	40%
3 years, but less than 4	15%	22.5%	30%
4 years, but less than 5	10%	15%	20%
5 years, but less than 6	5%	7.5%	10%

—Added 1973, No. 81, § 8, eff. May 1, 1973.

* Gain, as percent of basis, shall be rounded to the next highest whole percentage.

1. Constitutionality. It was not the function of the Vermont Supreme Court to pass upon validity of the legislative concern over land use and development or the wisdom of the means the legislature chooses to deal with it, in reviewing the constitutionality of land gains tax imposed by this chapter, but merely to determine whether the legislature may have acted in response to such a concern and whether, in so doing, it acted within its constitutional bounds. *Andrews v. Lathrop* (1974) 132 Vt. 256, 315 A.2d 860.

In action attacking constitutionality of tax imposed by this chapter, court would not hold that legislature could not have properly acted to restrict land speculation by means of the tax structure. *Id.*

2. Purpose. That tax imposed by this chapter taxes profits in sales of real property, to a decreasing degree as period of land retention increases and to an increasing degree as profit increases, is alone sufficient, for constitutional purposes, to support view that legislature could have had as a purpose the deterrence of land speculation. *Andrews v. Lathrop* (1974) 132 Vt. 256, 315 A.2d 860.

§ 10004. Sale or exchange

(a) As used in this chapter "sale or exchange of land" shall mean any transfer of title to land for a consideration. As used in this chapter "transfer" and "title" shall have the same meaning as "transfer" and "title to property" as used in section 9601 of this title, except as modified or enlarged by explicit provisions of this chapter and as limited herein to land. The transfer of an option for the sale or exchange of land shall be considered a transfer of title to land for the purposes of this chapter.

(b) Contracts for the sale of land constitute sales or exchanges of land for all purposes of this chapter. However, contracts shall not constitute sales or exchanges until some consideration has passed thereunder to or for the benefit of the seller or exchanger. The sale or exchange is considered to take place at the time any consideration whatsoever, of whatever nature, first passes under the contract. A mere promise to purchase, and amounts paid as earnest money, or amounts paid in deposit or amounts paid in escrow to which the seller has no immediate right, do not constitute the passing of consideration for the purposes of this chapter.

(c) Any sale or exchange of shares in a corporation or other entity, or of comparable rights or property interests in any other form of organization or legal entity, which effectively entitles the purchaser to the use or occupancy of land constitutes a sale or exchange of land.—Added 1973, No. 81, § 8, eff. May 1, 1973.

§ 10005. Basis, gain and holding period

(a) The provisions of the Federal Internal Revenue Code shall determine the basis (tax cost) of land sold or exchanged.

(b) The amount realized from the sale or exchange shall be the full actual consideration therefor, paid or to be paid, including the amount of any liens or encumbrances on the land existing before the sale or exchange and not removed thereby. The amount realized from the sale or exchange shall be the gross amount thereof, reduced by any expenses of sale and commissions. In the event that a sale includes land and buildings or other structures, the amount realized shall be allocated between the land and the buildings or other structures on the basis of fair market value.

(c) The taxable gain from the sale or exchange is the amount realized minus the basis (tax cost) of the land as determined under subsection (a) of this section. No gain shall be recognized in cases where gain is not recognized under the Federal Internal Revenue Code, as amended, in relation to the sale or exchange of capital assets.

(d) The land sold or exchanged shall be deemed to have been held as determined under the Federal Internal Revenue Code. However, as to any person whose holding period is claimed by the seller or exchanger, such holding period shall not exceed the time for which such person has had actual and recorded title thereto in his own name, and shall include the time the land was so held prior to the effective date of this chapter. If a husband and wife are tenants by the entirety there may be added to the holding period the amount of time the land was held by one spouse alone before that spouse created the tenancy by the entirety. Notwithstanding any provision to the contrary under the Federal Internal Revenue Code, if a tenancy by the entirety is dissolved by reason of death, the holding period during the tenancy by the entirety will be added to the holding period of the surviving spouse owning the property in his or her own name. In the case of a gift, the holding period of the donee shall include the time that actual and recorded title was held by the donor.

(e) The taxable gain under this chapter from the sale or exchange of land shall not be reduced by any losses incurred in other transactions.—Added 1973, No. 81, § 8, eff. May 1, 1973; amended 1973, No. 187 (Adj. Sess.), eff. March 30, 1974.

1973 (Adj. Sess.) amendment. Subsection (d): Second sentence rephrased and added fourth sentence relating to a tenancy by the entirety dissolved by reasons of death.

§ 10006. Liability for tax

The person liable for the tax is the transferor (which includes the owner, seller, or other exchanger) of the land sold or exchanged.—Added 1973, No. 81, § 8, eff. May 1, 1973.

§ 10007. Withholding at source; payment

(a) The buyer or transferee of any land held by the seller or transferor for less than six years, shall withhold ten per cent of all consideration paid to the seller or transferor for such land, including ten per cent of all partial payments made pursuant to installment sales under section 10008 of this title. At the time any payment is made to the seller or transferor, the amounts withheld shall be remitted to the commissioner of taxes.

(b) Within 30 days of the sale or exchange of land, for which withholding is required under this section, the seller or transferor shall file a return with the commissioner of taxes setting forth the amount of the tax due pursuant to section 10003 of this title and the amount withheld by the buyer or transferee pursuant to subsection (a) of this section. The seller shall either remit with the return the balance of the tax due or make claim for a refund. Any refund not made by the commissioner within 15 days of receipt by him of a valid claim shall accrue interest at the rate of one-half of one per cent per month. For good cause shown and upon conditions set by him, the commissioner may extend the time for filing the return and paying the tax required by this chapter.

(c) Notwithstanding either subsection (a) or (b) of this section, the seller or transferor may, in advance of the sale or exchange, pay the tax imposed by this chapter or obtain a written ruling from the commissioner of taxes that no tax is due under this chapter. In either case the commissioner shall certify to the seller or transferor that such payment has been made or that no tax is due. Upon receipt by the buyer or transferee of such certification from the seller or transferor, the buyer or transferee shall not be required to withhold under subsection (a) of this section.

(d) All taxes required to be paid or withheld under this chapter shall constitute a personal debt of the person liable to pay or withhold the same to the state of Vermont to be recovered in an action on this statute.

(e) An action may be brought to recover the amount of the taxes to be paid or withheld in the manner prescribed for recover-

ing amounts owed for taxes under chapter 151 of this title. The amount of taxes to be paid or withheld shall be a lien in favor of the state of Vermont upon all property and rights to property, whether real or personal, belonging to the person liable for the tax or for the withholding. The lien shall be enforced in the manner prescribed by section 5895 of this title.—Added 1973, No. 81, § 8, eff. May 1, 1973.

§ 10008. Installment sales

(a) For the purpose of this section "installment sale" means sale or exchange of land as defined in section 10004 of this title for which the total tax due under this chapter is greater than \$2,000.00 and in which the parties agree in advance that payments shall be received by the seller or transferor in more than one installment on a date or dates other than the date of closing. A sale financed by a mortgage, deed of trust, or other financing arrangement in which the seller or transferor is paid in full on the date of the sale or exchange shall not be considered an installment sale. A lease-purchase agreement under which any part of the rental payments constitute a portion of the purchase price of the land shall be considered an installment sale, and for the purposes of this chapter the end of the holding period with respect to the sale or exchange shall be determined as of the date of the agreement.

(b) Notwithstanding any provision of law to the contrary, the tax under this chapter on any installment sale shall be due within 30 days of the date of payment of each installment paid to the seller or transferor. However, except for the first installment the seller or transferor may elect to file his return as part of his Vermont income tax return for any year in which subsequent installments are paid or due, and to pay the balance of such tax as part of such income tax; provided that, if the seller or transferor elects to file annual returns no interest shall accrue on any withholding as provided by section 10007 (b) of this title.

(c) In an installment sale, the total amount of taxes due under this chapter shall be the amount that would have been due had the total purchase price been paid on the date the sale or exchange took place. The amount of taxes due on each separate installment, including the first installment, shall bear the same proportion to the total amount of taxes due as the amount of that installment bears to the total consideration.—Added 1973, No. 81, § 8, eff. May 1, 1973.

§ 10009. Administration of tax

(a) The commissioner of taxes shall administer and enforce this chapter and this tax. He may issue, amend, and withdraw from time to time, reasonable regulations to assist such administration and enforcement.

(b) All the administrative provisions of chapter 151 of this title, including those relating to the collection and enforcement by the commissioner of the withholding tax and the income tax shall apply to the tax imposed by this chapter.—Added 1973, No. 81, § 8, eff. May 1, 1973.

§ 10010. Criminal penalties

(a) Any person who wilfully defeats or evades or attempts to defeat or evade the tax imposed by this chapter shall be imprisoned not more than one year or fined not more than \$10,000.00 or five times the amount of the tax defeated or evaded or attempted to be defeated or evaded, whichever is larger, or may be both thus imprisoned and fined. A corporation or other taxable entity not being a natural person shall be subject to the fine provided by this section.

(b) Any officer, employee, director, trustee or other responsible person of a corporation or other taxable entity, and any other person, who counsels, aids, abets, participates in, or conceals the defeat or evasion of tax, or the attempt thereat, shall be subject to the penalties of subsection (a) of this section.

(c) The form for the payment of the tax under this chapter shall set forth in large type the penalties provided by this section.—Added 1973, No. 81, § 8, eff. May 1, 1973.

TABLES AND INDEX

CONSULT POCKET PART TO VOL. 9

December 10, 1975

TO: Senator John Huber
FROM: Terry Berman
SUBJECT: Land Gains Tax

The land gains tax, as enacted by the Vermont legislature in 1973, is a tax on profits made from short-term land holdings. One of the major reasons for the tax is the myriad of problems associated with land speculation. These include windfall profits, increases in land prices, increases in property taxes, depletion of open space, premature and unplanned development, and overall increases in the costs of goods and services.

It must be emphasized that only holdings of less than six years are subject to taxation. This includes only gains on land, exempting the first acre of land on which a principal residence is found. The rate of taxation is on a sliding scale, increasing directly with the percentage profit and inversely with the length of the holding. The longer one holds the land, the less she pays in taxes. Leaseholds of 99 years or longer are treated as transfers and subject to the tax.

The tax has two functions: 1) as a regulating device and 2) as a source of revenue. As a regulatory device, it discourages the rapid turnover of land. Speculators may find that the costs of holding land are not worth it. Subdividers will only want to subdivide if there is a ready market for homes. In turn, this leads to larger lot sizes, to less division and unnecessary development of land. The problems mentioned above (increased land prices and property taxes, accelerated and inefficient development, loss of community aesthetic wealth, and windfall profits) may be avoided.

The Vermont tax as a source of revenue creates a new basis for taxation by states. It hits those who have the capacity to pay at a time when they have liquid assets available for taxation.

Land Gains Tax
December 10, 1975
Page 2

In Vermont, the tax was expected to yield between 1 and 1.5 million dollars in the first year, which would be about one percent of the total state revenue. This indicates that its function as a source of revenue has proved valuable.

There are several improvements that can be made on the Vermont tax if such a tax is considered by the Legislature. First, there should be an adjustment for inflation. Second, the distinction between land and structure needs to be clarified in terms of the gains made. Third, an exemption for land actively used in agriculture (which was included in a similar bill in Washington State) should be considered.

With such a tax, some of the social costs of unplanned growth and speculation may be shifted back to the speculator.

TB/kb



III

Ontario

Ministry of Treasury
Economics and
Intergovernmental
Affairs
(965-6869)

Queen's Park
Toronto Ontario
4th Floor,
Frost Bld. S.

December 12, 1975

Mr. Terry Berman,
Administrative Research Analyst,
Special Committee on Taxation
and Revenue,
Alaska State Legislature,
Senate,
Pouch V,
Juneau,
Alaska 99811

Dear Mr. Berman,

I enclose per your request copies of the Land Speculation Tax and Land Transfer Tax Acts. These statutes have been in force for some 20 months and each has been substantially amended once.

On April 9th, 1974, the Ontario Government began to tax land speculation and non-resident purchases of Ontario land. If you will bear with me, I will attempt to provide some of the background to these taxes as to why they were considered necessary and what our experience with them has been to date.

The Land Speculation Tax

Land and consequently housing prices had been rapidly escalating in Ontario since 1968. At one point in 1973, the escalation rate was 40% per year. There are of course several factors which contribute to this behaviour. Among them are a shortage of serviced land, rapid population growth, complexities of local zoning and building permit regulations, general anti-growth sentiment and last but not least simple speculation. Most of these factors are not susceptible to short-term solutions. However, land speculation is, and the Government therefore chose to act in this area.

The Land Speculation Tax is a tax on all land and buildings in the Province of Ontario. The tax is brought to bear where properties are bought and sold without any improvements being added.

AGO 529781 +

There are of course some basic exemptions, these being exemptions for an individual's principal residence, his principal recreation property (and up to 20 contiguous acres) and a special treatment for senior citizens who leave their home to live in nursing institutions but choose not to sell their principal residences at that time.

There are a variety of ways that transactions can become exempt and they are based on percentage content of buildings in the transaction; percentage value of any improvements; in the case of rental accommodation units the length of time the owner has held the property; and of course generous provisions covering family farms. In practice, these allowances work to make all commercial and industrial properties exempt.

A revised special treatment for developers has recently been added to the Act whereby a land owner who complies fully with a municipal plan of subdivision may sell the land to a builder tax free.

With regard to the administration of the tax, there have of course been problems with complexity of legislation, the fact that it is a new tax, points of interpretation and lack of taxpayer knowledge. However, generally the administration has been successful since it was decentralized into the provincial land registry offices in September of 1974.

The rate of tax was originally set at 50% which, when combined with deductibility for income tax purposes, produced maximum effective rates in excess of 80%. However, the Government of Canada has since ruled that the speculation tax is not deductible and therefore the rate has been reduced to 20% which when combined with the income tax can still produce maximum rates in excess of 80%.

You may be aware that several other jurisdictions levy a speculation tax, among them the State of Vermont, New Zealand, Mexico and Israel.

Land Transfer Tax

Because of its comparative attractiveness politically, socially and economically, Ontario has always enjoyed large amounts of foreign money and direct investment. These funds have been a large force in establishing the standard of living we enjoy today. However, with the advent of strong world-wide inflation and various currency problems, Ontario began to attract large quantities of money seeking a haven from inflation. For example, in 1973 alone, one European syndicate (primarily German) invested in excess of \$400

Cont'd....

million in the Southern Ontario area in land and buildings. I must stress that these funds and others like them are not expanding the industrial and employment capacity in Ontario but are simply purchasing existing assets. When these financial pressures are coupled with speculation by residents, the result is an acceleration of already rapidly rising land and housing costs. Accordingly, the Government decided to act to stem this flow of "hot" money as well as attempt to curb domestic speculation.

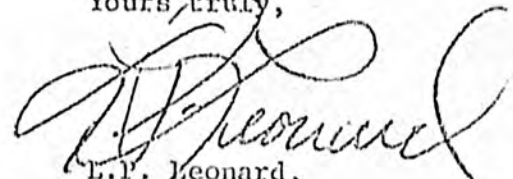
The vehicle chosen for this was the Land Transfer Tax which for residents of Canada is a low tax (3/10 of 1% on the first \$35,000 and 6/10 of 1% on the balance of the purchase price) payable on registration of title. The treatment of non-residents of Canada is to tax their purchases at a 20% rate. I must stress that the statute refers to non-residency of Canada, not Ontario. Any other definitions would be beyond the competence of a province. I must also stress that the tax is based on a need to restrain the inflow of non-productive money and not on xenophobia.

There was never any intention to restrain the flow of non-resident productive investment. However, it was determined at the outset that we would allow the exemption procedure to evolve over the summer of 1974 and to derive the final policy from experience. You will see from the legislation as amended that we seem to have arrived at a fairly workable solution to this problem. While there are still a few problems in the Act, primarily in the area of mortgage foreclosure, generally the system is running smoothly.

Revenue from both statutes has been very low as it should be if each does its job.

I realize my comments are perhaps a little vague. If you or your staff would like more information either generally or on specific details, I or my staff will be pleased to accommodate you.

Yours truly,



L.P. Leonard,
Senior Budget Advisor,
Taxation and Fiscal Policy
Branch

/sr
Encls.

⁶⁸ 32 V.S.A. ch. 231 (1970).

⁶⁹ The major non-taxable transfers are transfers to secure or discharge a debt, and some intra-family gratuitous transfers.

⁷⁰ Letter from Commissioner Robert Lathrop dated October 1, 1974. The tax is self-regulating to a degree. To the extent its land market effects curtail land value appreciation, the staggered rate schedule means less profit may be drawn off by the tax directly. If on the other hand, the effect of the tax is to cause land market effects that add to land value increments, the same rate structure will capture a larger portion for the state.

⁷¹ See NETZER, *ECONOMICS OF THE PROPERTY TAX* 212-13 (1966); REPORT OF THE NATIONAL COMMISSION ON URBAN PROBLEMS, *BUILDING THE AMERICAN CITY*, 391-92 (Douglas Chmn. 1968); Harriss, *Alternative Bases for Real Estate Taxation*, in *PROPERTY TAXES* 219 (1940); Harvith, *Subdivision Dedication Requirements—Some Observations and an Alternative: A Special Tax on Gain from Realty*, 33 ALB. L. REV. 474 (1969); Lent, *The Taxation of Land Value*, 41 INTERNATIONAL MONETARY FUND STAFF PAPERS 89 (1967); Spengler, *The Taxation of Urban Land Value Increments*, 17 JOURNAL OF LAND AND PUBLIC UTILITY ECONOMICS 54 (1941); L. ROSE, *TAXATION OF LAND VALUE INCREMENTS ATTRIBUTABLE TO REZONING* (Econ. Research Center, University of Hawaii, 1971). Walker, *Taxation of Land Value Increases*, 38 TAX POLICY NOS. 8-9 (1971).

Land value increment taxation has been in use for some time outside the Anglo-Saxon countries in Israel, some African and Latin American countries, Denmark and Spain, and Taiwan. See Lent and Netzer, *supra*; communication from Orville F. Grimes, Jr., of International Bank for Reconstruction and Development, Jan. 14, 1975.

⁷² In February, 1974, Representative Ora J. Halvorson introduced into the Montana legislature a modified version of the Vermont tax as House Bill No. 651. After being reported out favorably by the Taxation Committee, it was killed by the House on a 48-39 vote. Representative Halvorson indicates she intends to reintroduce the bill again in some form in the 1975 legislative session. Conversation with Representative Halvorson on July 23, 1974.

House Bill 651, as approved by the Committee on Taxation, was similar to the 1973 Vermont land gains tax (before the 1974 amendments) with several important differences. First, the Montana tax would be collected by a filing of a return and payment of any tax due when the transferor filed his Montana income tax return,

though losses, as in Vermont, would not apparently be available to offset gains. Second, the act would not apply to the sale, lease, or agreement to buy and sell land where the parties to the transaction enter into a covenant running with the land, which is revocable only after a period of at least six years, that the land will be used exclusively for agricultural purposes. Finally, the revenues obtained from the tax would be paid into the general fund, and not earmarked for special purposes as in Vermont.

⁷³ House Bill 502. The agricultural exemption may have questionable utility as a means of preserving farmlands. *See supra* note 67. Also, as in 1973 Vermont legislation, the proposed Washington bill provides a one-acre residential homesite exemption.

⁷⁴ For a readable brief history of the recent emergence of special real estate gain taxes in parts of the Anglo-Saxon World (Vermont), United Kingdom, Canada, Australia and New Zealand *see* D. Hagman and D. Misczynski, Special Capital and Real Estate Windfall Taxes (Screwts)—A Short Story (unpublished paper for the British Columbia Institute for Economic Policy Analysis Conference on the Pricing of Local Services and Effects on Urban Spatial Structure, June 26, 28, 1974, Vancouver, British Columbia, Canada.) The author wishes to acknowledge his debt to Professor Hagman in alerting him to these developments.

⁷⁵ The Land Speculation Tax Act was designed to curb escalating housing costs (close to 2 percent a month, compounded) by attacking land speculation which the government felt artificially fueled land price increases. Conversation on July 18, 1974 with Larry Leonard of the Tax and Fiscal Policy Branch, Ministry of Treasury Economics and Intergovernmental Affairs, Province of Ontario.

As to the Ontario tax itself, with one exception discussed below, there is no abatement for the length of time the land was held by the transferor.

Like the 1974 Vermont Tax, the Land Speculation Tax exempts the primary residence of the transferor, but it also extends that exemption to include transfers of the transferor's principal recreational property and up to 20 acres of surrounding land, unless the disposition is to a non-resident person as defined in Land Transfer Tax Act, 1974. (Ontario also enacted the Land Transfer Tax Act, 1974, which provides for a tax of twenty percent of the consideration paid for any transfer to or in trust for any transferee who is a nonresident. Statutes of Ontario, 1974, Chapter 8, as amended by 1974, Chapter 16. The tax was aimed at deterring foreign investment which had escalated the cost of Ontario land, especially in the To-

ronto Area. Conversation with Larry Leonard, *supra*).

Like the proposed Montana legislation, the Ontario tax attempts to protect agricultural transfers, providing an exemption for land actively used in farming which is disposed of to a member of the transferor's family or to a farming corporation for the purpose of enabling the transferor to carry on farming.

Instead of providing a blanket exemption for structures, like Vermont, the Land Speculation Tax provides total exemption if the sale involves structures meeting certain specific criteria. For example, the disposition is exempt if it involves land on which the structures were constructed or renovated by the transferor, and such improvements meet certain threshold values, or land on which the structures account for 40 percent or more of the sale proceeds and are used for commercial, industrial or tourist resort purposes. Tax Act, Sections 1.-(1)(b); 4.(9); 4.(d).

Apartment rental property disposed of after April 9, 1977, constituting 40 percent of a parcel's fair market value, qualifies for a thirty percent reduction in the tax with an additional ten percent reduction for each year thereafter during which the property is held without disposition. Tax Act, Section 20.(1) and (2). This provision constitutes the closest analogue to the long term holding exemption provided by the Vermont rate schedule.

Finally, dispositions of subdivided land are exempt if the transferor assumes the liability for the tax and begins construction on at least half of the lots sold to him within nine months and on the remainder within eighteen months.

⁷⁸ On August 22, 1973 New Zealand enacted the Property Speculation Tax Act, 1973 (No. 18) applying to dispositions taking place after June 15 of that year.

The Act, as implied from its name, was designed to penalize property speculation which was not defined in the Act but has been defined by the inland revenue department as "the trafficking in land with a view to short term profits and without having contributed any worthwhile improvements in the period between purchase and sale." HEAD OFFICE, INLAND REVENUE DEPARTMENT, PROPERTY SPECULATION TAX EXPLANATORY NOTES AT 1. (November, 1973).

Unlike Vermont, but like Ontario, the Property Speculation Tax defines land to include structures on the land. Section 2(1). INLAND REVENUE DEPARTMENT, PROPERTY SPECULATION TAX EXPLANATORY NOTES at 1 (November, 1973).

Also like Ontario, the New Zealand Tax contains exemptions for certain land in which the transferor has constructed improvements

or undertaken renovation of certain threshold costs. Section 20 (no express provision applying to subdivision).

Like Vermont (as amended) the New Zealand Act provides an exemption for transfers of land acquired for the purpose of occupancy or construction of a residence, (provided profit was not a motive) though there is no requirement of construction within a limited time. The act also exempts certain transfers of business property (other than property involved in the business of land development). Section 19.

Finally, unlike Vermont, the New Zealand tax provides that losses arising from short term dispositions of land may offset subsequent gains until the loss is exhausted. Section 10.

⁷⁷ The British Finance Act 1974 contained a complicated set of provisions designed to tax certain gains arising on the disposal of land and buildings at ordinary income rather than more favorable capital gains rates. In addition to other exemptions where the total proceeds of all disposals of land and buildings by an individual in a tax year do not exceed £10,000, no part of the new gains would be subject to the special tax. Sections 38 and 39.

⁷⁸ 315 A.2d 860, 865-66 (Vt 1974). On the enactment issue, the Vermont Supreme Court held that since the trial court had found that the primary purpose of the land gains tax was to raise revenue to fund the tax relief program, it need not have originated in the House, since only "revenue bills" enacted to produce general revenue were required to originate there. The court also noted that since the revenue-raising provisions were germane to the subject matter of the whole bill, they could properly have been raised for consideration as an amendment by the Senate.

Appellants had also claimed that the tax was unconstitutionally discriminatory.

Their first two claims were: (1) that the one-acre residential exemption had discriminatory effects on rural landowners (since rural zoning regulations often required a five-acre minimum residential lot), and (2) that nonresidents were discouraged from purchasing property subject to the gains tax. (This latter argument is discussed in more detail below in the text.) The court found that appellants had failed to introduce any evidence to establish that such discrimination occurred.

Appellants next argued that sellers were already burdened with a Vermont income tax on gains derived from the sale or exchange of capital assets, including land. To this the court responded that the legislative intent to burden those already taxed was clear.

**ALASKA
STATE LEGISLATURE**

MEMORANDUM

TO: Special Committee on Taxation and Revenue DATE: January 9, 1976

FROM: Ed Sterner

RE: Effect of price control provisions of the Federal
"Energy Policy and Conservation Act" on Alaska state revenues

- I. Brief description of Act's price provisions pertaining to Alaska
- II. Possible effects of the price provisions on Alaska per barrel prices
- III. Affects of possible price levels on Alaska State Revenues

I. Price provisions pertaining to Alaska

Sections 401, 402 and 403 of the "Energy Policy and Conservation Act of 1973" pertain to the control of oil prices.

These provisions have been added to the "Emergency Petroleum Allocation Act of 1973." Section 401 adds two new sections numbered 8 and 9. The provisions critical to Alaska are contained under Section 8(a), (b), (d), (e), (f) and (g). Sections 402 and 403 make technical and administrative adjustments which are not of critical concern for this review.

Section 8(a) extends price controls for 40 months, beginning January of 1976, and mandates an initial average price for U. S. production of \$7.66 per barrel. Section 8(b) provides for the continuation of "old" and "new" oil price differentials. "Old" oil prices may be increased only if the President can provide evidence showing that increased prices will encourage continued production in fields still regulated by "old" prices. As long as "old" oil prices are kept below \$7.66, "new" oil may be sold at a higher price to ensure an average price of \$7.66.

Sections 8(d), (e) and (f) provide for inflation and production incentive increases in the average price of \$7.66 per barrel. In any year the President may raise the \$7.66 price to compensate for inflation.

He may also increase the price an additional 3 percent to encourage additional production. The total price increases may not exceed ten percent in any year without being subjected to Congressional review.

Section 8(g) requires the President to submit a report to Congress on arctic petroleum production on April 15, 1977. If this report indicates that special regulations are needed for arctic petroleum development, Congress may exclude up to 2 million barrels of crude oil per day transported through the trans-Alaska pipeline from the \$7.66 average price figure.

According to Section 8, at least the first 22 months of the Prudhoe Bay oil production will be regulated according to the average price control level (plus a possible 3 percent real increase each year) unless exempted by special provision.

II. Effect of price provision on Alaska oil prices

It is estimated that if "old" oil prices are continued at the current \$5.25 level, "an initial ceiling price of approximately \$11.28 per barrel could be applied to new oil," (Conference Report, Senate Report No. 94-516, p. 190). Prudhoe Bay oil will increase the quantity of new oil by 1.5 to 2.0 million barrels per day. In order to maintain the national average price at \$7.66 (in 1975 dollars), the average new oil price will have to fall to around \$10.07 a barrel. If 2 million barrels per day of additional new oil is found in other areas of the United States, new oil prices would have to fall to \$9.27. If "old"

oil prices are allowed to rise, the "new" oil prices would have to fall even more. Should "old" oil prices be allowed to rise to the average price, "new" oil would have to fall to that same price.

Unless Prudhoe Bay oil is exempted from the national average limitation, it will probably have a price between \$7.66 and \$10.00 per barrel, in 1975 dollars, plus any production incentive increases.

III. Effect of price provision on state revenues

If the federal government had removed all price controls, the committee's proposed tax package would have collected approximately 21 billion dollars during the first 23 years of Prudhoe Bay production. State royalties would have been in the range of 8 billion dollars. If the regulations allow "old" and "new" prices to quickly converge at the weighted average of \$7.66 per barrel, with only the 3 percent real increase allowed each year, tax revenues would be decreased by 6 billion and royalty income by 2 billion.

It is fairly unlikely that Congress can be convinced to give arctic oil special treatment. This is due to the healthy income which Prudhoe Bay can probably produce even at the \$7.66 price. It is also highly unlikely, that "old" oil prices will be allowed to rise quickly to the average price. This would enable Prudhoe Bay oil to be sold at a higher than average price to off-set the lower than average "old" oil prices. Should Prudhoe Bay prices range around \$2.00 per barrel above the national average, tax revenues would be around 18 to 19 billion with royalties of 7 billion.

If price controls had not been continued, Alaska's total oil revenues from Prudhoe Bay might have been around 29 billion. The lowest price control case under the present law with possible extensions would reduce revenues to around 21 billion. The most likely range under the controls is around 25 to 26 billion over the first 23 years of Prudhoe Bay operation.