HB
322

COMMITTEE REPORT

**Finance

SENATE

5/14/77

5/18/77 Date

Mr. President:

The Committee on RESOURCES has had CSHB 322 establishing an oil and gas corporate franchise tax under consideration. A majority of the members of the Committee

/_7 recommends it do pass

/_7 recommends it do not pass

/_7 recommends it do pass with attached amendment(s)

/X7 recommends it be replaced with SCS for CSHB 322 and that

SCS for CSHB 322 do pass Individual Recs

/_7 (and) recommends it be referred to the committee

/_7 reports it back without recommendation

/_7 AND attaches a report of its intent

/_7 (other)

MEMBERS SIGNING THE MAJORITY REPORT:

[illegible]	No Rec	
[illegible]	No Rec	
[illegible]	Do Pass	

MEMBERS NOT CONCURRING IN THE MAJORITY REPORT:

recommends:

recommends:

recommends:

[illegible signature]
Chairman

AGO 547898

COMMITTEE REPORT

SENATE

1/20/78

FURTHER: ____________________

____

Date: 6/4/78

Mr. President:

The Committee on RESOURCES has had CSHB 322

establishing an oil and gas corporate franchise tax

under consideration and (a majority of the committee) (the committee reports it back as follows)

( ) recommends it do pass ( ) recommends it do not pass

( ) recommends it do pass with attached amendment(s)

(✓) recommends it be replaced with CS for CS HB 322 (Resources)

and ____________________ ( ) new title ( ) same title

( ) AND attaches a Letter of Intent ( ) New Fiscal Note

(✓) reports it back without recommendation

( ) and recommends it be referred to the ____________ Committee

MEMBERS SIGNING DO PASS: | OTHER RECOMMENDATIONS:

____________________ Chairman

AGO 547899

S 60 (rev. 6/77)

EFFECTS OF PROPOSED CHANGES IN ALASKA'S CORPORATE INCOME TAX LAW

Summaries of Three Studies Conducted
by Multistate Tax Authorities
for the Alaska Oil & Gas Association

This report summarizes three studies conducted for the Alaska Oil & Gas Association by recognized authorities on taxation of multistate corporations. The studies were commissioned to obtain expert opinion concerning the fairness and effectiveness of the current Alaska corporate income tax law as applied to the oil and gas industry. Limited copies of the complete studies are available from the Alaska Oil & Gas Association, Suite 219, 505 West Northern Lights Blvd., Anchorage, Alaska 99503.

AGO 547987

KUST STUDY

SUMMARY

INCOME TAXATION OF MULTISTATE CORPORATIONS ENGAGED IN OIL AND GAS PRODUCTION AND TRANSPORTATION IN ALASKA

By Leonard E. Kust,
Senior Tax Partner
Cadwalader, Wickersham & Taft
New York, New York

AGO 547989

I. PRINCIPLES OF TAX JURISPRUDENCE

Where the activities of a business extend over two or more states, all of the income from such business cannot reasonably be taxed by each of the states. The whole development of the law regarding state taxation of multistate business income rests on this manifest and undisputed principle. Similarly, international tax jurisprudence and tax treaties are grounded on this basic principle with respect to national taxation of multinational business income.

Under the Constitution and with our federal system, this principle has been implemented by Supreme Court decisions under the commerce and due process clauses and through the voluntary and mutually compatible actions of state legislatures and tax administrators.

The effort has been to avoid multiple taxation of the income of a multistate business through the taxing by each state in which the business has activities of only a portion of the income, determined by some reasonable method of apportionment. The system which has developed has two basic elements: (i) a tax base measured by a company's worldwide income determined by Federal taxable income and (ii) a method of dividing this base through use of an apportionment formula.

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The Massachusetts, or three-factor, formula apportions the income of a multistate business to the taxing state on the basis of the average of three fractions: (1) property within the state over total property, (2) payroll within the state over total payroll, and (3) sales within the state over total sales.

It was recognized at the outset that multiple taxation of multistate business income arises not merely from failure to apportion reasonably but from disparity in methods of apportionment as well, even though each method by itself and applied universally might be reasonable. The National Tax Association began advocating uniformity in the method of apportionment as early as 1919. Ultimately, these and other efforts culminated in the Uniform Division of Income for Tax Purposes Act (UDITPA) adopted by the National Commissioners on Uniform State Laws in 1957. UDITPA incorporated the three-factor formula and, most notably, defined the numerator of the sales fraction, with respect to which the greatest divergence from uniformity had developed, as being sales having their destination, that is, delivered to customers, in the state.

The Multistate Tax Compact, inaugurated in 1966 to promote uniformity and thereby avert Federal legislation then under consideration to impose uniformity on the states, incorporated UDITPA.

ASO 547991

Out of a total of 44 states and the District of Columbia which impose a corporate net income tax, 40 provide for the three-factor formula, 25 by adoption of UDITPA or the Multistate Tax Compact and 15 by incorporation in their own tax statutes, four of the latter giving greater weight to the sales factor than to the property and payroll factors. Differences in the economies of the states as to whether primarily industrial, or commercial, or agricultural or extractive have not affected the general acceptance of the three-factor formula as essentially fair and reasonable.

II. ALASKA INCOME TAX--PRESENT STRUCTURE AND APPLICATION TO THE OIL AND GAS PRODUCTION AND TRANSPORTATION INDUSTRIES

Alaska has adopted both UDITPA and the Multistate Tax Compact and determines taxable income by reference to the Federal tax base. No distinction is made between the oil and gas industry and other industries engaged in the production and sale of tangible personal property. Since this is essentially the same treatment which is accorded to the oil and gas industry by all of the states imposing a corporate income tax, Alaska suffers no disadvantage in comparison with other states. Accordingly, there does not appear to be justification for change and departure from uniformity. The burden of proof should rest on those who advocate departure.

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III. THE ZEIFMAN-AINSWORTH REPORT

The Zeifman-Ainsworth Report contends that Alaska's tax base has been eroded through Federal tax subsidies and incentives which are unrelated to the definition of net income but which are provided solely to accomplish certain economic and social goals, and that the UDITPA apportionment formula reduces the amount of taxable income attributable to Alaska by corporations which export non-renewable petroleum resources from the state.

Zeifman and Ainsworth's recommendations which have been endorsed by the Department of Revenue and incorporated in H.B. 322 are:

1. Adoption of a tax base measured by the greater of book income or Federal taxable income.
2. Replacement of the destination-oriented sales factor with an "extraction factor" — the ratio of oil and gas energy units produced in Alaska to total oil and gas energy units produced everywhere.

These changes would apply only to corporations with ordinary gross receipts in excess of $250,000,000 more than 50% of which is derived from production, transportation,

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refining, manufacturing, processing, distribution or retail sale of oil or gas or products derived from oil and gas.

The "tax subsidies" cited by Zeifman and Ainsworth are for the most part available to all corporations. It is unfair and perhaps unconstitutional to single out the oil industry.

Furthermore, with respect to the one Federal "tax subsidy" allowed to the oil and gas industries, a current deduction for intangible drilling costs, Alaska does not, as Zeifman and Ainsworth claim, provide an incentive to drill wells outside Alaska. Federal taxable income reflects not only deductions for the cost of wells drilled throughout the world but also the income from such wells. It is not a one-way street. Alaska is no more providing an incentive for drilling outside Alaska than other states are providing an incentive for drilling in Alaska. Denial of this current deduction in Alaska, however, could reduce the incentive to drill wells in Alaska.

Congressman Vanik's computations of "effective taxable income" do not support the view that the adoption of the Federal tax base by Alaska automatically causes Alaska's "effective tax rate" to be less than 9.4%, by something comparable to the difference between the statutory 48% rate and the Vanik "effective U.S. tax rate on

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worldwide income." Congressman Vanik's approach of measuring Federal income tax due as a percentage of worldwide income is patently incorrect because the United States, recognizing the principles of international tax jurisprudence, provides a credit against its tax on worldwide income for taxes paid to other countries. Alaska does not provide a credit but imposes its tax rate of 9.4% on a corporation's worldwide income apportioned to Alaska. Obviously after apportionment (or after the foreign tax credit at the Federal level) the amount of Alaskan tax as a percentage of worldwide income will be less than 9.4% (or the Federal tax will be less than 48%).

Book income is an inappropriate tax base. It will greatly increase the administrative and audit costs and burdens of both the oil companies and the Department of Revenue. Furthermore, book income not only reflects taxable income before tax subsidies but also many timing differences unrelated to Congressional tax policies. Use of the higher of Federal taxable income or book income as a tax base would tax income twice to the extent of such timing differences.

The UDITPA apportionment formula provides for fair and equitable division of income of oil and gas corporations between Alaska and the rest of the world and fairly reflects the extent of their activity in Alaska as compared to the rest of the world. The destination sales factor properly

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gives recognition to the contribution of the market states to the creation of income. Without the demand and purchasing power of the market states, the value of Alaska's oil and gas would be less and the income tax base of oil and gas companies would be smaller. The extraction factor ignores the contribution of the market state and creates multiple taxation, since nearly every other state uses a destination oriented sales factor.

The extraction factor has been proposed not to make Alaska's apportionment formula "fairer" in terms of reasonable sharing of the income tax base with other states, but to generate more tax revenue. Apportionment formulas are not intended to be vehicles to generate tax revenue but to divide income among the states fairly and uniformly so as to avoid multiple taxation.

IV. SEPARATE ACCOUNTING--S.B. 105

The declared purpose of the "net proceeds" tax is to tax production and pipeline transportation income in Alaska by means of a statutory separate accounting, while retaining formula apportionment (as modified) to apportion all other income.

Conceptually, separate accounting constructs an income or loss statement for the activities of the business in the state as if they constituted an independent business

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dealing at arm's-length with the remainder of the business and the outside world. In practice separate accounting is impossible to administer and determine. Separate accounting requires that hypothetical prices be established for goods and services between affiliated companies. Separate accounting must effectively contend with efforts of companies to shift income among divisions, affiliates and states and must devise some reasonable way to attribute overhead expenses to the various business locations and activities of the taxpayer, no doubt by means of an apportionment formula, thereby abandoning to that extent its initial purpose of avoiding the apportionment formula. Furthermore, separate accounting requires maintenance of records needed in the effort to determine geographic income--records which serve no other business function.

S.B. 105 handles the problem of allocating overhead expenses by simply denying a deduction for such costs. Pricing difficulties are "solved" by using as gross income the value of oil and gas produced as determined for purposes of the production tax.

Thus, the proposed net proceeds tax would not by definition apply separate accounting even though it purports to do so.

The proposed net proceeds tax has major infirmities. It purports to be an application of separate accounting but it is not. It represents a sharp deviation

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from uniformity and as such would constitute a major disruption of the common consensus underlying the system of state taxation of interstate business income. Separate accounting applied by one state to a whole industry in order to increase its share of the total income over that resulting from the three-factor formula necessarily results in multiple taxation because income which is fully taxed by one state is also apportioned by formula to other states.

V. THE MULTISTATE TAX COMPACT

Alaska's continuing membership in the Multistate Tax Compact and the administrative benefits derived from such membership may not be tenable if either the Zeifman-Ainsworth proposals or S.B. 105 were adopted. The courts may find such proposals to be in conflict with the Compact and as a result may further hold that Alaska has in effect withdrawn from the Compact or that the Compact remains in effect but enactment of the proposals is ineffective to prevent taxpayers from applying the UDITPA formula under the provisions of the Compact.

VI. UNIFORMITY, COMITY AND ENLIGHTENED SELF-INTEREST

Great progress has been made in recent years in adopting uniform allocation methods. Part of the drive for voluntary uniformity has obviously been the desire of both

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states and taxpayers to avoid Federal intervention. As long as states strive toward uniformity as a goal of fair taxation, Congress will be hesitant to act. If the drive for uniformity falters through independent action by states asserting their currently perceived self-interest without restraint, Congress will be constrained to exercise its constitutional responsibility to protect interstate commerce by prescribing a Federal standard of uniformity.

Alaska has been in the forefront of the drive for uniformity. By the collective judgment reflected in the development and general acceptance of the three-factor formula, Alaska's net income tax fairly and effectively reaches its proportionate share of the income of multinational oil and gas corporations doing business within the state. The proposed changes would be destructive of community and comity among the states in dealing reasonably with state taxation of multistate business and are parochially designed to increase tax revenues without regard to the general principles of tax jurisprudence for division of interstate business income adhered to by other states.

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LEONARD E. KUST

Biographical Information

LEONARD E. KUST is a partner in the New York Law firm of Cadwalader, Wickersham & Taft. He was formerly Vice President and General Tax Counsel of Westinghouse Electric Corporation with which he was associated from 1955 to 1970.

A native of Wisconsin, Mr. Kust is a graduate of the University of Wisconsin and the Harvard Law School. He is a member of the New York and Pennsylvania bars.

He is a past president of the Tax Institute of America, and of the Tax Executives Institute. Mr. Kust has served as Chairman of Governor Scranton's Committee on Tax Administration, Chairman of Task Forces for Governor Shafer's Tax Study and Revision Commission, and was a member of the Advisory Committee of the Commissioner of Internal Revenue. He has served on the Executive Committee of the National Tax Association, as a Director of the Chamber of Commerce of the United States, and as a member of the Taxation Committee. He is a member of the Tax Section of the American Bar Association, a member of the Council of the U.S.A. Branch of the International Fiscal Association, a member of the Advisory Board of the Tax Management, and a member of the Advisory Board of the Tax Foundation.

AGO 54800C

Mr. Kust has written on a wide variety of tax issues, including "State Taxation of Income from Interstate Commerce: New Dimensions of an Old Problem," S.W. L.J. 1 (1960); "State Taxation of Interstate Sales," 46 Va. L. Rev. 1290 (1960); "Federal Tax Reform," the Tax Executive, Vol. XIV, April, 1962; "Standards of Conduct for Tax Executives," the Tax Executive, Vol. XIV, July 1962; "A Reappraisal of Taxation of International Business Income," National Tax Association Proceedings, Annual Conference, 1966, p.154; "Alternatives for New Federal Revenues," Tax Review, Tax Foundation, Vol. XXXIV, No. 7, July, 1973.

AGO 548001

SUMMARY

POSITION PAPER ON ALASKA OIL AND GAS TAXATION

By John S. Warren
Partner
Loeb and Loeb
Los Angeles, California

AGO 548002

WARREN STUDY

EXECUTIVE SUMMARY OF POSITION PAPER

ON ALASKA OIL AND GAS TAXATION

By John S. Warren

Alaska's existing corporation income tax meets all of the generally recognized criteria of a modern and efficient state corporation income tax. It is simple and inexpensive to comply with and enforce, it provides equality among taxpayers, and it contains rules for the allocation of income that provide the best possible assurance against overtaxation or undertaxation of multi-state businesses. The several bills which the Legislature has had under consideration (H.B. 145 and 322, S.B. 105 and 202) are all changes for the worse as far as meeting these criteria is concerned.

If the Alaska tax base for oil companies were to become the greater of book income or federal taxable income (H.B. 322), the Department of Revenue auditors could no longer rely on federal audits. Rather, they would have to verify two sets of figures for each company. Because the financial accounting rules for determination of book income allow some leeway, the Department would have to adopt regulations to prevent manipulation of book income for tax avoidance purposes and to assure equality

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among taxpayers. Furthermore, because income or expenses are often reportable in different years under federal income tax rules than they are under financial accounting rules, intricate adjustments would be necessary to avoid including the same item in the tax base for two years.

The changing o' the formula for apportionment of income by substituting an origin sales factor ("extraction factor") for the destination sales factor used by most states (H.B. 322) will force Alaska to withdraw from the Multistate Tax Compact and will deprive the state of the benefits of the joint audit program of the Multistate Tax Commission. More importantly, the use of the extraction factor cannot be justified under the generally accepted principles for apportionment of the income of a unitary business.

Determining Alaska tax liabilities on the basis of separate accounting (H.B. 145, S.B. 105, and H.B. 322 as amended in the Senate) is an even more drastic departure from generally accepted principles of proper state tax policy. It would force Alaska out of the Multistate Tax Compact, would create horrendous audit problems for the Department of Revenue, and might even result in a net revenue loss to the state.

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The analytical approaches of the Department of Revenue and the several consultants who have been advising the Legislature leave much to be desired. They have created the impression that Alaska does not get as much tax revenue from the oil companies as it should because the present tax structure does not attribute to Alaska the net income actually earned in Alaska. They then attempt to persuade the state to turn its back on all of the principles of state taxation and multistate business that have been hammered out over the last century -- principles that have been widely endorsed by the courts, by tax administrators of other states, and by tax scholars -- and to adopt instead one of several new proposals. They have no difficulty in showing that these proposals would increase Alaska's tax collections, but they fail completely to show that they will come any closer to the ideal of taxing the "net income actually earned in Alaska," no more and no less. Alaska would be ill advised to warp its tax structure away from the tried and true principles simply to collect more taxes from one type of business.

AGO 548006

JOHN S. WARREN

Biographical information

Education:

Bachelor of Science in Law, University of Minnesota - 1943

Bachelor of Laws, University of California, Hastings College of Law - 1950

Professional:

Loeb and Loeb, Los Angeles, California - 1957 to present (partner 1960 to present)

Government Positions:

Associate Tax Counsel, California Franchise Tax Board - 1951-1957

Consultant, California Department of Finance - 1962

Consultant, California Legislature, Senate Fact Finding Committee on Revenue and Taxation - 1964

Memberships:

State Bar of California

- Committee on Taxation (1958-1962)
- Committee on Property Sales and Local Taxes (1975-)
- Chairman, Subcommittee on Occasional Sales (1976-)

Los Angeles County Bar Association, Tax Section:

- Committee on Federal and California Death and Gift Taxes

American Bar Association, Section of Taxation, Committee on State and Local Taxes:

- Subcommittee on Non-Federal Solutions to Interstate Tax Problems (1974)
- Subcommittee on Important Developments (1975)
- Vice Chairman, Subcommittee on Corporation Net Income Taxes (1976)

Articles:

"Sales of Depreciated Properties to Related Entities," 1959 Southern California Tax Institute

"The Unitary Concept in the Allocation of Income," 12 Hastings Law Journal 42 (with Frank M. Keesling"

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"Selected Problems in California Corporation Taxes,"
1962 Southern California Tax Institute 939

"Income Taxation of Testamentary Trusts,"
23 Journal of Taxation 278

"California Franchise Tax Allocation of Income of Unitary Business,"
1966 Southern California Tax Institute 529

'California's Uniform Division of Income for Tax Purposes Act,"
15 U.C.L.A. Law Review 156 (with Frank M. Keesling)

"Reform Act Changes in Pension and Profit Sharing Plans,"
1971 Southern California Tax Institute 137

Lecturer:

"Tax Problems of Closely Held Corporations and Their Shareholders"
California Continuing Education of the Bar, 1974

"Advising on California Taxes"
California Continuing Education of the Bar, 1975

"California State and Local Tax Rules Pertaining to the Entertainment Industry"
California CPA Foundation, 1974

Teacher:

Adjunct Professor of Law in State and Local Taxes,
Loyola University, School of Law
commencing January 1977.

AGO 548008

BOREN
STUDY

SUMMARY

THE EFFECTS OF HOUSE BILL 322 and SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL 322 ON UNIFORMITY AND EQUITY

By Gary T. Boren
Professor of Law
Washington University
St. Louis, Missouri

AGO 548010

I.

The removal from Alaska of its oil and gas is compensated for through payments by oil and gas producers of the Oil and Gas Properties Production Tax. That tax has recently been reviewed and amended by the Legislature to ensure that a proper price is being paid for the removal of these resources. Consideration of the treatment of taxpayers under the corporate income tax therefore should be considered independently of concern about proper compensation to the state for the withdrawal of its natural resources.

II.

Alaska, as most states, uses the federal definition of taxable income under the corporate and personal income taxes. Concern has been expressed that erosion of federal taxable income has resulted in an inappropriately small tax base for oil and gas producers under the Alaska corporate income tax. Examination of the items considered as eroding the federal base indicates that oil and gas producers do not receive a disproportionate benefit. To single out oil and gas producers for the withdrawal of all deductions deemed erosions (whether or not peculiar to the oil and gas industry) means that the oil and gas industry in Alaska will bear an excess burden, shifted to them from other taxpayers who continue to be able to receive those deductions.

A study by Congressman Vanik investigating the tax burden of major corporations under the federal income tax has been

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advanced as demonstrating that oil and gas producers are paying a disproportionately low effective rate on their income to Alaska in comparison to the rates paid by local taxpayers. The Vanik study, however, demonstrates primarily that the foreign tax credit has been used to reduce the amount of taxes paid the U.S. Alaska does not permit the foreign tax credit, nor does it grant a deduction for taxes paid on income to any government. The result therefore is that oil and gas producers, and other multinationals, would be paying a higher proportionate effective rate to Alaska than to the federal government. The Vanik study therefore is an argument against the very proposal that it has been used to advance.

Reform of the Corporate Income Tax by the Alaska legislature to be fair must be reform for all taxpayers.

III.

A state may tax only the portion of the income of a corporation to which it has a sufficient connection. The manner of determining how much a state may tax used by almost all states is formulary apportionment. Taxable income for state purposes is determined by multiplying taxable income by a formula of three fractions, called factors. The factors represent the proportions respectively of property, payroll and sales occurring in the taxing state to the total amount of property, payroll and sales occurring everywhere. The three fractions are then divided by

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three to obtain an average proportion of activities occurring within the taxing state to activities everywhere. The largest number of states, including Alaska, have adopted a model law called the Uniform Division of Income for Tax Purposes Act to determine the income they may tax.

If states do not apply the same or similar methods for division of income it is possible, even likely, that taxpayers will be subjected to tax on more or less than their total income. Nonuniformity also causes taxpayers difficulties in complying with the laws of numerous states. Federal legislation has been proposed to require a uniform formula by Act of Congress. Progress toward uniformity by the states has been at least one reason why no federal solution has as yet been imposed.

No special uniform apportionment formulas have evolved for oil and gas producers. The normal manner of division of income has been considered appropriate to them. The use of a special formula by one state to increase the income taxable by that State must therefore necessarily result in overtaxation.

IV.

House Bill 322, which has been passed by the House of Representatives would impose a special formula on oil and gas producers in Alaska. The standard sales factor would be eliminated and an extraction factor substituted for it. The sales factor is justified because sales are requisites to income and because a state

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may exact a tax for maintaining an orderly market and protecting the sales activities of a taxpayer and the customers who purchase goods from the taxpayer. The states have resisted elimination of the sales factor in a federally proposed formula. Alaska, a market state, benefits usually from the existence of the sales factor. Elimination of sales for oil and gas producers is supported by no plausable justification.

The proposed extraction factor has no comparison in the apportionment formulas of other states applied to oil and gas producers. Had the extraction factor been substituted for sales in the year 1975 the result would have been subjecting $53,000,000 of the income of a limited number of oil and gas producers to double taxation.

The proposed extraction factor has a diminishing connection with activities of taxpayers not involving the processing and sales of petroleum products. Questions of constitutionality are raised for all, and for diversified taxpayers two formulas would seem clearly required. This creates the problems of separate accounting, discussed elsewhere in the paper. The extraction factor would also require maintenance of extensive records not used for business purposes. They would be expensive to maintain and difficult to audit.

House Bill 322 also attempts to include in the numerators of the apportionment formula (which increase the amount of income

AGO 548014

taxable by Alaska) items connected to the Outer Continental Shelf. Congress has declared that state tax laws should not apply to the Outer Continental Shelf. California which has considered the action contemplated by House Bill 322 has determined that it is not permissible.

V.

A method of dividing income known as "separate accounting" has from time to time been forwarded for use by Alaska. The doctrine is an attempt to identify income with geographic areas. It is the theoretical opposite of the use of a formula. Formulary apportionment has as its basis the inability to segregate items geographically and the belief that total income of a corporation is to be divided among the states. Taxpayers have attempted to avoid formulary apportionment and to use separate accounting by such pleas as disproportionately high costs in a taxing jurisdiction, or by operating through multiple corporations. It has, however, been demonstrated that higher cost in one state may yet produce additional income for the business, and some of that income therefore is attributable to that state. Nor does the use of multiple corporations mean that application of a formula to total group income is improper: the formula determines how much of the total income is attributable to activities of corporations that are connected with the taxing state. Formulary apportionment permits the taxation of worldwide income, separate accounting does not.

AGO 548015

Separate accounting is expensive for the taxpayer and the state and requires the constructing of hypothetical transactions, permitting the possibility of taxpayer avoidance. The main flaw of the doctrine is that it ignores the interdependence of different portions of a unitary business, and the values created by that integration of operations. Separate accounting has been rejected by the overwhelming majority of studies and scholars that considered the question in modern times.

Senate CS for CSHB 322 which would impose a "net proceeds tax" bears some resemblance to separate accounting in its use of hypothetical values and treatment of taxpayers as though they were engaged in two separate businesses. It has attempted to avoid the possibility of taxpayer manipulation but in doing so has arbitrarily eliminated deductions connected to the production of income. In separating oil and gas production and pipeline transportation income in Alaska from worldwide operations and denying the deductions mentioned it increases revenue taxed by Alaska on this portion of a taxpayer operation and apportions the balance of income from worldwide operations by a special formula designed also to maximize Alaska revenue. The result must be double taxation, and for oil and gas production in Alaska approaches the taxation of gross receipts at income tax rates.

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VI.

Taxes tailored to increased revenues from producers operating in interstate commerce raise serious constitutional questions. The U.S. Supreme Court has recently stated the necessity to examine such tailored taxes closely. Moreover, specialized tax treatment by individual states reduces uniformity and increases the possibility of federal action. Discrimination against oil and gas producers makes it unlikely that those taxpayers would attempt to expand their Alaska operations. The ultimate question for the legislature, however, is whether the bills would result in a tax structure for Alaska that is fair to the taxpayer and the state. The attempt to increase revenue from the one class of taxpayers under the circumstances investigated in this paper indicates that on this basis also the taxes should not be enacted.

AGO 548017

GARY I. BOREN

Biographical Information

Education:

Bachelor of Arts, University of California, Los Angeles - 1957

Bachelor of Laws, University of California, Los Angeles - 1961

Member of the Order of the Coif
Note and Comment Editor, U.C.L.A. Law Review

Professional:

Professor of Law and Director of the Graduate Tax Program, Washington University School of Law, St. Louis, Missouri

Assistant Professor - 1967-1971
Associate Professor - 1971-1975
Professor - 1975-Present

Private practice, Los Angeles, California - 1961-1967

Member State Bar of California

Major Publications:

Equitable Apportionment: Administrative Discretion and Uniformity in the Division of Corporate Income for State Tax Purposes
49 So. Cal. L. Rev. 991 (1976)

Specific Allocation of Corporate Income in California: Some Problems in the Uniform Division of Income for Tax Purposes
30 TAX. L. REV. 607 (1975)

Separate Accounting in California and Uniformity in Apportioning Corporate Income
18 U.C.L.A. L. REV. 478 (1971)

AGO 548018

Courses Taught:

*State and Local Taxation
*Federal Income Taxation
*Federal and Estate Gift Taxation
*Seminar in Tax Policy and Current Legislation
Seminar in Advanced Tax Research
Natural Resources

*Courses taught currently

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y · STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

May 6, 1978

MEMORANDUM

SUBJECT: Corporate Income Tax Legislation - SCSCSHB 322

TO: The Honorable Kay Poland

FROM: Gregg K. Erickson
Director of Research

Enclosed is a memorandum received from the Alaska Public Utilities Commission responding to a much earlier request of mine concerning the fiscal impact on the Commission of the above cited legislation. They indicate that the total cost of carrying out their responsibilities under the bill in FY 79 would be about $33,000.

Under the draft committee substitute proposed by Senator Croft and the Administration, the fiscal impact on the Commission would presumably be zero, since all the auditing and determination responsibilities would be vested in the Department of Revenue. The Department is preparing a fiscal note on the Croft/Administration bill.

GKE:dh
Enclosure

AGO 547863

02-001B (Rev. 10/76)

STATE
of ALASKA

MEMORANDUM

TO: Pam Knode
Information Officer
Division of Administrative Services

DATE: April 5, 1978

FILE NO:

TELEPHONE NO:

FROM: Carolyn S. Guess
Commissioner
Alaska Public Utilities Commission

SUBJECT: Comments on SCSCSHB 322

Enclosed please find our comments on SCSCSHB 322. We were requested by Gregg Erickson to examine this committee substitute to see if it would change the fiscal impact on the Commission.

As you can tell from the research that Susan Knowles did, it will not change the fiscal impact on this Commission and, therefore, the original fiscal note should remain.

I understand that John Messenger of Revenue is coordinating comments in regard to the committee substitutes. Will you see that he gets a copy of our comments as well as transmitting, as quickly as possible, our comments to Gregg Erickson, noting please that we are responding to his request of over a month ago.

Thanks a lot.

CSG:lin
Enclosure

AGO 547864

DRAFT COMMENTS SCSCSHB 322

The certification procedure prescribed under SCS CSHB 322, like its predecessor HB 145, involves a significant extension of the Commission's responsibilities.

Section 43.20.068(b) defines taxable income primarily in terms of amounts presented on FPC* report forms and requires the APUC to certify that the calculation was made in accordance with FPC "principles" and regulations. Firms which do not normally prepare FPC report forms in the manner envisioned by the proposed legislation would be required to do so for certification purposes. Section 42.05.502 directs the Commission to review the accounts of the carrier and to certify that net pipeline income submitted under proposed AS 43.20.069** is in accordance with APUC regulations. In addition, the net income so defined was intended to coincide as nearly as possible with the definition of income used in establishing rates. Under both sections the Commission is responsible for identifying deficiencies and, if possible, providing a report of the true and correct income.

Having summarized those components of the proposed legislation which it believes have the greatest probable impact, the Commission offers the following comments. First, there is a potential for two different definitions of taxable income arising under the aforementioned sections of the statutes, one based on FPC report forms and one based on APUC regulations. A similar dichotomy may exist between net income for tax purposes and that f r rate-making purposes. The Commission believes that it would be i the public interest for the legislature to make the definition uniform in all sections. Second, the thorough knowledge of FPC principles and regulations discussed in the legislation will involve a greater commitment to monitoring the FPC than is currently required. Third, it is apparent that the legislature's intent is for the APUC to more than simply rubber stamp figures provided by gas pipeline companies. In this light, the certification procedure appears to be akin to issuing an independent audit opinion and will require comparable standards of review and expertise. Additionally, the Commission is constrained to issue a certificate of compliance or deficiency within 45 days from receipt of a request of a pipeline carrier.

Given the Commission's workload, satisfactory performance of the certification responsibility will necessitate hiring a staff person with specialized knowledge of tax accounting. The alternative of developing in-house expertise and diverting limited staff resources to certification would dilute effective performance of existing regulatory responsibilities. Therefore, the fiscal note attached to HB 145 applies to SCSCSHB 322.

* It is presumed that the legislature will modify all references to the FPC to the Federal Energy Regulatory Commission (FERC).

** The Commission believes that this is a drafting error and should be AS 43.20.068. The latter will be assumed in further comments.

AGO 547865

Second Session – Ninth Legislature
First Tenth

I. REQUEST
Bill No. HB 145
Title: [illegible]
Requested by: Date:
Return Date Requested:
Agency: Commerce Program: Public Protection

II. FISCAL DETAIL
Budget Request Unit(s) Affected:

A. EXPENDITURES: (Thousands of dollars)

	OBJECT	FY 76	FY 77	FY 78	FY 79	FY 80	FY 81
100	PERSONAL SERVICES		0	15.3	30.6		
200	TRAVEL		0				
300	CONTRACTUAL		0	2.1	2.1		
400	COMMODITIES		0	.2	.2		
500	EQUIPMENT		0	.8			
600	LAND & STRUCTURES						
700	GRANTS, CLAIMS, ETC.						
	TOTAL			18.4	32.9		

B. FUNDING: (Thousands of dollars)

	FY 76	FY 77	FY 78	FY 79	FY 80	FY 81
GENERAL FUND			18.4	32.9		
FEDERAL FUNDS						
OTHER						

C. POSITIONS:

	FY 76	FY 77	FY 78	FY 79	FY 80	FY 81
PERMANENT/TEMPORARY	/	/	1/	1/	/	/
MAN MONTHS (P./T.)	/	/	5/	12/	/	/

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

Passage of this proposed legislation will require the Alaska Public Utilities Commission to employ at least one additional Financial Analyst III who would be responsible for examining the tax returns for intrastate pipelines.

IV. ATTACHMENTS

Detailed expense estimate

V. DATE: PREPARED BY:

Original: Legislative Finance
cc: Budget and Management
Prime Sponsor (First Legislator Named)

AGO 547866

H/S 50

FISCAL NOTE

Re HB 145

1 Tax Accountant (UFA III, Range 18C)	$24408	
Benefits 25 1/2%	6226	$30634
Contractual:		
Office Space	1890	
Telephone	240	2130
Commodities:		
Stationery and Office Supplies	230	230
Equipment:		
Desk	295	
Chair	135	
Calculator	150	
Dictating Machine (Pocket Secretary)	250	830
		$33824

AGO 547867

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

MEMORANDUM

January 26, 1978

SUBJECT: Membership in the Multistate Tax Compact - (Work Order No. 4448)

TO: Gregg K. Erickson
Director
Division of Research Services

FROM: Randolph Berry
Legislative Counsel

The question presented is whether Alaska will be able to retain its membership in the Multistate Tax Compact should CS HB 322 (Oil and Gas Corporate Franchise Tax) or SCS CSHB 322 (Separate Accounting) or a "4th-factor" approach to multistate oil company taxation be adopted.

The stated purposes of the Multistate Tax Compact, contained in Article I of the compact, are as follows:

1. Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicative taxation.

The primary mechanism by which the compact is designed to achieve a uniform manner of apportionment and allocation of tax liability of multistate business taxpayers between states is through the use of the three-factor formula based on property payroll and sales set out in the Uniform Division of Income for Tax Purposes Act (UDITPA), which is incorporated as Article IV of the compact.

AGO 547868

However, the ability of a taxpayer to utilize apportionment and allocation under the formula of the UDITPA and the compact is not without provision for exception. Section 18 of Article IV of the compact reads as follows:

> 18. 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
>
> (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income. (Emphasis Supplied)

Thus, where the state tax administrator determines that the allocation and apportionment formula of the compact does not fairly represent a taxpayer's business in Alaska, he may employ a different method of allocating the taxpayer's income, rather than allowing the taxpayer to use the compact formula.

In both CSHB 322 and SCS CSHB 322, there is a stated legislative finding to the effect that the three-factor formula contained in the UDITPA does not fully reflect business activity or corporate income-producing activity in the state of multistate corporations engaged in the extraction, transportation and refining of oil and gas.

Although in this situation the determination that the allocation and apportionment provisions of the compact "do not fairly represent the extent of the taxpayer's business in the state" is being made legislatively, and the legislative process is being used as the "state tax administrator" rather than the case-by-case judgment of the Commissioner of Revenue, this should not logically affect the outcome of the question involved.

If the UDIPTA allocation and apportionment formula is determined to not fairly reflect business activity in the state by multistate oil and gas corporations, then the compact by its own terms provides a list of alternate methods of allocating and apportioning income for such taxpayers which would include the three proposed methods as permissible alternatives.

To date, there have not been any Alaskan cases interpreting or defining the scope and limits of Article IV, section 18 of the compact, so it is necessary to look to other jurisdictions for assistance in interpreting the state's authority under the compact to utilize alternate methods of allocating and apportioning income of multistate businesses.

The majority of cases of note in recent years dealing with the question of separate accounting versus statutory allocation under UDITPA have hinged on the issue of whether the business in question was unitary or non-unitary, with the outcome of this issue being presumed to be determinative of the question of whether separate accounting was permissible or required.

The concept of "unitary business" activity is a judicially developed concept utilized by the courts in determining whether, and the extent to which, a business has income which is subject to formula apportionment under the compact, UDITPA, or other state statutes requiring or allowing apportionment of income from multistate business activity. Whereas the language and application of the UDITPA and UDITPA type three-factor formulas has been comparatively uniform once it is determined that a business has multistate business income subject to formulary apportionment, the definitions and tests of what constitutes a "unitary business" subject to formulary apportionment vary substantially from one jurisdiction to the next, producing what appear to be inconsistent results in the applicability of UDITPA. (An extensive discussion of the concept of "unitary business" is not necessary for purposes of this memorandum, but will be covered in a separate memorandum. For purposes of this memorandum, it is sufficient to say that if a particular multistate business activity is not "unitary," then the UDITPA formula is not applicable and we would not reach the question presented in this memorandum.)

In Superior Oil Company v. Franchise Tax Board, 386 P.2d 33 (Cal. 1963) and the companion case Honolulu Oil Corp. v. Franchise Tax Board, 386 P.2d 40 (Cal. 1963) the California Franchise Tax Board was seeking to impose separate accounting on multistate oil companies, arguing in both cases that the companies were not true "integrated" oil companies, and that the comparatively profitable California operations should not be subject to allocation under the statutory formula. In both cases, the California Supreme Court overruled the Board's contention that the companies' operations were not unitary in nature, and concluded that the companies were authorized to use formulary allocation. However, no contention was argued in either case that even if the companies were determined to be unitary, the allocation formula nonetheless did not fairly reflect business activity in the state.

It should be noted in the Superior case that Superior operated in eight other states, showed losses from its operations in six of the eight states and utilized separate accounting in seven of these states, including the six in which it showed losses. Use of formulary apportionment by Superior allowed it to allocate a portion of these losses to income arising from its operations in California.

In contrast, in Webb Resources, Inc. v. McCoy (401 P.2d 879, Kansas 1965) the Kansas Supreme Court determined that Webb's multistate oil business was not subject to statutory apportionment, but rather its Kansas oil production was subject to separate accounting. But this case, like Superior, was decided on the basis of whether the business activity was unitary in nature.

There is, however, a recent Utah case under the UDITPA involving the same language as section 18, and a business activity roughly analogous to oil production, in which the contention was argued and the decision made on the basis of whether the standard three-factor formula fairly represented the taxpayer's business in the state. (Kennecott Copper Corp. v. State Tax Comm., 493 P.2d 632, 1972) Kennecott Copper Corporation and subsidiary corporations owned and operated mining properties in Utah, with virtually the entire production of the mining properties being sold and delivered to purchasers out of state. Under the UDITPA formula, for the tax years 1967 and 1968, Kennecott had property factors of 42.46 and 35.65 per cent and payroll factors of 42.88 and 33.36 per cent, respectively. But the sales factor for 1967 showed sales in the state of $3.3 million on total sales everywhere of $397 million and resulted in an apportionment fraction of 0.83 percent. The 1968 sales apportionment fraction was 0.568 percent. Yet for purposes of computing its depletion allowance for 1967, Kennecott reported gross receipts for sales from its Utah division of $158 million. The Utah tax commission concluded under the same language as contained in Article IV, section 18 of the compact that the UDITPA allocation and apportionment formula did not fairly represent the extent of Kennecott's business activity in Utah, and made its own determination and allocation of income attributable to business activity in the state. In Kennecott Copper Corp. v. State Tax Commission, 493 P.2d 632 (1972) the Utah Supreme Court upheld the tax commission, stating that the commission was authorized under the UDITPA to depart from the formula and adopt another method to make its own allocation if the apportionment provisions of the Uniform Act do not fairly represent the taxpayer's business activity in the state.

Additionally, of note is the case of Texas Co. v. Cooper (07 So 2d 687, La. 1959) which squarely presented the question of whether the statutory three-factor formula fairly allocated to Louisiana income from oil

AGO 547871

produced in the state but sold out of state. Although not decided under UDITPA, the formula used by Louisiana contained the same factors, and the issues were the same as would have arisen under UDITPA. The Louisiana statutes place the burden of showing "manifest unfairness" of the statutory three-factor formula on the party seeking to use separate accounting, and in this case the court, after extensive discussion, held that the tax commissioner had met the burden of showing that the sales-oriented three-factor formula did not fairly reflect the extent of income attributable to oil production in Louisiana.

In view of the above discussion, the answer to the question at hand of whether the adoption by Alaska of either CSHB 322 or SCS CSHB 322 or a "4th-factor" approach would jeopardize Alaska's membership in the Multistate Tax Compact appears to be "no". If, as stated in the legislative findings incorporated in each bill, the UDITPA three-factor formula does not fairly reflect the extent of business activity conducted in the state by multistate oil corporations, which is the foundation upon which both of the above bills are predicated, then the adoption of either bill or of a "4th-factor" approach would be entirely consistent of the compact, and could not be viewed as a breach by the state of its agreements under the compact.

RB:jpd

AGO 547872

TAX BURDEN COMPARISON

I. Taking the Arthur Anderson Approach, but using a sensitivity analysis to determine the extent to which the relative tax burden ranking is influenced by various assumptions employed such as market price and transportation charges.

II. Expand the scope of the Arthur Anderson approach to include all fields and activities in the state such as Cook Inlet and gas along with potential development of marginal fields such as Kuparik and Lisburne.

III. Develop figures from each state showing gross oil and gas production, wellhead values, total tax payments. Then compute tax payments as a percentage of total wellhead value and as a percentage of per barrel production. Also, if data is available take tax payments as a percentage of net profit per barrel in each state.

Revenue: John Messenger

AGO 547873

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

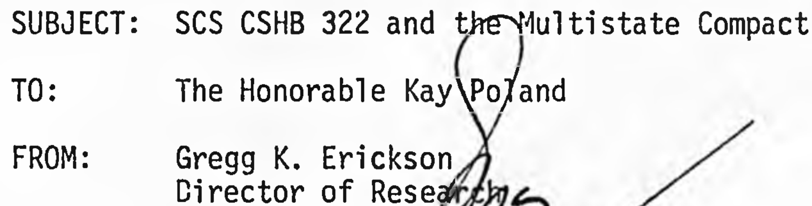
POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907 465-3800

MEMORANDUM April 1, 1978

SUBJECT: SCS CSHB 322 and the Multistate Compact

TO: The Honorable Kay Poland

FROM: Gregg K. Erickson
Director of Research



Several weeks ago, Mr. John Warren testified before your committee and suggested that adoption of the Senate committee substitute for HB 322 would jeopardize Alaska's membership in the Multistate Tax Compact. As you requested at that time, an analysis of these assertions has been prepared and is enclosed herewith (memorandum of March 31 from Mr. Berry to me). A January 26 memorandum on the same subject [illegible] also enclosed. An even earlier memorandum is available in our files.

All these memoranda indicate fairly clearly that adoption of either the proposed or existing Senate committee substitutes for HB 322 would not jeopardize the state's membership in the multistate compact. The last paragraph of each memorandum contains a fairly concise summary of its findings.

Please let us know if you wish to have these memoranda circulated to other members, or if you believe additional work is needed in this area.

GKE:jm
Attachments

AGO 547874

STATE OF ALASKA
THE LEGISLATURE

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

LEGISLATIVE AFFAIRS AGENCY

M E M O R A N D U M — March 31, 1978

SUBJECT: Membership in the Multistate Tax Compact (Work Order No. 4448 - Part II)

TO: Gregg K. Erickson
Director
Division of Research Services

FROM: Randolph Berry RHB
Legislative Counsel

The question continues to be raised as to the effect on Alaska's membership in the multistate compact of the enactment by Alaska of a statute mandating specific accounting and allocation of income methods for corporations engaged in the production of oil and gas in the state.

As this question has been raised and discussed by various legislative and industry consultants with inconsistent or conflicting answers, it is felt that it would be worthwhile to continue and elaborate on my memorandum on that subject, dated April 28, 1976, to Gregg Erickson, with an attempt to clarify the current state of the law and the practice of allocation of income from oil production in other oil producing states.

There are presently nineteen states which have adopted or joined the Multistate Tax Compact (referred to hereinafter simply as the "compact"). 1/ Of the twelve major oil producing states, 2/ six in addition to Alaska have joined the compact 3/ and five have not. 4/ Of these same twelve oil producing states, ten have income taxes on corporate income; 5/ and of these ten, six are members of the compact. 6/ Of the six oil producing states, in only three has there been litigation on the issue of allocation of income from extractive industry under the compact or UDITPA formula versus separate accounting or other modification of the statutory formula. The litigation in two of these states 7/ involved section 18 of Article IV (the "relief provision"), in the third, the litigation turned on the issue of whether or not the business was unitary in nature, 8/ and the "relief provision" was not raised by either side.

AGO 547875

Of the four significant oil producing states which do not belong to the compact but do impose an income tax on corporations with statutory allocation formulas, 9/ one now has a statute which specifically provides that "the income from oil production shall be allocated according to the location of the producing property." 10/ In a second, the court has upheld the requirement of separate accounting for oil production on the ground that the statutory three-factor formula is manifestly unfair to the state. 11/ In the other two, no cases involving departure from the statutory formula was found. Thus it can be seen that there is currently a wide disparity of allocation provision and practice even in the twelve states with the most significant oil production.

In considering whether separate accounting is permitted to be used or may be imposed by a compact state on a business taxpayer involved in business activity in more than one state, it should be borne in mind that the determination may occur in two stages; and either stage may result in a decision that separate accounting is permissible (or conversely that the party requesting separate accounting has not made the necessary showing).

The first stage turns on the question of whether the business activity in the particular state is separate in nature from the taxpayer's business activity in other states, or whether it is part of a "unitary" business. The definition of what is a "unitary" business varies from state to state, which has lead to inconsistencies between member states in the application of the mulitstate compact. However, for a rough working definition, one might say that a unitary business is one in which the business activities of the taxpayer in several states are so interrelated that each part is dependent on the parts occurring in other states.

If the business activity is unitary, then the compact provisions would be applicable to that business activity, and allocation would occur under the three-factor formula, unless relieved under the second stage of the determination.
If, on the other hand, the taxpayer's business activity in the particular state is essentially separate and distinct from his activity in other states, then separate accounting would be appropriate, and the compact formula would not be applicable.

If the business activity falls within the definition of "unitary" as in effect in the particular state, separate accounting may still be permissible for, or required of, that business taxpayer if it is determined, under the "relief provision," that the three-factor compact formula "does not fairly represent the extent of the taxpayer's business activity" in the state.

Whereas the first stage determination of whether a multi-state business activity is "unitary" might be viewed as a decision at the front door of whether the taxpayer enters into the compact's coverage, the determination made at the second stage (under the "relief" provision) is one of whether a taxpayer, already determined to be covered by the compact, leaves its coverage out the side door.

Of the cases discussed in the memo of January 26, 1978, the two California cases - Superior Oil Co. v. Franchise Tax Board, 386 P.2d 33 (Col. 1963) and Honolulu Oil Corp. v. Franchise Tax Board, 386 P.2d 40 (1963), and the Kansas case Webb Resources, Inc. v. McCoy, 401 P.2d 879 (1965), [decided prior to Kansas' entry into the compact], all involved the threshold question of whether or not the business activity involved was unitary in nature, and the question of fairness of the statutory formula was not raised. In both the Utah case Kennecott Copper Corp. v. State Tax Commission, 493 P.2d 632 (1972) and the Louisiana case - Texas Co. v. Cooper, 107 So 2d 687 (1959) [although Louisiana is not a member of the compact, its statutory formula parallels that of the compact] the question was decided on the basis of whether the statutory formula fairly represented the taxpayer's business activity in the state, and in both instances it was determined that it did not.

Since the decision of the Webb case in Kansas, which upheld separate accounting of oil production in the state, Kansas has joined the compact (1967), and the question of separate accounting has again been litigated in Amoco Production Co. v. Armold, 518 P.2d 453 (1974), this time on the question of whether the compact's three-factor formula fairly represented Amoco's oil production business in Kansas. Although John S. Warren, in a position paper, relies on the Amoco case for the proposition that oil companies are not excludable from the compact (p. 4), the case did not in fact contain any such holding. The court did say that although the legislature had chosen to specifically exclude certain businesses from

AGO 547877

the Uniform Division of Income for Tax Purposes Act, it had not chosen to exempt oil companies. However, the holding of the case was based on the fact that the tax administrator had misinterpreted the Act; and the case was remanded for further proceeding by the tax administrator on the question of whether the UDITPA formula fairly represented the extent of the taxpayer's business activity in Kansas. The court, (contrary to the impression given by Mr. Warren), recognized that if the tax administrator found that the formula did not fairly represent the extent of Amoco's business activity in Kansas, then departure from the formula was appropriate; and the use of separate accounting was one of the authorized alternatives.

From the above discussion, it should be evident that there is no clear authority for the statement that Alaska's enactment of HB 322 in any of its versions would jeopardize Alaska's membership in the Multistate Tax Compact. Absolute uniformity is not required by the compact; its own provisions recognize the need for some flexibility on the part of state tax administration. The court in the Kennecott case recognized that the compact formula might be inappropriate to certain industries unless modified, and the Kansas court in Amoco impliedly recognized the legislature's authority to exclude specific businesses or industries as is proposed in HB 322.

RB:jpd

FOOTNOTES

1/ Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Michigan, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah, and Washington.

2/ Alaska, California, Colorado, Florida, Kansas, Louisiana, Mississippi, New Mexico, Oklahoma, Texas, Utah and Wyoming.

3/ California, Colorado, Kansas, New Mexico, Texas and Utah.

4/ Florida, Louisiana, Mississippi, Oklahoma and Wyoming.

5/ Alaska, California, Colorado, Florida, Kansas, Louisiana, Mississippi, New Mexico, Oklahoma and Utah.

6/ Alaska, California, Colorado, Kansas, New Mexico and Utah.

7/ Kennicott Copper Corp. v. State Tax Commission, 493 P.2d 632 (Utah 1972); Amoco Production Co v. Armold, 518 P.2d 453 (Kansas 1974).

8/ Superior Oil Co. v. Franchise Tax Board, 386 P.2d 33 (Calif. 1963) and the companion case Honolulu Oil Corp. v. Franchise Tax Board, 386 P.2d 40 (Calif. 1963), decided under UDITPA prior to California's entry into the Multistate Tax Compact.

9/ Florida, Louisiana, Mississippi and Oklahoma.

10/ Oklahoma.

11/ Louisiana - Texas Co. v. Cooper, 107 so 2d 687 (1959).

AGO 547879

January 26, 1978

MEMORANDUM

SUBJECT: Impact of Proposed Changes in Corporate Income Tax Treatment of Oil and Gas Operations on Alaska Membership in the Multistate Tax Compact (W. O. 4448)

TO: The Honorable John Rader

FROM: Gregg K. Erickson
Director
Division of Research Services

The attached memorandum responds to your questions proposed in the above Work Order. The brief answer to your question is that neither the "franchise tax", "direct accounting", or "4th-factor" approaches are likely to be construed as a breach of the multistate tax compact.

In accordance with your instructions we are forwarding a copy of this memorandum to the Department of Revenue for comment.

GKE:ftc
Attachment

b
cc: Attached memoranda to John Messenger,
Deputy Commissioner of Revenue

AGO 547880

04-D3LH

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

POUCH S – JUNEAU 99811

May 8, 1978

The Honorable Kay Poland
Chairman
Senate Resources Committee
Alaska State Legislature
Juneau, AK 99801

Dear Senator Poland:

In his testimony on April 28, 1978, Milton Lipton noted three points of a technical nature which he felt should be addressed by the committee. I have talked to Gregg Erickson about these three items and believe that there is either an explanation of the specific language in the draft or a suggestion of specific language to the draft, to clear up the points raised by Mr. Lipton. I will discuss each point in order that it was mentioned.

1. Page 3, line 3

   On this point, Mr. Lipton raised the concern that a tariff properly on file with a regulatory agency might be ultimately overturned by that agency or the courts with appropriate refunds ordered. In this situation, he felt that we should assure ourselves that the income tax for any prior periods would be recomputed based upon the new tariff. That was our intent and we believe that the matter can be clarified with the addition of the following additional language at line 6 on page 3 of the proposed committee substitute:

   If a tariff properly on file with a regulatory agency is subsequently amended, changed, or overturned retroactively, the reasonable costs of transportation shall be recomputed for that period using the newly determined tariff.

2. Page 3, line 8, (c)(1)

   On this point, Mr. Lipton felt that this deduction for royalty paid was too narrow since it included only royalties paid to the state or the United States. We agree. Our intent was to insure that a company would

AGO 547881

only be taxed upon its interest in the oil and gas. Accordingly we would propose the following amendment at line 8 on page 8 of the proposed committee substitute:

(1) royalties paid in kind or in value. [TO THE STATE OR THE UNITED STATES.]

3. Page 3, line 13, (c)(4)

On this technical point, Mr. Lipton raised the concern that this particular deduction for operating expenses should fit with the definition of gross value so as to assure that there is not a double deduction of these particular expenses of producing, gathering, preparing the oil or gas for pipeline transportation. We have rechecked the interrelationship of the definition of gross value and this deduction and believe that they do fit together without overlap to assure no double deduction.

We have tied our definition of gross value to the definition of "gross value at the point of production" in the production tax statute. That definition contained in AS 43.55.140(12) provides essentially that the value at the point of production is the value at the point where the oil or gas is metered or measured in a condition of pipeline quality. This means that the oil or gas is valued without deduction for the costs of production including the costs of gathering, conditioning and treating prior to pipeline transportation. For example, for Prudhoe Bay oil production the oil is valued under this definition at the point where it is metered into the Trans Alaska Pipeline (Pump Sation No. 1) and no deductions upstream from that point are allowed. In (c)(4) the companies are then allowed to take their direct upstream operating costs as deductions from the gross value in arriving at net income. Since gross value is determined without deducting these operating expenses under the definition in the production tax statute, there is no double deduction of these items. Therefore we believe the definition of gross value and deduction for operating expenses fit together.

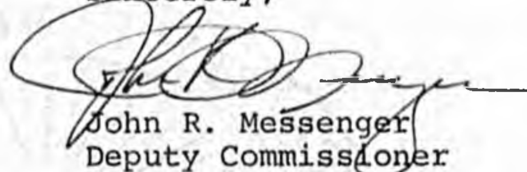
Also, I might note in response to a question from you regarding the proposed Sec. 43.21.050 ASSESSMENT OF INCOME AND TAX, Mr. Lipton did not specify any objection but noted that this was, as far as he knew, a standard provision in other taxes. I agree, but I would like to emphasize the importance of this provision in the separate accounting approach. This provision would help to assure that the tax

AGO 547882

avoidance problems which we have pointed out in last year's CS HB 322 are eliminated, since the department itself would be directly assessing the income and tax. This would be similar to the way the property tax is now administered and in our view is essential to administer a separate accounting approach to income taxation.

Mr. Lipton also raised certain policy considerations for the committee on the proposed committee substitute for HB 322. Those items included (1) the use of "book income" instead of "federal taxable income" as a definition of net income from activities other than oil and gas production and pipeline transportation, and (2) the use of the OCS apportionment factors for apportioning income from activities other than oil and gas production and pipeline transportation. As you know, these are items which were contained in our original franchise tax approach, and we believe that they would enhance a new corporate income tax for the oil and gas industry.

Sincerely,



John R. Messenger
Deputy Commissioner

cc: Gregg Erickson

AGO 547883

TO: ALASKA OIL AND GAS ASSOCIATION

FROM: JOHN S. WARREN

DATE: APRIL 24, 1978

RE: INCOMPATIBILITY OF PENDING TAX LEGISLATION WITH MULTISTATE TAX COMPACT

In my "Position Pager on Alaska Oil and Gas Taxation," I stated that enactment of the pending legislation on income taxation of oil companies might very well be a breach of the Multistate Tax Compact which would require Alaska to give up its membership in the Comp.. and the benefits inuring therefrom, such as participation in the joint audit program. I made this statement with respect to both HB 322 and SB 105 (which has become SCS CSHB 322). Crawford Thomas also spoke on this point in his testimony before the Senate Resources Committee on February 24, 1978.

The Legislative Affairs Agency disputes my contention and has advised the Senate Committee that adoption of the proposed legislation would not jeopardize the states membership in the Compact. You have asked for my further comments. There is no present authority squarely on the question of how far a party State may depar. f.om the apportionment prescribed in the Compact without forfeiting its membership; therefore no one

can say dogmatically that enactment of SCS CSHB 322 will or will not forfeit Alaska's membership. Any opinion of what the outcome would be must necessarily be somewhat speculative, but I still believe that an examination of the relevant authorities that do exist will show that jeopardy would surely be created and the end result would probably be termination of Alaska's membership.

The Relevant Provisions of the Compact and MTC Regulations

Article I. "The purposes of this compact are to ... (2) Promote uniformity or compatibility in significant components of tax systems."

Article II. "As used in this compact: ... 4. 'Income tax' means a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions."

Article III. "1. Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party State or pursuant to the laws of subdivisions in two or more party States may elect to apportion and allocate his income in the manner provided by the laws of such State or by the

AGO 547885

laws of such States and subdivisions without reference to this compact, or may elect to apportion and allocate in accordance with Article IV."

Article IV. (the UDITPA provisions) "... 2. Any taxpayer having income from business activity which is taxable both within and without this State, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this Article. ..."

"18. 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 one 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

"(d) the employment of any other method to effectuate an equitable allocation and apportionment

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of the taxpayer's income."

Regulation IV-18. "Article IV, Sec. 18 permits a departure from the allocation and apportionment provisions of Article IV only in limited and specific cases where unusual fact situations (which ordinarily will be unique and non-recurring) produce incongruous results under the apportionment provisions contained in Article IV."

It is clear that the tax to be imposed on oil companies by SCS CSHB 322 would be an "income tax." Therefore, the oil companies must be allowed the option to continue using the standard formula method. There is nothing in the compact that excludes oil companies from the standard treatment; only financial corporations and public utilities are excluded. It follows, therefore, that Alaska's only hope of defending its proposed special treatment of oil companies is to show that it is authorized by § 18 of Article IV.

It would seem impossible to bring Alaska's proposed action within the restrictive language of Regulation IV-18. The situation with respect to the oil companies is neither unusual, unique, or nonrecurring. Moreover, the determination under § 18 is supposed to be made by the tax administrator, not by the state legislature.

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How Would the Multistate Tax Commission React to the Issue?

If Alaska enacts SCS CSHB 322, the Multistate Tax Commission will be faced with a difficult problem. On the one hand, they want very much to maintain and increase the membership in the Compact. On the other hand, they are sure to realize that the Compact's only hope of success is for all party States to remain true to the principle of uniformity. This is why they have committed themselves to a very strict construction of § 18 in their own regulations. Surely they will know that any laxity in enforcing this strict construction would be a serious setback to their efforts to convice the business community, state governments, and particularly the U.S. Congress that the Compact is the best answer to the uniformity problem.

A recent incident involving Florida may be illuminating. After that state had joined the Compact, its legislature passed a law providing for double weighting of the sales factor (a maneuver which increased Florida's tax-take as primarily a market state and which also gave it a selling point in attracting business to establish factories in the state). Reliable sources have told me that there were considerable expressions of displeasure over this at Multistate Tax

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Commission meetings. A confrontation was avoided, however, when Florida voluntarily withdrew from the Compact. Alaska can be expected to incur this same kind of pressure to resign if it enacts SCS CSHB 322.

The recent approval of the Compact by the U.S. Supreme Court in the U.S. Steel case has brightened the future of the Compact. The party States look upon it as their best chance to convince Congress that the states can achieve and maintain uniformity on their own and that federal internention is neither necessary or desirable. They are not likely to risk spoiling this opportunity by allowing the legislature of one Party State to take a whole class of taxpayers completely out of the ambit of the Compact. Such lack of self-restraint by one Party State, if left unchallenged by the other Party States, could destroy the credibility of the Compact. It would stand as evidence that any Party State can depart from the standard apportionment formula whenever it thinks it is not getting enough revenue from a particular industry. As such, it would provide wonderful ammunition for the advocates of federal intervention.

Of course, Alaska could try to persuade the other party States to amend the Compact to make the proposed

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Alaska method the standard method for taxing oil companies. The chances of Alaska being successful, however, are nil. The market states would never agree to it. They would never consent to the downgrading of the place of marketing as compared to the place of production. They would insist that tax revenue from the oil industry be shared between production states and market states in the same way that it is for all other businesses.

In summary, Alaska is sure to become a pariah among party States to the Compact if SCS CSHB 322 is enacted into law. If Alaska is unwilling to share the tax revenue of the oil industry with other states in the conventional way, it has no future in the Compact.

How Would the Courts React to the Issue?

As improbable as it may be, let us assume that the Multistate Tax Commission takes no action to expel Alaska from the Compact. Any oil company would then be able to force the issue into court by a declaratory relief action, by refusing to submit to a joint audit in which Alaska is participating, or by contesting an Alaska deficiency assessment based on denial of the UDITPA option. This raises the question of how the courts will interpret § 18.

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The following cases have been cited by the Legislative Affairs Agency or by me, or both, as having a possible bearing on the question:

Texas Co. v. Cooper, (La. 1959) 107 So. 2d 676.

Superior Oil Co. v. Franchise Tax Board, (Cal. 1963) 386 P. 2d 33.

Honolulu Oil Corp. v. Franchise Tax Board, (Cal. 1963) 386 P. 2d 40.

Webb Resources, Inc. v. McCoy, (Kan. 1965) 401 P. 2d 879.

Kennecott Copper Corp. v. State Tax Commission, (Utah 1972) 493 P. 2d 632.

Donald M. Drake Co. v. Dept. of Revenue, (Ore. 1972) 500 P 2d 1041.

Amoco Production Co. v. Armhold, (Kan. 1974) 518 P.2d 453.

None of these cases involves the Compact. The last three are interpretations of § 18 of UDITPA. The first four involve the question of separate accounting versus formula apportionment for oil companies prior to UDITPA.

The Texas and Webb cases held that the oil companies in question were not engaged in a unitary business and therefore separate accounting was favored over formula apportionment. The Superior and Honolulu cases held that the oil companies in question were unitary businesses, and therefore separate accounting was rejected and formula

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apportionment was required.

In the Alaska situation, no one can dispute that the oil companies under consideration are unitary businesses. The Department of Revenue has so treated them in the past, and under the pending bill they would still be treated as unitary businesses, with formula apportionment being applied to all of their income except their Alaska production income. Therefore, Alaska's proposed use of separate accounting could not be defended on the ground that the oil companies are not unitary businesses, and the Texas and Webb cases would be of no help to Alaska.

If it is found to be a fact that an oil company is a unitary business, then the Superior and Honolulu cases are the persuasive authority. They were decided under a statute giving much broader discretion than does UDITPA, and still they held that separate accounting could not be used for oil companies that were found to be unitary businesses.

The more helpful cases, of course, are those decided under UDITPA. The first of these was Kennecott. That corporation was one of the largest taxpayers in Utah, but the Tax Commission felt it was not collecting enough revenue from Kennecott because the sales factor in

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the apportionment formula was working to the state's disadvantage, i.e., almost all of the copper was sold outside the state. (Note the parallel to the Zeifman and Ainsworth complaint against the formula as applied to oil companies in Alaska). So the Tax Commission invoked § 18 and required Kennecott to use separate accounting. The court upheld the Tax Commission. The decision, however, would be a very weak reed for Alaska to lean upon. In the first place, it was a 3-to-2 decision, with Chief Justice Callister writing a scathing dissent. It is quite possible that other courts will find the dissent more persuasive than the majority opinion. Secondly, it has been criticized by commentators. See, e.g., Peters, "State Income Tax Problems of Interstate Business," 33 N.Y.U. Tax Inst. 899, 952. Finally, the courts of two other states have indicated their disdain for it. In Chase Brass & Copper Co. v. Franchise Tax Board, (Cal. 1977) 138 Cal. Rptr. 901, it was ruled that Chase and its parent, the very same Kennecott, were engaged in a unitary business and that formula apportionment was proper. In Amoco, infra, the Director of Taxation relied heavily on Kennecott to support his claim to broad authority under § 18, but he still lost his case.

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The next court to interpret § 18 was the Oregon court in Drake. There the tax administrator sought to compel a construction contractor to use separate accounting, citing § 18 as authority. The court held that, in keeping with the purpose of UDITPA, the use of any method other than apportionment should be exceptional, and the party - the taxpayer or the tax administrator - who seeks to invoke § 18 has the burden of proof.

Amoco is another case where both the majority opinion and the dissenting opinions should be read. The majority opinion is favorable to my position, and the dissents are even more favorable. The Director of Taxation thought he could continue to require oil companies to use separate accounting after Kansas adopted UDITPA, just as he had been doing before, and as had been upheld by the court in Webb. The court rebuffed him, saying that separate accounting and formula apportionment were no longer two methods of equal stature and that UDITPA made formula apportionment the preferred method, even for oil companies, since they were not among those businesses expressly excluded from the act.

The Director also contended that his action was authorized by § 18. The majority opinion endorsed

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Drake as a correct interpretation of UDITPA and found Kennecott to be unpersuasive because of the 3-to-2 split in the Utah court. But the majority thought the Director should have another chance to meet his burden of proof because he had applied the wrong test. His evidence consisted solely of a wide discrepancy in the percentage of the taxpayer's income attributed to Kansas by separate accounting and the percentage arrived at by formula apportionment. The majority pointed out that the test is not whether the standard method clearly reflects net income but whether it fairly represents the extent of the taxpayer's business activities in the state. They remanded the case so that the Director could make a new finding under § 18 using the business activities test.

The two dissenters felt that the Director had failed to meet his burden of proof and so the litigation should end with a judgment for the taxpayer. Chief Justice Falzer wrote: "Tax liability is to be computed on the basis of business activity, and a comparison between formula allocation and separate accounting to ascertain the higher tax, is not within the scheme of the Uniform Act" (518 P 2d 469).

Both the majority and the dissenters agreed

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that a showing that separate accounting will allocate more income to the state is not sufficient to support the imposition of separate accounting under § 18. They disagreed only as to whether the administrator should be given another bite at the apple.

There is a clear lesson to be learned by Alaska from the Amoco case. The only evidence that the proponents of SCS CSHB 322 have offered to show that a variance under § 18 is justified is evidence that separate accounting will allocate more income of oil companies to the state than does formula apportionment. In the views of both the majority and the dissenters in Amoco, this evidence is incompentent to meet the burden of proof under § 18.

It is to be noted that in all four of these cases interpreting § 18 of UDITPA were cases where the tax administrator determined that a variance should be made. The incipient Alaska case will present the question of the propriety of the legislature making the determination. Again, Alaska will not be within the express language of § 18. The court is quite likely to find significance in the fact that the language of § 18 contemplates action by the tax administrator rather than

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the state legislature, for this would indicate an intention that the section is to be used only sparingly and in very specific cases. It is one thing for the tax administrator, upon review of the facts of a particular case, to find that the standard method does not fairly represent the extent of the taxpayer's business activity in the state and to devise another method that works better in that particular case. It is quite another thing for a state legislature to pre-empt the question and declare that a whole class of taxpayers shall receive non-standard treatment. The framers of UDITPA and the Compact intended the former as a limited continuation of traditional administrative discretion in this field, but they certainly did not intend to include the latter within the meaning of § 18. Such action by a state legislature would probably be viewed by the courts as nothing but an attempt to unilaterally amend the Compact itself.

Conclusion

If SCS CSHB 322 is enacted, Alaska will come under considerable pressure from other party States to quit the Compact. If the issue is not forced at that level, Alaska will have to defend itself in court and will have great difficulty in meeting the burden of proving that its action is compatible with the Compact.

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TELEX PD CLEVELAND , OHIO APRIL 24, 1978 988599

BP ALASKA
ANCHORAGE ALASKA
ATTN JOHN SAINT

FOR IMMEDIATE RELEASE

CLEVELAND, OHIO, APRIL 24--THE STANDARD OIL CO. (OHIO) REPORTED TODAY THAT NET EARNINGS PER SHARE FOR THE FIRST QUARTER OF 1978 WERE $.75, UP 56 PER CENT, ON A GREATER NUMBER OF SHARES OUTSTANDING, FROM $.48 CENTS FOR THE SAME PERIOD OF 1977. PER SHARE COMPUTATIONS WERE BASED ON 48 MILLION AVERAGE SHARES OUTSTANDING FOR THE FIRST PERIOD THIS YEAR, AND 38.6 MILLION SHARES FOR THE FIRST QUARTER OF 1977.

THE INCREASE IN SHARES REFLECTS ADDITIONAL COMMON SHARE EQUIVALENTS EARNED BY THE SPECIAL STOCK OWNED BY THE BRITISH PETROLEUM COMPANY LIMITED AS SOHIO'S ALASKAN CRUDE OIL PRODUCTION INCREASED.

"NET INCOME ROSE TO $36.3 MILLION FOR THE FIRST QUARTER OF 1978 COMPARED TO $18.7 MILLION IN 1977. THIS INCREASE WAS DUE TO ALASKAN CRUDE OIL OPERATIONS THAT OFFSET SUBSTANTIALLY INCREASED INTEREST EXPENSE, LOSSES FROM THE LENGTHY NATIONWIDE COAL STRIKE, AND LOWER INCOME FROM ROYALTIES," SOHIO CHAIRMAN ALTON W. WHITEHOUSE REPORTED.

RETURN ON ALL-TIME RECORD SALES FOR ANY QUARTER OF $1.03 BILLION WAS UP TO 3.5 CENTS ON EACH SALES DOLLAR FROM 2.3 CENTS FOR THE FIRST QUARTER LAST YEAR DESPITE THE FACT THERE WAS A LOSS FROM THE COAL BUSINESS.

THE COMPANY'S RETURN ON TOTAL CAPITAL EMPLOYED IN THE BUSINESS FOR THE TWELVE MONTHS ENDED MARCH 31, 1978, ROSE TO 5.8 PER CENT FROM 3.2 PER CENT FOR THE TWELVE MONTHS ENDED MARCH 31, 1977.

"SOHIO'S SHARE OF NET CRUDE OIL PRODUCTION FROM THE PRUDHOE BAY FIELD AVERAGE 332,600 BARRELS PER DAY DURING THE FIRST QUARTER OF 1978, WITH NO OIL PRODUCTION FROM THIS SOURCE IN THE FIRST QUARTER OF 1977," WHITEHOUSE SAID. IN EARLY APRIL, NET SUSTAINED PRODUCTION PASSED 400,000 BARRELS PER DAY, WHICH RAISES BP'S STOCK INTEREST TO 45.5 PER CENT.

REPAIRS TO PUMP STATION EIGHT, WHICH WAS DAMAGED BY FIRE DURING STARTUP OPERATIONS OF THE TRANS-ALASKA PIPELINE, WERE COMPLETED EARLY IN MARCH AND AN OPERATING LEVEL OF MORE THAN 1.1 MILLION BARRELS PER DAY IS EXPECTED TO BE SUSTAINED DURING THE SECOND QUARTER THIS YEAR. FOR THE FIRST HALF OF APRIL, OPERATIONS AVERAGED ABOUT 1,130,000 BARRELS PER DAY. AT THIS RATE, SOHIO'S NET SHARE OF PRUDHOE BAY PRODUCTION WAS ABOUT 525,000 BARRELS PER DAY.

INCOME FROM OPERATIONS BEFORE INTEREST AND INCOME TAXES WAS $164.7 MILLION, UP FROM $43.8 MILLION IN 1977. PETROLEUM OPERATIONS IMPROVED TO $173.2 MILLION FROM $25.2 MILLION IN 1977, ALTHOUGH THE IMPROVEMENT WAS RESTRAINED BY LOWER THAN EXPECTED REFINERY RUNS DUE TO SEVERAL MECHANICAL PROBLEMS DURING THE QUARTER. COAL OPERATIONS LOST $10.7 MILLION, COMPARED TO AN $8.7 MILLION INCOME IN 1977. CHEMICALS AND PLASTICS DECLINED TO $2.1 MILLION FROM $3.1 MILLION. ROYALTIES WERE DOWN $7.7 MILLION IN THE FIRST QUARTER OF 1976, WHEN A FIXED SUM LICENSE WAS SOLD TO A TURKISH FIRM.

FIRST QUARTER SALES AND OPERATING REVENUE REACHED $1.03 BILLION, UP 25 PER CENT OVER $823.5 MILLION FOR THE SAME PERIOD LAST YEAR, DUE PRIMARILY TO ALASKAN CRUDE OIL SALES.

COSTS AND EXPENSES, OTHER THAN INTEREST AND INCOME TAXES, ROSE 11 PER CENT TO $865 MILLION FROM $761.9 MILLION IN THE FIRST QUARTER OF 1977. THERE WAS A SUBSTANTIAL INCREASE IN DEPRECIATION AND DEPLETION BECAUSE OF ALASKAN OIL OPERATIONS.

"NET INTEREST EXPENSE INCREASED TO $114.9 MILLION FROM $17 MILLION IN THE FIRST QUARTER OF 1977, REFLECTING THE DISCONTINUANCE OF CAPITALIZING OR DEFERRING INTEREST DURING CONSTR-UCTION, TESTNING, AND FILLING OF THE TRANS- ALASKA PIPELINE. INCOME TAX EXPENSE INCREASED DUE TO HIGHER PRE-TAX INCOME.," WHITE-HOUSE CONCLUDED.

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04/2478 - -1

SOHIOBPA A ANG

SOHIO 2 CLV

EXXON COMPANY, U.S.A.
POUCH 6601 • ANCHORAGE, ALASKA 99502

PRODUCTION DEPARTMENT
ALASKA OPERATIONS

March 22, 1978

Mr. W. Monte Taylor

The alleged Croft-Hammond Compromise substitute bill adopts Croft's separate accounting approach for the determination of corporate income tax liability for oil and gas production and pipeline transportation income. The compromise bill adopts Hammond's apportionment of book income approach for the determination of income other than oil and gas production and pipeline transportation income.

Croft's Senate CS 322, currently in the Senate Resources Committee, and the compromise proposal would adopt variations of wellhead value to directly determine gross income from Alaska oil and gas production with the compromise bill allowing the Department of Revenue flexibility to determine that value by regulation. Definitions of gross income from Alaska production and specific deductions therefrom to arrive at taxable net income are compared below. The major difference between the two bills in allowable deductions is the allowance of some overhead and administration expense by the compromise bill.

Income from oil and gas pipeline transportation would be the same as reported to certain regulatory agencies under both the compromise and Croft's Senate CS 322.

With respect to income from activities other than oil and gas production and pipeline transportation, the compromise proposal differs from Croft's bill, but is similar to Hammond's bill that passed the House, in that it adopts certified consolidated net income as apportionable income. Croft's bill would use a two-factor property and payroll formula whereas the compromise proposal would use a three-factor property, payroll and sales formula requiring the inclusion of Alaska OCS property and payroll in the formula.

Determination of Gross Oil and Gas Production Income:

Croft's Senate CS 322:	Croft-Hammond Compromise:
Gross value as established for purposes of production tax.	Gross income at the Point of Production. Dept. of Revenue by regulation may

Croft's Senate CS 322:

Croft-Hammond Compromise:

use (1) actual prices or values received, (2) posted price, same field or (3) prevailing prices or values, same field.

Deductions from Gross Income to Determine Net Taxable Income:

Croft's Senate CS 322:

Royalties actually paid

Severance tax actually paid

Property taxes actually paid on property directly associated with production after date of initial production

Direct costs incurred by corporation in operating field

Depreciation on investments associated with production including depreciation on capitalized interest and amortization of lease payments and property taxes paid before initial production

Interest expense not capitalized according to the percentage that property associated with production in Alaska bears to corporate fixed assets everywhere

Expenses after 12/31/76 of unsuccessful exploration efforts in Alaska

Croft-Hammond Compromise:

Royalties actually paid

Severance and conservation tax actually paid

Property taxes actually paid on property used directly in production after date of commercial production

Direct costs incurred by or for corporation in operating lease or property

Depreciation on property used directly in production including amortization of capitalized interest, lease payments and property taxes paid before commercial production

Interest expense not capitalized according to the percentage that property used directly in production in Alaska bears to real and tangible personal property everywhere

Expenses after 12/31/77 of unsuccessful exploration efforts in Alaska

General overhead and administration expenses according to

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Croft's Senate CS 322:

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Croft-Hammond Compromise:

the percentage that property used directly in production in Alaska bears to tangible personal and real property everywhere or .12 cents/bbl or .02 cents for each MCF gas

Determination of Income from Oil and Gas Pipeline Transportation:

Croft's Senate CS 322:

Oil - "Net balance transferred from income" reported to ICC. Certified by Alaska P/L Comm.

Gas - "Balance transferred from income" reported to FPC. Certified by Alaska Public Utilities Commission

Croft-Hammond Compromise:

Oil - "Net balance transferred from income", determined by Dept. of Revenue, reported to Fed. Energy Regulatory Comm.

Gas - "Balance transferred from income", determined by Dept. of Revenue, reported to Fed. Energy Regulatory Comm.

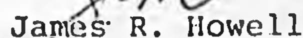
Determination of Income from Activities Other Than Oil and Gas Production and Pipeline Transportation:

Croft's Senate CS 322:

Subtract oil and gas production and P/L transportation income from combined corporate income and apportions balance using two-factor payroll and property formula

Croft-Hammond Compromise:

Subtract oil and gas production and P/L transportation income from consolidated net income certified by CPA for purposes of reporting to stockholders (book income) and apportion by three-factor property, payroll and sales formula, including property and payroll from Alaska OCS in factors



James R. Howell

JRH:djb

xc: W. M. Barstow
H. W. Beathard
N. C. Fitch
S. J. Kettelkamp
R. J. Walker

AGO 547904

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y · STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

April 4, 1978

M E M O R A N D U M

SUBJECT: Milton Lipton's Comments on Draft No. 5 of Proposed CS of CS for HB 322

TO: The Honorable Kay Poland

FROM: Gregg K. Erickson
Director of Research

Briefly, Milton Lipton's comments to me over the telephone were as follows:

1. He suggested that the definition of gross income was too broad. Mr. Messenger and I have not discussed specific language by which it might be narrowed, but I believe such language could be developed in a matter that satisfies the administration.

2. He suggests that we should not necessarily assume that transportation costs set by a tarrif on file with the pipeline commission are necessarily resonable (page 3, line 3-5). He suggests language to take care of the situation where a filed tarrif may be later found to be unreasonable by a court. I am sure that the administration would have no problem with this change.

3. On page 3, line 8, Lipton suggests that we make it clear that royalties paid to individuals or corporations are also deductable As the bill stands now these are taken account of in the determination of gross value, but there should be no problem (no change in the effect of the bill) by putting this deduction here.

4. Milton questions the usefulness of the concept of book income in the allocation of "other income" (page 6, line 25).

5. On page 7, line 18, he questions the "semmetry" of the attempt to use payroll and property located on the Alaska OCS in the allocation formula for "other income".

I am not sure that the administration would accept these last two changes, although their revenue impact seems almost negligable to us.

AGO 547905

LEONARD E. KUST is a partner in the New York law firm of Cadwalader, Wickersham & Taft. He was formerly Vice President and General Tax Counsel of Westinghouse Electric Corporation with which he was associated from 1955 to 1970.

A native of Wisconsin, Mr. Kust is a graduate of the University of Wisconsin and the Harvard Law School. He is a member of the New York and Pennsylvania bars.

He is a past president of the Tax Institute of America, and of the Tax Executives Institute. Mr. Kust has served as Chairman of Governor Scranton's Committee on Tax Administration, Chairman of Task Forces for Governor Shafer's Tax Study and Revision Commission, and was a member of the Advisory Committee of the Commissioner of Internal Revenue. He has served on the Executive Committee of the National Tax Association, as a Director of the Chamber of Commerce of the United States, and as a member of the Taxation Committee. He is a member of the Tax Section of the American Bar Association, a member of the Council of the U.S.A. Branch of the International Fiscal Association, a member of the Advisory Board of Tax Management, and a member of the Advisory Board of the Tax Foundation.

Mr. Kust has written on a wide variety of tax issues, including "State Taxation of Income from Interstate Commerce: New Dimensions of an Old Problem", S.W. L.J. 1 (1960); "State Taxation of Interstate Sales", 46 Va. L. Rev. 1290 (1960); "Federal Tax Reform", the Tax Executive, Vol XIV, April, 1962; "Standards of Conduct for Tax Executives", the Tax Executive, Vol. XIV, July 1962; "A Reappraisal of Taxation of International Business Income", National Tax Association Proceedings, Annual Conference, 1966, p.154; "Alternatives for New Federal Revenues", Tax Review, Tax Foundation, Vol. XX"IV, No. 7, July, 1973.

AGO 547906

GARY I. BOREN

Biographical Information

Education:

Bachelor of Arts, University of California, Los Angeles - 1957

Bachelor of Laws, University of California, Los Angeles - 1961

Member of the Order of the Coif
Note and Comment Editor, U.C.L.A. Law Review

Professional:

Professor of Law and Director of the Graduate Tax Program, Washington University School of Law, St. Louis, Missouri

Assistant Professor - 1967-1971
Associate Professor - 1971-1975
Professor - 1975-Present

Private practice, Los Angeles, California - 1961-1967

Member State Bar of California

Major Publications:

Equitable Apportionment: Administrative Discretion and Uniformity in the Division of Corporate Income for State Tax Purposes
49 So. Cal. L. Rev. 991 (1976)

Specific Allocation of Corporate Income in California: Some Problems in the Uniform Division of Income for Tax Purposes
30 TAX. L. REV. 607 (1975)

Separate Accounting in California and Uniformity in Apportioning Corporate Income
18 U.C.L.A. L. REV. 478 (1971)

AGO 547907

Courses Taught:

*State and Local Taxation
*Federal Income Taxation
*Federal and Estate Gift Taxation
*Seminar in Tax Policy and Current Legislation
*Seminar in Advanced Tax Research
Natural Resources

*Courses taught currently

JOHN S. WARREN

Biographical information

Education:

Bachelor of Science in Law, University of Minnesota - 1943

Bachelor of Laws, University of California, Hastings College of Law - 1950

Professional:

Loeb and Loeb, Los Angeles, California - 1957 to present (partner 1960 to present)

Government positions:

Associate Tax Counsel, California Franchise Tax Board - 1951-1957

Consultant, California Department of Finance - 1962

Consultant, California Legislature, Senate Fact Finding Committee on Revenue and Taxation - 1964

Memberships:

State Bar of California

Committee on Taxation (1958-1962)
Committee on Property Sales and Local Taxes (1975-)
Chairman, Subcommittee on Occasional Sales (1976-)

Los Angeles County Bar Association, Tax Section:

Committee on Federal and California Death and Gift Taxes

American Bar Association, Section of Taxation, Committee on State and Local Taxes:

Subcommittee on Non-Federal Solutions to Interstate Tax Problems (1974)
Subcommittee on Important Developments (1975)
Vice Chairman, Subcommittee on Corporation Net Income Taxes (1976)

Articles:

"Sales of Depreciated Properties to Related Entities," 1959 Southern California Tax Institute

"The Unitary Concept in the Allocation of Income," 12 Hastings Law Journal 42 (with Frank M. Keesling)

"Selected Problems in California Corporation Taxes," 1962 Southern California Tax Institute 939

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"Income Taxation of Testamentary Trusts,"
23 Journal of Taxation 278

"California Franchise Tax Allocation of Income of Unitary Business,"
1966 Southern California Tax Institute 529

"California's Uniform Division of Income for Tax Purposes Act,"
15 U.C.L.A. Law Review 156 (with Frank M. Keesling)

"Reform Act Changes in Pension and Profit Sharing Plans,"
1971 Southern California Tax Institute 137

Lecturer:

"Tax Problems of Closely Held Corporations and Their Shareholders"
California Continuing Education of the Bar, 1974

"Advising on California Taxes"
California Continuing Education of the Bar, 1975

"California State and Local Tax Rules Pertaining to the Entertainment Industry"
California CPA Foundation, 1974

Teacher:

Adjunct Professor of Law in State and Local Taxes,
Loyola University, School of Law
commencing January 1977.

AGO 547910

Alaska State Legislature

Senate

SENATOR
KAY POLAND
DISTRICT L
P.O. BOX 45
KODIAK, ALASKA 99615

KODIAK-ALEUTIAN
DISTRICT

WHILE IN JUNEAU
POUCH V
JUNEAU, ALASKA 99811

February 17, 1978

Don Dickey, President
Alaska State Chamber of Commerce
310 Seward Street
Juneau, Alaska 99801

Dear Don:

Thank you for your letter regarding SCS/CS HB 322. It will be inserted in the Resources Committee hearing record as you have requested.

Additional hearing dates for SCS/CS HB 322 have been scheduled for Wednesay, February 22 and Friday, February 24. If you are interested in providing additional testimony, please contact Sharon Stoops at 465-3717 as soon as possible.

Sincerely,

Kay Poland

Kay Poland
State Senator
Kodiak-Aleutian District

KP:ts

AGO 547911

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

M E M O R A N D U M   April 1, 1978

SUBJECT: SCS CSHB 322 and the Multistate Compact

TO: The Honorable Kay Poland

FROM: Gregg K. Erickson
Director of Research

Several weeks ago, Mr. John Warren testified before your committee and suggested that adoption of the Senate committee substitute for HB 322 would jeopardize Alaska's membership in the Multistate Tax Compact. As you requested at that time, an analysis of these assertions has been prepared and is enclosed herewith (memorandum of March 31 from Mr. Berry to me). A January 26 memorandum on the same subject is also enclosed. An even earlier memorandum is available in our files.

All these memoranda indicate fairly clearly that adoption of either the proposed or existing Senate committee substitutes for HB 322 would not jeopardize the state's membership in the multistate compact. The last paragraph of each memorandum contains a fairly concise summary of its findings.

Please let us know if you wish to have these memoranda circulated to other members, or if you believe additional work is needed in this area.

GKE:jm
Attachments

AGO 547912

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y · STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

M E M O R A N D U M

March 31, 1978

SUBJECT: Membership in the Multistate Tax Compact (Work Order No. 4448 - Part II)

TO: Gregg K. Erickson
Director
Division of Research Services

FROM: Randolph Berry RHB
Legislative Counsel

The question continues to be raised as to the effect on Alaska's membership in the multistate compact of the enactment by Alaska of a statute mandating specific accounting and allocation of income methods for corporations engaged in the production of oil and gas in the state.

As this question has been raised and discussed by various legislative and industry consultants with inconsistent or conflicting answers, it is felt that it would be worthwhile to continue and elaborate on my memorandum on that subject, dated April 28, 1976, to Gregg Erickson, with an attempt to clarify the current state of the law and the practice of allocation of income from oil production in other oil producing states.

There are presently nineteen states which have adopted or joined the Multistate Tax Compact (referred to hereinafter simply as the "compact"). 1/ Of the twelve major oil producing states, 2/ six in addition to Alaska have joined the compact 3/ and five have not. 4/ Of these same twelve oil producing states, ten have income taxes on corporate income; 5/ and of these ten, six are members of the compact. 6/ Of the six oil producing states, in only three has there been litigation on the issue of allocation of income from extractive industry under the compact or UDITPA formula versus separate accounting or other modification of the statutory formula. The litigation in two of these states 7/ involved section 18 of Article IV (the "relief provision"), in the third, the litigation turned on the issue of whether or not the business was unitary in nature, 8/ and the "relief provision" was not raised by either side.

Of the four significant oil producing states which do not belong to the compact but do impose an income tax on corporations with statutory allocation formulas, 9/ one now has a statute which specifically provides that "the income from oil production shall be allocated according to the location of the producing property." 10/ In a second, the court has upheld the requirement of separate accounting for oil production on the ground that the statutory three-factor formula is manifestly unfair to the state. 11/ In the other two, no cases involving departure from the statutory formula was found. Thus it can be seen that there is currently a wide disparity of allocation provision and practice even in the twelve states with the most significant oil production.

In considering whether separate accounting is permitted to be used or may be imposed by a compact state on a business taxpayer involved in business activity in more than one state, it should be borne in mind that the determination may occur in two stages; and either stage may result in a decision that separate accounting is permissible (or conversely that the party requesting separate accounting has not made the necessary showing).

The first stage turns on the question of whether the business activity in the particular state is separate in nature from the taxpayer's business activity in other states, or whether it is part of a "unitary" business. The definition of what is a "unitary" business varies from state to state, which has lead to inconsistencies between member states in the application of the mulitstate compact. However, for a rough working definition, one might say that a unitary business is one in which the business activities of the taxpayer in several states are so interrelated that each part is dependent on the parts occurring in other states.

If the business activity is unitary, then the compact provisions would be applicable to that business activity, and allocation would occur under the three-factor formula, unless relieved under the second stage of the determination.
If, on the other hand, the taxpayer's business activity in the particular state is essentially separate and distinct from his activity in other states, then separate accounting would be appropriate, and the compact formula would not be applicable.

If the business activity falls within the definition of "unitary" as in effect in the particular state, separate accounting may still be permissible for, or required of, that business taxpayer if it is determined, under the "relief provision," that the three-factor compact formula "does not fairly represent the extent of the taxpayer's business activity" in the state.

Whereas the first stage determination of whether a multi-state business activity is "unitary" might be viewed as a decision at the front door of whether the taxpayer enters into the compact's coverage, the determination made at the second stage (under the "relief" provision) is one of whether a taxpayer, already determined to be covered by the compact, leaves its coverage out the side door.

Of the cases discussed in the memo of January 26, 1978, the two California cases - Superior Oil Co. v. Franchise Tax Board, 386 P.2d 33 (Col. 1963) and Honolulu Oil Corp. v. Franchise Tax Board, 386 P.2d 40 (1963), and the Kansas case Webb Resources, Inc. v. McCoy, 401 P.2d 879 (1965), [decided prior to Kansas' entry into the compact], all involved the threshold question of whether or not the business activity involved was unitary in nature, and the question of fairness of the statutory formula was not raised. In both the Utah case Kennecott Copper Corp. v. State Tax Commission, 493 P.2d 632 (1972) and the Louisiana case - Texas Co. v. Cooper, 107 So 2d 687 (1959) [although Louisiana is not a member of the compact, its statutory formula parallels that of the compact] the question was decided on the basis of whether the statutory formula fairly represented the taxpayer's business activity in the state, and in both instances it was determined that it did not.

Since the decision of the Webb case in Kansas, which upheld separate accounting of oil production in the state, Kansas has joined the compact (1967), and the question of separate accounting has again been litigated in Amoco Production Co. v. Armold, 518 P.2d 453 (1974), this time on the question of whether the compact's three-factor formula fairly represented Amoco's oil production business in Kansas. Although John S. Warren, in a position paper, relies on the Amoco case for the proposition that oil companies are not excludable from the compact (p. 4), the case did not in fact contain any such holding. The court did say that although the legislature had chosen to specifically exclude certain businesses from

AGO 547915

the Uniform Division of Income for Tax Purposes Act, it had not chosen to exempt oil companies. However, the holding of the case was based on the fact that the tax administrator had misinterpreted the Act; and the case was remanded for further proceeding by the tax administrator on the question of whether the UDITPA formula fairly represented the extent of the taxpayer's business activity in Kansas. The court, (contrary to the impression given by Mr. Warren), recognized that if the tax administrator found that the formula did not fairly represent the extent of Amoco's business activity in Kansas, then departure from the formula was appropriate; and the use of separate accounting was one of the authorized alternatives.

From the above discussion, it should be evident that there is no clear authority for the statement that Alaska's enactment of HB 322 in any of its versions would jeopardize Alaska's membership in the Multistate Tax Compact. Absolute uniformity is not required by the compact; its own provisions recognize the need for some flexibility on the part of state tax administration. The court in the Kennecott case recognized that the compact formula might be inappropriate to certain industries unless modified, and the Kansas court in Amoco impliedly recognized the legislature's authority to exclude specific businesses or industries as is proposed in HB 322.

RB:jpd

AGO 547916

FOOTNOTES

1/ Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Michigan, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah, and Washington.

2/ Alaska, California, Colorado, Florida, Kansas, Louisiana, Mississippi, New Mexico, Oklahoma, Texas, Utah and Wyoming.

3/ California, Colorado, Kansas, New Mexico, Texas and Utah.

4/ Florida, Louisiana, Mississippi, Oklahoma and Wyoming.

5/ Alaska, California, Colorado, Florida, Kansas, Louisiana, Mississippi, New Mexico, Oklahoma and Utah.

6/ Alaska, California, Colorado, Kansas, New Mexico and Utah.

7/ Kennicott Copper Corp. v. State Tax Commission, 493 P.2d 632 (Utah 1972); Amoco Production Co v. Armold, 518 P.2d 453 (Kansas 1974).

8/ Superior Oil Co. v. Franchise Tax Board, 386 P.2d 33 (Calif. 1963) and the companion case Honolulu Oil Corp. v. Franchise Tax Board, 386 P.2d 40 (Calif. 1963), decided under UDITPA prior to California's entry into the Multistate Tax Compact.

9/ Florida, Louisiana, Mississippi and Oklahoma.

10/ Oklahoma.

11/ Louisiana - Texas Co. v. Cooper, 107 so 2d 687 (1959).

January 26, 1978

MEMORANDUM

SUBJECT: Impact of Proposed Changes in Corporate Income Tax Treatment of Oil and Gas Operations on Alaska Membership in the Multistate Tax Compact (W. O. 4448)

TO: The Honorable John Rader

FROM: Gregg K. Erickson
Director
Division of Research Services

The attached memorandum responds to your questions proposed in the above Work Order. The brief answer to your question is that neither the "franchise tax", "direct accounting", or "4th-factor" approaches are likely to be construed as a breach of the multistate tax compact.

In accordance with your instructions we are forwarding a copy of this memorandum to the Department of Revenue for comment.

GKE:ftc
Attachment

b
cc: Attached memoranda to John Messenger,
Deputy Commissioner of Revenue

AGO 547918

STATE CHAMBER of COMMERCE

310 Second St.

Juneau, Alaska 99801

Phone 586-2323

February 14, 1978

The Honorable Kay Poland
Chairman
Senate Resources Committee
Alaska State Senate
Pouch V, State Capitol Building
Juneau, Alaska 99811

Dear Senator ~~Poland~~: Kay —

Because of the long list of technical witnesses who have appeared and testified on the oil and gas corporate franchise tax (SCS/CS HB 322), I have decided to conserve your Committee's time by putting our views on this proposal in writing.

As you know, I have attended almost all the hearings on this important subject. However, I have yet to hear anyone justify the need for this legislation which Robert Moore of Arthur Anderson's Accounting Firm testified would skyrocket Alaska's tax load to 61% higher than the national average and increase by $1.9 billion the cost to the oil industry over the 25 year life of Prudhoe Bay. Certainly it would be difficult for the State to argue we need the added income to operate government in view of pending legislation dealing with the "Permanent Fund." In the Administration's bill on the fund, HB 298, they proposed setting aside 50% of all royalties, and 100% from bonuses to operate the Permanent Fund. The House version, HB 596, calls for depositing 30% in the fund of royalties, and 100%of bonus monies, while the Senate version calls for a split of 25% royalties and 25% bonuses.

My point is, if the Administration and the legislators feel we can set aside these substantial funds, in a so called "people's savings account", then certainly additional taxes are not needed or justified.

AGO 547919

Senator Kay Poland, Chairman
Senate Resources Committee
Page Two
February 14, 1978

The Alaska State Chamber of Commerce firmly believes that every industry should pay their fair share of supporting needed state government services. With the oil industry presently providing over 60% of the State's operating income, certainly it would appear that they are paying their share, and then some.

Our statewide membership is representative of all of Alaska's basic industries: fishing, timber, minerals, as well as oil and gas. My concern is that if this oil tax legislation were to pass, and it resulted in putting, to any degree, a damper on future exploration for energy resources, other industries would quickly be called upon to pick up the slack and carry a heavier burden of taxation.

With the many problems presently facing all of Alaska's basic industries, the need now is for encouragement, not additional obstacles in their path to expansion.

The Alaska State Chamber requests you reject this costly, unneeded legislation proposed in SCS/CS HB 322.

Thank you for this opportunity to state our position for te record.

Sincerely,

Don Dickey
President

DD:rh
cc: All Alaska State Senators

AGO 547920

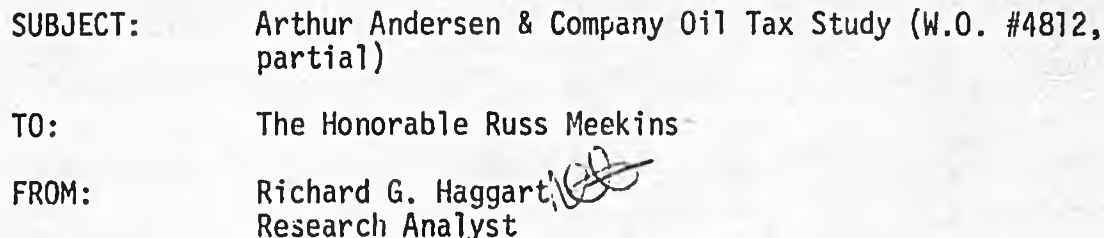
STATE OF ALASKA
THE LEGISLATURE

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

January 31, 1978



SUBJECT: Arthur Andersen & Company Oil Tax Study (W.O. #4812, partial)

TO: The Honorable Russ Meekins

FROM: Richard G. Haggart
Research Analyst

This memorandum is in response to your request that we analyze the Arthur Andersen & Co. report of January, 1978 ("Prudhoe Bay Field and Trans-Alaska Pipeline System Comparative State Tax Burden Study"), and the issues raised therein. Generally, you requested that we examine the following points:

1. The general accuracy of the Andersen report.

2. The applicability of its findings to Alaska.

3. Whether or not the Andersen study is an accurate representation of Alaska's tax burden on the oil industry generally (as opposed to an isolated consideration of Prudhoe Bay).

4. What other factors, if any, might modify or affect the conclusions reached in the Andersen study.

The Andersen Report

The Arthur Andersen report compares the relative tax burden on the Prudhoe Bay field and the trans-Alaska pipeline, of Alaska and seven other oil producing states -- California, Kansas, Louisiana, New Mexico, Oklahoma, Texas, and Wyoming. To make this comparison, Andersen developed a *pro forma* income and expense model for the Prudhoe Bay field and the pipeline for the period 1977-2001, based generally on publicly available data. The tax regimes of the seven other oil producing states were then transplanted to Alaska and applied to the Prudhoe Bay oil field and the Alyeska pipeline over the 25 year period. The results were then tabulated, and compared to the taxes which Andersen estimated would be paid under Alaska's current tax laws.

AGO 547921

The study indicates that, given Andersen's assumptions, Alaska's tax system would generate the greatest amount of revenue from the Prudhoe Bay field and the pipeline of the eight states considered. *In general, we believe the Andersen study represents an accurate appraisal of the relative impact of Alaska's tax system on one oil field and its associated pipeline system. It is not, however, an accurate representation of the relative position of Alaska's oil tax system generally.* This last comment should not be considered a critique of the Andersen report *per se*, since the company performed only that analysis which was requested by its clients. As was noted above, we believe the Andersen report is an accurate response to the precise questions that were raised -- however narrow and incomplete such questions might be, in terms of determining the tax "burden" imposed by Alaska, and the effects of this "burden" on corporate incentives to find and produce oil in the state.

Outlined below are some of the major issues, which, in our judgment, must be considered in determining Alaska's relative position in terms of state taxation of oil and natural gas. Because of time and resource limitations, the material set forth below *cannot be considered definitive.* Instead, we believe it should serve as a starting point in considering the issues raised by the Andersen report and recent associated industry statements regarding Alaska's tax structure. We intend to pursue this analysis and will report further within the next two weeks.

Alaska's Taxes Outside Prudhoe Bay

By limiting the Andersen study to Prudhoe Bay and the trans-Alaska pipeline, an important aspect of Alaska's tax policy was omitted. Specifically, the state of Alaska imposes a *progressive* severance tax, designed to impose higher tax rates on profitable fields and production and much lower rates (or none at all) on less profitable production. By focusing on Prudhoe Bay, with very high per-well productivity, Alaska's severance taxes emerge at very high levels. According to the Andersen study, the effective rate of severance taxation imposed by Alaska on Prudhoe Bay is 11.2% over the life of the field.*

Alaska's relative position in terms of severance taxation, as calculated by Andersen & Co., is shown in Table I.

---

*We currently have underway an analysis of the extent to which this assumption departs from current expectations.

Table I
Relative Severance Tax Burden on Prudhoe Bay Oil 1977-2001

State	Aggregate Severance Tax Collections	% Gross Value
Louisiana	$5.7 billion	12.5%
New Mexico	$5.4 billion	11.4%
Alaska	$5.1 billion	11.2%
Oklahoma	$3.2 billion	6.97%
Texas	$2.2 billion	4.6%
Wyoming	$1.9 billion	4.0%

Source: Arthur Andersen & Co. report "Prudhoe Bay Field and Trans-Alaska Pipeline System Comparative State Tax Burden Study", January, 1978.

In contrast, however, a similar analysis of Alaska's tax burden on Cook Inlet (calculated for the years 1978-1980 utilizing the Legislative Affairs Agency's Severance Tax Model) results in an average tax rate of only 4.6% -- due to the much lower profitability and productivity of the Cook Inlet fields. In contrast, Louisiana's tax rate on Cook Inlet would remain at 12.5%, New Mexico's would *increase* somewhat to 12%, and Wyoming's rate would remain at 4%. The comparative severance tax burden of the six states which impose severance taxes is shown in terms of Cook Inlet in Table II.

Table II

Comparative Severance Tax Burden
Cook Inlet Oil Production 1978-1980

State	(MM/bbl) Cook Inlet Prod.	$ Value	Severance Taxes Due	% Effective Rate
Louisiana	150.5	$876.4	$109.6	12.5%
New Mexico	150.5	$876.4	$104.9[1]	11.97%
Oklahoma	150.5	$876.4	$ 61.4	7.0%
Alaska	150.5	$876.4	$ 40.6	4.63%
Texas	150.5	$876.4	$ 40.3	4.6%
Wyoming	150.5	$876.4	$ 35.1	4.0%

[1] Sum of New Mexico's percentage of value tax and cents per barrel charge.

Source: Arthur Andersen & Co. report "Prudhoe Bay Field and Trans-Alaska Pipeline System Comparative State Tax Burden Study", January, 1978; Alaska Effective Tax Rate from Legislative Affairs Agency, Research Division, Severance Tax Model.

In our judgment tables I and II are significant indicators of one of the important aspects of Alaska's current tax structure: namely, that Alaska imposes much lower tax rates on marginal or expensive production than do most other states. This relative flexibility of Alaska's severance tax statute, and its ability to operate without harming the essential profitability of high-cost or marginal producers, is not adequately addressed by the Andersen study which limits its consideration to the Prudhoe Bay field.

Another important consideration, and one that does not appear in Table II, is that Alaska's tax rate on such marginal fields *continues to decline* as the field's production goes down. Hence, while Alaska's *average* rate for the 1978-1980 period covered in Table II is 4.63%, it is declining each year. Thus, in 1978 the rate is 4.96%, in 1979 it is 4.59%, and in 1980 is down to 4.26%. In contrast, the rates of the other states in the Andersen study will not change appreciably as the rate of production in Cook Inlet declines -- and consequently, would pose ever increasing tax burdens on the producers in that field.

Suitability of Alaska's Tax Structure

Another consideration not addressed in the Andersen report, is the degree to which Alaska's tax system has been uniquely tailored to Alaska's oil situation. Like[illegible], it is at least plausible to assume that other state's have acted simila[illegible]y in designing their own tax systems. Consequently, it is useful to delineate the differences between various producing states that have lead to such different tax structures, and to consider how such different circumstances might make state-to-state comparisons difficult or misleading.

Table III outlines one key distinction between Alaska and several other representative producing states -- average per well productivity.

TABLE III

Well Productivity Calendar 1975

State	Average Daily Production
Alaska	947 bbl/d/well
Louisiana	64 bbl/d/well
California	21.7 bbl/d/well
Texas	20.0 bbl/d/well

While certainly not the sole determinant, well productivity is a very significant factor in determining profitability of a well. It is useful to note that in 1975, prior to any production at Prudhoe Bay, Alaskan oil fields produced at the highest average rate in the United States. The only other state in the U. S. with an average well productivity over 100 barrels per day was Florida. In comparison, recent productivity estimates of Prudhoe Bay wells indicate an average daily production of about 5000 barrels per day -- and the Department of Revenue anticipates that in peak production, the average will be in excess of 7000 barrels per day per well.

AGO 547925

Yet another comparative measure between the various states is the success rate of exploratory ventures. Table IV outlines expenditures for drilling in calendar year 1975 for three states, along with reserves discovered.

TABLE IV

Cost of New Reserves & Field Extensions Calendar 1975
Compared with Prudhoe Bay

State	Drilling Exp. ($ Million)	Oil Found (MM/bbl)	Cost/bbl ($/bbl)	Finding Cost as % of Wellhead Value[1]
California[2]	$ 231.7	18.1	$12.80	100%
Texas[2]	$1507.6	329.9	$ 4.57	35.7%
Louisiana[2]	$2138.6	311.3	$ 6.87	53.7%
***				
Alaska[3] (Prudhoe Bay)	$3,000- $8,000	7,600	$0.395- $1.130	7% - 20.1%

[1] Wellhead values for these three states were assumed to be $12.80 per barrel for newly discovered oil. This figure utilizes the $13.30 per barrel market value for Alaskan crude used in the Andersen study, adjusted for a $0.50 per barrel marketing and transportation charge. It is used for general purposes of comparison only and is not meant to be a definitive valuation of new crude oil discovered in these states.

[2] Data for these three states was calculated from the Joint Association Survey and the Basic Petroleum Data Book, both published by the American Petroleum Institute.

[3] Values for Alaska were taken from the Arthur Andersen & Co. report, January, 1978.

AGO 547926

Tables III & IV are not meant to provide a conclusive demonstration of some aggregate level of profitability of Prudhoe Bay oil. They are, however, illustrative of several comparative measures by which relative levels of state taxation could be compared. On the basis of the data in the Tables, Prudhoe Bay and Alaska generally, clearly emerge as an unusually productive oil province. For example, in 1975, even without Prudhoe Bay, Alaska's per well productivity was 43 times greater than that of California. If current Prudhoe Bay production is included, the ratio expands to over 240 to 1 -- meaning that the average California well produces only about 4/10 of one per cent as much oil per day as does an Alaskan well. Despite this vast disparity, Alaska's tax level on Prudhoe Bay is only about 8% greater than that which would be imposed under California's system of taxation. Again, based on return on investment (as measured by development costs versus wellhead prices) Alaska's oil emerges as highly profitable production, relative to recent experiences in other states. Thus, utilizing the Andersen data, the *full* finding and development over the entire life of the field costs of Alaska oil in Prudhoe Bay total only about 20% of wellhead value on a per barrel basis. This can be compared with the weighted average drilling cost (which does *not* include full field development expenditures as does the Alaska figure) for the three states in Table IV, which is 46% of the wellhead value. It should be noted here that investment in the trans-Alaska pipeline should not be included in these sorts of calculations, since for comparative purposes, the carriers are earning *no less* a rate of return on the pipeline than they would in any other taxing jurisdiction. And, even if the pipeline were included in the calculation, total investment in the line and the field would still only total 41% of the wellhead value of the Prudhoe Bay reserves 5% less than the weighted average of the states in Table IV.

Conclusions

The Andersen study compares the Alaska tax system with seven other taxing jurisdictions and concludes that in terms of Prudhoe Bay, Alaska's tax burden is the highest. For the reasons discussed above, we believe the Andersen study is of very limited value in determining whether or not Alaska's tax structure is "fair" or whether it is excessive compared with other states.

The key element in Alaska's tax structure which is not reflected in the Andersen report is the essentially progressive nature of the state's severance tax. *It is absolutely clear that if Alaska's severance tax system were transferred, without modification, to the other five states that impose severance taxes (as outlined in the Andersen report) the severance tax collections would be virtually nil in those states.* This is simply because Alaska's current law imposes no severance tax on wells producing less than 300 barrels per day, while the average daily production in *all* states, save Florida, is less than 100 bbls/d. As a consequence, we believe that Alaska's tax system would generally rank relatively low

AGO 547927

if it were transferred "as is" to other states. What does this prove about Alaska's "tax burden"? In our judgment, it proves little, save that indiscriminate transfers of state tax systems among otherwise dissimilar jurisdictions can produce somewhat unusual -- and misleading -- results.

RGH:fc

AGO 547928

February 9, 1978

The Honorable Kay Poland
The State Senate
Pouch V
Juneau, AK 99811

Dear Senator Poland:

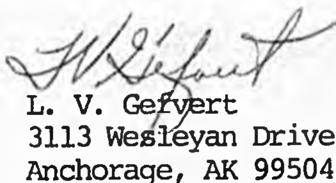
I subscribe to both the morning and evening newspapers here in Anchorage. From what I read I reach the conclusion that the oil industry pays more than its fair share of taxes in the State of Alaska. These newspapers and the TV news media state that Alaska taxes the oil industry the highest of any state in the Union. There might be some argument that by some standards that Alaska does not tax the highest but there seems to not be any argument by any standards that Alaska is at least second highest in assessing taxes upon the oil industry of any state in the Union.

These same sources of news point out that the current Legislature wants to raise these taxes significantly higher so that, among other things, there will be no question in anyone's mind as to which state treats the oil industry worst in providing an encouraging environment for the discovery and development of additional reserves of oil. The industry drilled only ten exploratory wells in 1977 in Alaska, a state twice the size of Texas which drilled over 3,000 exploratory wells. The only conclusion I can reach is that the Alaskan Legislature does not want the oil industry's presence in Alaska except on a subsistence level to where no risk capital can be generated for a meaningful amount of exploratory drilling.

I work in the oil industry and have done so for well over 30 years. I have lived in Alaska six years. My family and I enjoy Alaska. I wish to finish my career in the oil industry working here in Alaska.

I want you to know that if I hear that further oil industry taxation is passed by the legislative session or future legislative sessions, I will express my disgust in the voting booth and encourage my family to do the same. I furthermore will encourage my friends, neighbors and business associates including storekeepers, barbershops and all to express themselves similarly in the voting booth. I will exhort my family to encourage their friends, neighbors, business associates, storekeepers, etc. to do the same thing. Please make it possible for me not to have to carry out such a threat.

Sincerely,



L. V. Gefvert
3113 Wesleyan Drive
Anchorage, AK 99504

AGO 547929

February 10, 1978

Senator Kay Poland, Chairwoman
Resources Committee
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Senator Poland:

The reason for my writing is to let you know my thoughts on the on-going debate relating to increasing, stabilizing or decreasing taxes being sought on oil, minerals and the like.

First: I am in the middle income group, work in a non resource oriented field - health care, don't know too much about oil taxation, am a moderate politically, and feel that non-renewable resource development - although perhaps destructive at times to the enivornment - is a fact of life to our country until another reasonable energy source can be developed that is affordable to the general population. If we have the resource - it should be developed, and in developing we should encourage the industry - not make them pay through the nose at the expense of all the consumers who end up paying for it (because of high taxes).

Alaska, to me, is a land of many special interests to special interest groups. There are very few people here who don't have a special interest. Some of these special interest groups can contribute significantly to our tax base - monies which will and are used to pay for the many services required by non-income producing special interest groups. As there are only a few groups that can make this contribution via taxes, then it looks to me that 1. we either have to stop spending - if taxes are to stay the same 2. Increase their taxes over and over and over -- or tax the public higher and higher or 3. Bite the tax bullet for a while to stabilize taxes - so other companies might look to Alaska as a good place to come and invest. New companies could then help to pick up the slack in tax revenues that we have been taking from a few and revenues would be increased because of larger numbers contributing a moderate amount - rather than a few pavi[illegible] all the freight.

Lastly, I seriously wonder if all the money we are asking for is all that necessary. I realize that we have to look to the future (a la permanent fund savings), but that is only if we are going to continually rely on non-renewable resources for our revenues. I would rather be more optimistic about Alaska and say that our growth potential in other industries which don't have to totally rely on these resources can be as great in revenue producing efforts.

Lets stabilize our tax base so investors won't be looking over their shoulders each year - thinking that the legislature is going to change taxes and structures every year. No company can feel comfortable with that spectre facing them.

Don't increase taxes to oil and gas. I would hate to see those golden eggs turn to lead -- while at the same time turn potential nuggets of potential in another direction to line someone elses pocket.

AGO 547930

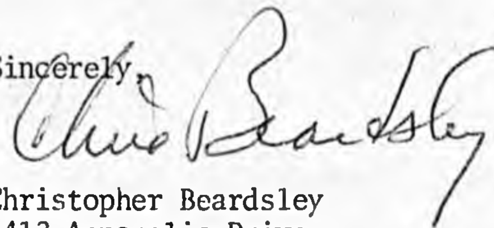
The point here is not whether ARCO, Exxon, Mobile, BP and others are making alot of money here or anywhere else. The point is that Alaska must continue to provide from a stable base, and that means encouraging other industries in addition to our good working relationship with the non-renewable people in resources.

Our people (me included) and the existing companies are now paying some of the highest taxes in the nation. Frankly I think our state is overspending in some areas and that there is some waste. The fishing,commercial and sport industries, timber development, and soft ware and service industries are taking a back seat in being encouraged. As long as we continue to change and increase taxes, the situation is going to become worse.

As just a regular tax power, who lacks the sophistication of totally understanding this whole complex structure, I hope that you will consider my points.

Thank you for your consideration.

Sincerely,



Christopher Beardsley
1412 Annapolis Drive
Anchorage, Alaska 99504

cc. Sen. Chancy Croft
Sen. Pete Meland

AGO 547931

TELEGRAM

RCA ALASKA COMMUNICATIONS, INC.
PHONE 586-9140
JUNEAU, ALASKA 99801

1978 FEB 13 PM 7 58

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PMS SEN KAY POLAND CHAIRMAN OF RESOURCE COMMITTEE

JUN

THE ANCHORAGE CHAMBER OF COMMERCE OPPOSES ANY INCREASES IN TAXES ON OIL AND GAS OR OTHER BUSINESSES AT THIS TIME AS WE BELIEVE SUCH WOULD NOT SERVE THE LONG TERM BEST INTERESTS OF THE BUSINESS COMMUNITY, THE STATE OR THE PEOPLE OF ALASKA, SINCE EXISTING TAXES ARE EXPECTED NOT ONLY TOMEET FUTURE NEEDS OF THE STATE BUT ALSO TO BUILD A HUGH SURPLUS. TAX INCREASE ARE NOT NEEDED, TAXATION POLICIES WHICH PROVIDE INCENTIVE FOR INVESTMENT, BUSINESS DEVELOPMENT AND CREATION OF NEW JOBS WILL BETTER SERVE THE PEOPLE OF ALASKA.

WALT BONNETT LEGISLATIVE AFFAIRS CHAIRMAN

AGO 547932

TABLE I

Net Income Tax Liability in Prudhoe Bay Under Present Tax Laws and Under Proposed CS for CS for HB 322 (Resources)
($ Thousands)

	Pre-Tax Net	State Income Tax	Federal Income Tax	Total Income Taxes
Current State Income Tax[1]	$37,294.000	$1,539,000	$17,162,000	$18,701,000
Effective Rate on Pre-Tax	NA	4.1%	46%	50.1%
Income Tax Under Proposed Substitute[2]	$37,294,000	$3,506,000	$16,218,000	$19,724,000
Effective Rate on Pre-Tax	NA	9.4%	43.5%	52.9%
Net Change in Liability[3]	NA	+$1,967,000	($944,000)	+$1,023,000
Net Change in Rate	NA	+5.3%	(2.5%)	+1.8%

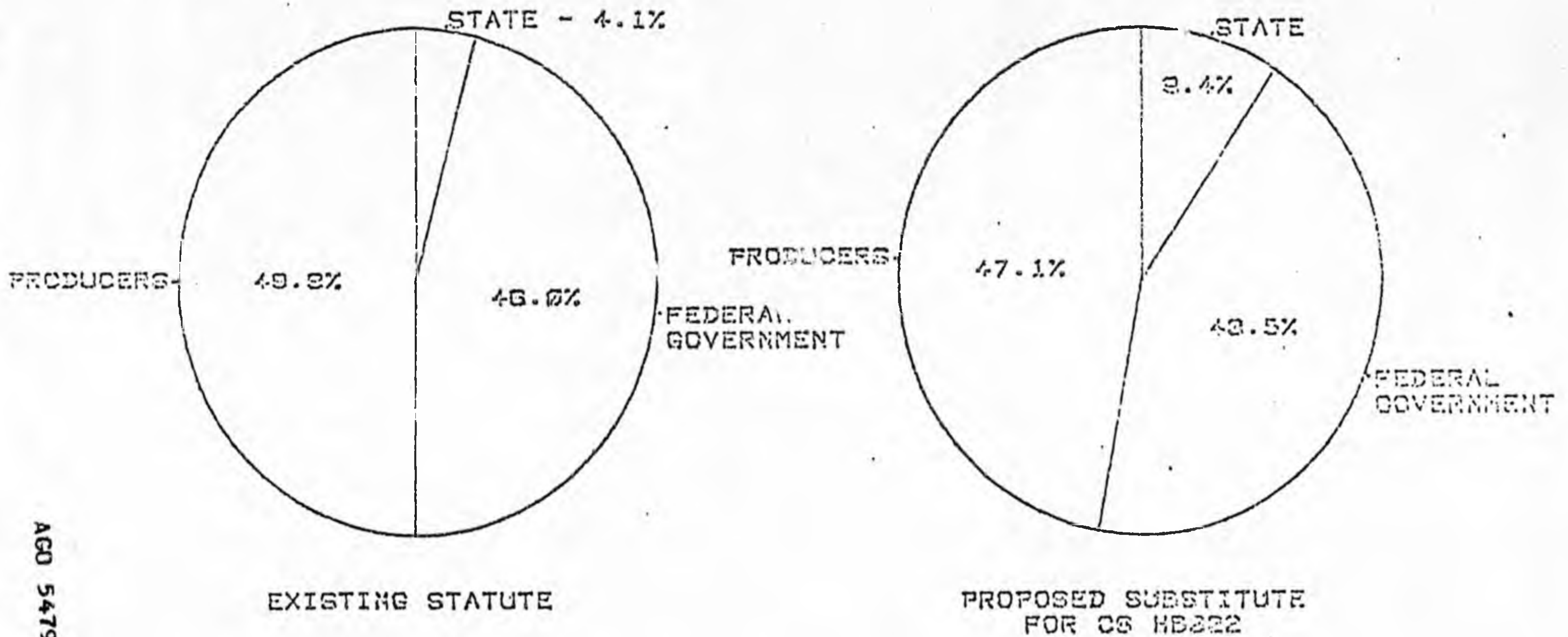
1 Pre-tax net income and estimated state income taxes from Prudhoe Bay and the trans-Alaska Pipeline system are taken from the Arthur Andersen & Co. report of January, 1978. Federal tax liability is assumed to be 48% of pre-tax after deduction of state income taxes. Total taxes are the sum of state and federal taxes.

2 Pre-tax net income is taken from the Arthur Andersen & Co. report of January, 1978. State income taxes were calculated as 9.4% of pre-tax net. Federal income taxes were assumed to be 48% of pre-tax after deduction of state income taxes. Total taxes are the sum of state and federal income taxes.

3 Net changes in tax liability represent the increase (or decrease) in tax liability for state, federal and total income taxes under the proposed substitute.

AGO 547933

COMPARATIVE INCOME TAX BURDEN

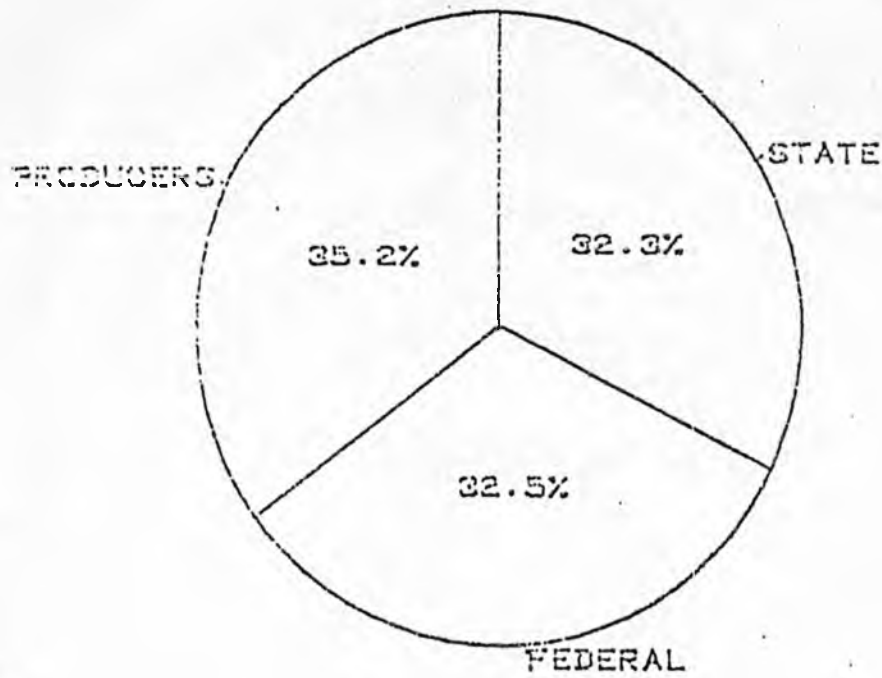


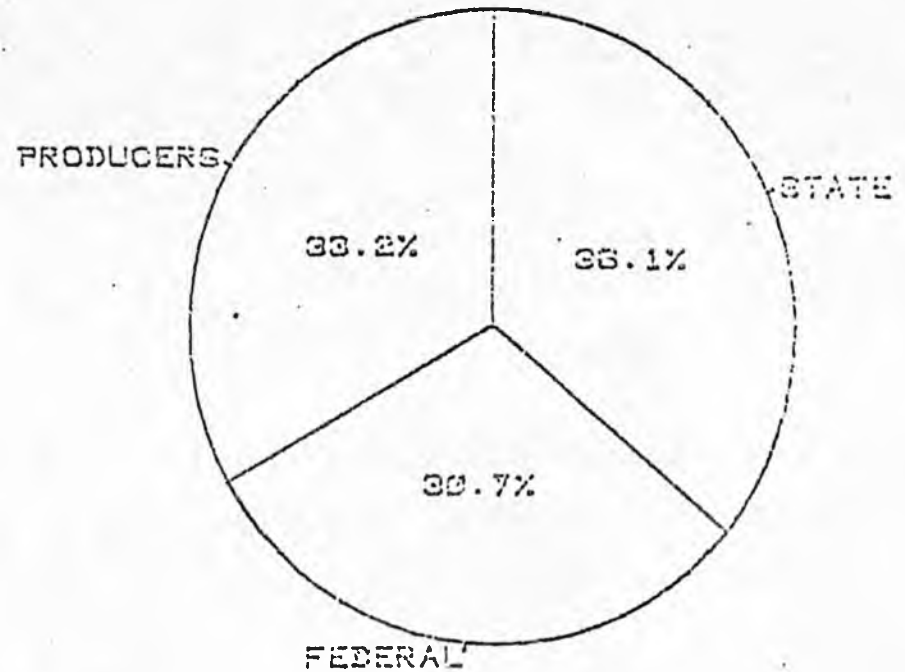
AGO 547934

Legislative Affairs Agency
Research Division
March 24, 1978

CHART J

NET REVENUE SHARES





AGO 547935

Legislative Affairs Agency
Research Division
March 24, 1978

TABLE I

Impact of Proposed CS for CS HB 322 (Resources)
On Relative Prudhoe Bay Net Revenue Shares
($ Millions)

	Existing Statute		Proposed Substitute		Net Change	
	Net Revenues	Per Cent Share	Net Revenues	Per Cent Share	Change in Revenues	Per Cent Change in Revenues
Companies	$18,593	35.2%	$17,570	33.2%	($1,023)	(5.5%)
State	$17,086	32.3%	$19,053	36.1%	+$1,967	+11.5%
Federal Government	$17,162	32.5%	$16,218	30.7%	($944)	(5.5%)

Note: Based on Arthur Andersen & Co. report of January, 1978. State revenues include all royalties and taxes. Federal revenues are assumed to be 48% of pre-tax income after deduction of state income taxes. Net revenues to the companies is assumed to be pre-tax income less state and federal income taxes.

Figures in Table I are for the three largest oil producers in Prudhoe Bay (representing 93.7% of production) and for the four largest owners of the trans-Alaska pipeline system (representing about 90.18% of ownership).

Prepared by:

Legislative Affairs Agency
Research Division
24 March 1978

AGO 547936

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

POUCH S – JUNEAU 99811

Summary of the Proposed Committee
Substitute for House Bill 322

This proposal contains provisions of both the original House Bill 322 as introduced by the Governor and the Senate Committee Substitute for House Bill 322. It represents a compromise between the two versions which retains in large part the concept of separate accounting approach to assessing oil and gas production and pipeline transportation income, but works to avoid the problems of corporate manipulations and profit shifting by providing the state greater control in the determination of that income. It also contains elements of the original House Bill 322 for purposes of determining that portion of the income earned by oil and gas corporations from activities other than production and pipeline transportation.

DETERMINATION OF INCOME

1. Oil and Gas Production

Production income is determined under a separate accounting method. That is, instead of taking world-wide income and apportioning that income to the state based upon a formula, the income in the state is determined directly by looking only at the income and expenses of the production activity in the state. This is done as is in the bill adopted by the Senate Resources Committee by taking the well head value of total production as gross income and deducting a specified list of expenses to arrive at net income. The same list of deductions is retained except an allowance for general administrative expense or overhead is made.

The major change to the approach however is that the state plays a major role in the determination of the income by assessing the net income and tax due. This direct role by the state in assessing income will hopefully avoid the possibilities for profit shifting and other income manipulations.

AGO 547937

2. Pipeline Transportation

Income from pipeline transportation is also determined on a separate accounting basis. As in the Senate Resources Committee substitute, the income is determined according to amounts reported to the Federal Energy Regulatory Commission.

This income is also assessed by the department.

3. Income from Activities other than Pipeline Transportation and Production

Income from activities other than production and pipeline transportation is determined under a formula approach after subtracting out production and pipeline transportation income.

First the world wide book income of the corporation is determined. From this amount is subtracted the income determined separately for production and pipeline transportation activities. The remaining net income is then apportioned using the present uniform formula of property, payroll and sales. Since production and pipeline transportation income are determined separately that portion of property, payroll and sales attributable to these activities in Alaska are subtracted from the numerators and denominators of the apportionment formula. What remains in the formula is just the elements of property, payroll and sales attributable to other activities.

In addition the proposal would adjust the apportionment formula to take account of OCS activity.

PUBLIC REPORTING AND LEGISLATIVE OVERSIGHT

As in the Senate Resources Committee Substitute, annual reporting of aggregate income and expense statistics is provided for. In addition, the proposed substitute provides for an annual review of the department's assessment actions by the legislative auditor with an annual report to the legislature.

ASSESSMENT

This proposal differs from the Senate Resources Committee Substitute in that the department is provided more control in the determination of income. This is done to help avoid profit shifting and other manipulations of income. Thus the authority is given to the department to assess directly the income taxable under the proposed statute. The resulting income that would be assessed is then taxed at the standard corporate income tax rate of 9.4 percent.

AGO 547938

BEFORE THE SENATE RESOURCES COMMITTEE

TESTIMONY OF

CRAWFORD H. THOMAS

SCS for CS for HB 322

February 24, 1978

Madame Chairman and Members of the Senate Resources Committee:

My name is Crawford Thomas. I live in Sacramento, California. I have had a long association with state income taxation. I am now retired. Until my retirement in early 1974, I was Chief Counsel of the California Franchise Tax Board for eight and one-half years. The Franchise Tax Board administers the income tax in California.

I commenced working for the Board as an attorney in 1940. My entire time while I was associated with the Board was devoted to legal and administrative problems of state income taxation.

I estimate that about one-half of my time was spent on matters involving the taxation of the income of multistate businesses and the apportionment of such income.

I started my career in taxation at the time when the unitary concept, which you have heard discussed at some length, was first being seriously applied, although the concept had been recognized for some time. I participated in the extension of the unitary concept from its application to a single corporation to its

AGO 547939

application to parent and subsidiaries, to foreign subsidiaries and, finally, to the so-called world-wide combinations. I understand that your state now uses essentially the system as is in effect in California.

I was heavily involved for several years in opposition to federal intervention in state income taxation, through the Willis bill and its successor bills.

I was involved with the Uniform Division of Income for Tax Purposes Act, from the time it was first being seriously considered by the states. I supervised the drafting of regulations under this act, which later became the basis of the regulations adopted by the Multistate Tax Commission. Alaska was one of the first states to adopt the Uniform Law for dividing income.

I was involved with the Multistate Tax Compact from the very birth of the Compact idea.

Some substantial portion of my time was spent reviewing and analyzing proposed tax legislation in the California legislature. A prime reason for this review was to spot problems in proposed bills. I have reviewed the bill before you and I have found what I believe to be some major problems. I would like to discuss these problems.

AGO 547940

Under your present Alaska law and your administrative practice, an integrated oil business is treated as a unitary business and its Alaska income is determined to be that percentage of its total income, as determined by use of the standard apportionment formula of property, payroll and sales.

This method of apportionment is set forth in the Multistate Tax Compact which Alaska has adopted as its law.

This Compact has a higher status than an ordinary state law. It is a solemn covenant entered into by Alaska and some 18 other states, guaranteeing that taxpayers will be taxed in accordance with the terms of this Compact.

This bill does not amend the Multistate Tax Compact contained in your present law.

I doubt that having adopted the Compact, a state could unilaterally amend it, without violating the Compact and eliminating Alaska as a Compact state.

This bill starts out by saying that, notwithstanding the present law which provides that income shall be apportioned as provided in the Compact, the income of oil and gas production or transportation companies derived from Alaska shall be determined by separate accounting under the provisions of Sec. 18 of Article IV of the Compact.

AGO 547941

I shall return to this Section 18 in a moment and at some length.

This bill thus segregates unitary oil and gas producing or transporting companies from other unitary companies and says oil and gas companies, alone, must use a separate accounting procedure. It thus treats these companies as conducting businesses in Alaska entirely separate and distinct from the rest of their world-wide completely integrated businesses.

Now, having totally discarded the unitary concept and use of the uniform formula for computing Alaska production or transporation income, the bill completely reverses itself and considers the out of state income, less the Alaska income, to be unitary income and apportions this by use of a two factor formula which uses only the property and payroll factors.

This treatment of a business as non-unitary for one purpose and unitary for another is completely inconsistent.

We now come to a very major problem, one that I believe has not been sufficiently called to your attention.

If my analysis is correct, then enactment of this bill will not change the present method of apportionment of oil companies. The reason is that in enacting the Compact you also enacted Article III, Section 1 of the Compact. This section provides

AGO 547942

that a taxpayer may elect to apportion its income either under the state law, or under Article IV of the Compact which is the uniform apportionment law. By enacting and entering into the Compact, Alaska guarantees this option to its taxpayers to use the formula of property, payroll and sales.

If this bill is enacted as law, an oil company would have a very strong legal argument that it could exercise its option not to report under this law, but to report under the Compact and use the uniform apportionment formula rather than the method used in this bill.

I can find nothing in anything presented to you denying that this would be so.

This bill apparently seeks to eliminate the taxpayer's option by attempting to use Article IV, Section 18, of the Compact to force oil companies to apportion their income by separate accounting.

You will recall that Section 18 states that if the uniform formula does not fairly represent the extent of the taxpayer's business activity in the state, the tax administrator may require the use of separate accounting or a change in the formula.

Leaving aside for the moment the fact that under this bill the legislature and not the tax administrator is making the deter-

AGO 547943

mination, I think we should look at this Section 18 in some depth.

Two years before Alaska adopted the Uniform Act for division of income now contained in the Compact, Professor Pierce of the University of Michigan, the drafter of the Uniform Act, published his article (35 Taxes 747 (1957)) stating that Section 18 should be employed sparingly and only to avoid situations which were unusual and where use of the uniform formula would create constitutional problems.

In other words, it was to take care of unforeseen situations unknown at the time the Act was drafted.

My personal knowledge, gained at meetings with state representatives to discuss the Uniform Act, is that the states were very wary of this section. It was felt that unless Section 18 was strictly interpreted, the Uniform Act could not achieve uniformity and could be rendered meaningless.

This strict interpretation has also been the interpretation of the states, including Alaska, forming the Multistate Tax Commission and entering into the Compact.

This strict interpretation is set forth in Regulation IV-18 of the regulations issued by the Multistate Tax Commission.

AGO 547944

The first paragraph of the regulation merely restates the text of Section 18. The second paragraph is very important. I do not believe it has been brought to your attention.

That paragraph states:

> "Article IV, Sec. 18 permits a departure from the allocation and apportionment provisions of Article IV only in limited and specific cases."

Here, the attempt in the bill before you is not to apply it to limited and specific cases, but to an entire industry.

The paragraph of the regulation continues to read:

> "Article IV, Sec. 18 may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce incongruous results under the apportionment provisions contained in Article IV."

There is nothing unusual about the fact situation concerning oil companies. Oil companies are not unusual. They have been around for years. For the same reason, it is not a "unique" situation as referred to in the regulation.

It is not nonrecurring, it is a permanent situation.

AGO 547945

The results are not incongruous, that is, unfit or inappropriate. To the contrary, they are fit and appropriate for a unitary business. About 95% of the other states, including Alaska, so hold, as does the great weight of legal authority in this country.

Getting back to Section 18, it specifically says that the tax administrator shall make the determination to use a different method of apportionment. It does not give this authority to a legislature.

As the section is to be used only in specific and unusual cases, this is not only a sound requirement but a vital one.

Only the tax administrator is in a position to investigate specific cases, and only he can make a determination that the case falls within the intent of the section and the regulations.

The Oregon Supreme Court has twice decided that the burden of proof is on the party seeking to invoke Section 18, whether the party be the taxpayer or the State. (Donald M. Drake Co. v. Dept. of Revenue, 236 Ore. 26,500 P2d 1041; Coca-Cola Co. v. Dept. of Revenue, ___ Ore. __,___ P2d ____).

This major problem, as I see it, is that under the present facts, the administrator would have a very difficult time

AGO 547946

meeting the burden of proof. The legislature could not. It would not only not be a party to the proceeding, but a mere legislative declaration that the formula does not fairly represent the extent of the business activities in the state is not proof.

The next major problem is that even if the proper party invoked Section 18, or if Alaska withdrew from the Compact and enacted a law requiring oil companies to allocate income by separate accounting, your revenue department, in either instance, would encounter extreme legal difficulties in putting the law into effect and enforcing it.

As others have testified at great length, the great weight of legal authority in this country is that integrated multistate companies such as these are unitary businesses.

I am not aware that you have been given any testimony or information that such companies are not unitary.

As others have also testified, if a business is unitary, the use of the formula is required to determine the income to be apportioned to the state.

I am not aware that you have been given any testimony or information that this is not so. Your revenue department has

AGO 547947

consistently taken the position that this concept is correct. The department's position is a matter of public record.

The only support I have seen for the use of the separate accounting method comes from your consultant, Milton Lipton. Mr. Lipton has simply stated a conclusion that there is a deficiency in the present income tax structure and that separate accounting is the way to cure the deficiency, as it will produce more revenue from the oil companies. Mr. Lipton has avoided the vital question of whether the separate accounting method may, in fact, be used.

In th face of the problems I have just outlined, plus those matters addressed by such undisputed experts in their fields as Mr. Kust, Mr. Warren, and Professor Borer in their papers and testimony, it would seem to me that this committee should need more than the mere unsupported conclusion of Mr. Lipton that use of separate accounting rests on a firm legal foundation.

I am aware of Alaska's situation, that the oil is being extracted and revenues from this source will decline unless new fields are developed.

I am also aware that oil is a wasting asset and that Alaska may not have a highly diversified tax base.

AGO 547948

If litigation should result from enactment of this bill, I think that a court would have no choice but to simply focus only on the question of whether the method used to determine income attributes to Alaska her share of the unitary income. I do not believe other matters should or would be considered by the court.

From the available material I have reviewed, it appears to me that Alaska's tax burden on oil companies is as high as that imposed by other states.

I am convinced that these companies are paying an effective rate of tax of 9.4%. They are paying a tax of 9.4% upon that portion of their income properly apportioned to Alaska.

For example, if the ABC Oil Company's total net income is $10 million and 10%, or $1 million, is apportioned to Alaska by the formula, then the ABC Company pays a tax of $94,000, or exactly 9.4% of its Alaska income.

To say, for example, that the effective rate of tax is only 4.7%, requires the assumption that $2 million rather than $1 million is the amount of income derived from Alaska sources.

Those that so argue rest their assumption upon the conclusion that Alaska income must be determined by a separate accounting method.

AGO 547949

All the testimony you have received shows that such conclusion has no foundation and nothing has been offered in its support.

In going over these matters, I have several times noted the comment that Alaska is not taxing the value of the oil extracted. Such statements misconceive the purpose and function of an income tax. An income tax is not intended to tax the value of oil produced within a state or anything else produced therein.

It is intended to tax that portion of the income of the entire taxpayer entity properly apportioned to the state.

Using an income tax to tax the value of oil produced is simply using the wrong vehicle on the wrong road.

AGO 547950

Crawford H. Thomas
1902 12th Avenue
Sacramento, California 95818
(916) 443-5071

Age:	67
Education:	University of California University of California Hastings College of Law, LL.B. 1937
Experience:	Admitted to Califrnia Bar 1937
1937-1940	Associate attorney, Shelton, Gray & McWilliams, San Francisco. Corporation, probate and x law practice.
1940-1942	Junior and Assistant Tax Counsel, Office of Franchise Tax Commissioner, Sacramento. Legal work in connection with administration of Franchise Tax Act, Corporation Income Tax Act and Personal Income Tax Act.
1942-1946	Military service, including ordnance procurement, contract renegotiation and price redetermination, St. Louis Ordnance District. Legal Officer, Military Government, Japan.
1947-1965	Associate Tax Counsel, Franchise Tax Board. Experience in this position is outlined below.
1965-1973	Chief Counsel, Franchise Tax Board. Experience in this position is also outlined below.

Thirty years of my entire legal career has consisted in working with state franchise or income taxation. I commenced work with the Franchise Tax Commissioner in the year of the landmark decision in Butler Bros. v. McColgan, and have, so to speak, grown up with the unitary concept. I participated in the extension of this concept to parent and subsidiary corporations and use of the combined return, world wide combinations, and through all of the developments of the doctrine to its present form and use.

AGO 547951

I have handled protested cases and hundreds of appeals involving every facet of this question, participated in all the California legislation, and assisted the attorney general in the preparation in all of the California court cases affirming or extending this doctrine. I estimate that close to a major portion of my time was spent on matters involving the unitary business.

In the eight and one half year period in which I was Chief Counsel of the Franchise Tax Board, I supervised all protests, appeals, litigation and legislation involving the unitary business. I participated in many studies and conferences with industry groups, including the oil industry. I was heavily involved in studies of, and opposition to, attempts by Congress to have federal intervention in the state tax field via the Willis bill and its successor bills. I participated in or supervised California's involvement in the affairs of the Multistate Tax Compact and Commission.

I have made many appearances before legislative committees, the Willis Committee, conferences of state tax administrators and tax executives, chambers of commerce and other groups concerned with state taxation.

My experience has given me an in depth knowledge of the problems faced by the state tax administrator and his legal counsel in the interpretation and enforcement of the unitary concept.

AGO 547952

TO: CHAIRMAN, HOUSE RESOURCES COMMITTEE
AND ALL COMMITTEE MEMBERS

FROM: SUB-COMMITTEE ON OIL & GAS

During the week of march 21 - 26 the Joint Senate and House Resources Committees met to hear testimony relating to the various oil and gas taxation bills currently before us. Some of the bills under discussion, have not been refered to this committee.

Of the ones that have been, the Sub-committee on Oil and Gas recommends that H.B. 321, H.B. 322, C.S.H.B. 323, H.B. 328, and S.B. 274 be brought to the full committee's attention for consideration and that they be acted upon and passed out of committee no later than April 7.

Each of these bills have a further referal to House Finance and the Finance Committee has scheduled hearings and work sessions on these bills beginning early next week. Representatives from the oil companies and several nationally recognized economists will be present. We urge all members, who are able, to attend.

RECOMMENDED BILLS

H.B. 321 - SEVERENCE TAX

This tax, in our opinion, rates highest in priorities. It's timeliness is dependant upon the actions undertaken by the Federal Energy Administration in setting a recommended "well head" price by April 15, 1977, and further by actions later taken by the I.C.C. in recommending the transportation cost of North Slope crude. For other features of the bill, we refer the committee's attention to the Governor's transmittal letter for H.B. 321, included with this report.

H.B. 322 - ALASKA NET INCOME TAX OR FRANCHISE TAX

This tax bill, in our opinion, has several advantages over our present income tax collection system. It is easy to administer, is based upon the amount earned within the state, including OCS development, and would provide the State and the industry with a stable taxation policy for years to come. For other features, we refer you to the Governor's transmittal letter for H.B. 322, included in this report.

AGO 547953

H.B. 323 - PROPERTIES AD VALOREM TAX

This tax bill, in our opinion, is premature. It would increase the scope of taxable property to include refining, liquefaction, and marine transportation. We believe that it would act as a "disincentive", at this time, for future development within our state, and of all the tax bills before us, meet with the most resistence. Accordingly, we have asked the Department of Revenue to place before this committee, a committee substitute for H.B. 323 which would reduce the bill to a "house-keeping" measure. This has been done and is before the committee for consideration.

H.B. 328 - RESERVE TAX

This tax bill amends the reserves tax bill to allow a credit reduction of tax levied 12 [20] if the oil flow through the Trans-Alaska Pipeline by October 1, 1977 has reached at least 600,000 barrels of oil on a daily average. Otherwise, the bill extends the reserve tax beyond the December 31, 1977 effective date of the original act. We urge its passage.

S.B. 274 - THE TAKING OF OIL AND GAS ROYALITY IN KIND

This bill requires that royality oil and gas be taken "in kind" rather than in money unless deemed otherwise by the commissioner, the Alaska Royality Oil and Gas Development Advisory Board, and the the Legislature. As an encouragement for future development within our state, we urge the passage of this bill.

Nic:
Are you taking up that bill tomorrow that is supposedly studied [illegible] of?

AGL 547954

CONCLUSION:

The Sub-committee bleieves that the passage of these tax proposals, taken in conjunction with the desire to have the Alaskan Permanent Fund replace the eventual and inevitable passage of our nonrenewable resources, will produce a desired benefit for the State of Alaska. We further believe that they will not act as a disincentive for the oil industry and that their passage will ensure Alaska's "fair share" in the wealth of our state. Regarding this aspect, we urge committee members to read the Tanzer Report, "IMPACT OF INCREASED TAXATION ON OIL EXPLORATION AND DEVELOPMENT IN ALASKA", submitted to all members of the Alaskan State Legislature on March 25, 1977.

We have asked that Mr. John Messenger from the Department of Revenue be present to assist committee members in answering their questions and would, as this time, like to highly commend the staff of Senate and House Resources for providing the back-up material needed for the committee's deliberations.

Rep. Merle G. Snider
Rep. Hugh Malone
Rep. William Akers.

AGO 547955

HOUSE BILL NO. 321 by the Rules Committee by request of the Governor, entitled: HB 321

"An Act relating to the oil and gas properties production tax; and providing for an effective date."

was introduced, read the first time and referred to the Committees on Resources and Finance.

The Governor's transmittal letters appear following the bill to which it pertains: fiscal notes appear in House Supplement No. 31 to today's journal.

"March 8, 1977

HB 321

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99311

Dear Mr. Speaker:

Under the authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.30.060(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill relating to the oil and gas properties production tax.

As a result of a recent study of Alaska's oil and gas tax structure, the Department of Revenue has recommended several changes in the state's production or "severance" tax. This bill incorporates those specific recommendations.

Currently the state's oil production tax is calculated according to "stair stepped" rates depending upon the level of production for the lease or property. As currently structured the tax may have an adverse impact upon a particular property as it reaches its economic limit. The "stair step" approach may not alleviate this adverse effect since the economic limit may vary substantially from one part of the state to another. This is because it may be more costly to produce and transport the oil in the more remote areas of the state. Accordingly, the bill contains an economic limit mechanism which automatically scales the tax rate down as the production nears its economic limit. This will insure that the tax will not unduly inhibit oil production as it reaches its economic limit.

One of the immediate dangers which face the state's revenue picture is the potential for artificially depressed pricing of the state's North Slope oil. This could result from federal pricing decisions or excessive tariff costs from the wellhead to the refinary. To insulate the state's petroleum revenues from these forces, the bill provides for a mechanism which would raise the cents-per-barrel floor to correspond to a mid-range market value for North Slope oil and tie that floor to an index which will let the floor keep pace with inflation.

One of the Department of Revenue's recommendations -- the oil and gas surtax -- which was designed to offset revenue losses due to depressed pricing of North Slope oil and which was to be imposed only on holders of state-owned leaseholds was deleted on the advice of this department because of the substantial legal problems involved.

The bill places the tax on gas at a parity with the tax on oil. Currently gas is taxed at only 4 percent while oil is taxed from 5 to 8 percent. The bill would tax both oil and gas at 10 percent. In addition, the bill sets a cents-per-Mcf floor for the gas tax similar to the cents-per-barrel floor for oil. This new floor for gas corresponds to the highest market price in the state, and it too is tied to an index to keep pace with inflation.

Sincerely,

Jay S. Hammond
Governor "

AGO 547956

HOUSE BILL NO. 322 by the Rules Committee by request of the Governor, entitled:

HB 322

"An Act establishing an oil and gas corporate franchise tax; and providing for an effective date."

was introduced, read the first time and referred to the Committees on Resources and Finance.

"March 8, 1977

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

Under the authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.50.060(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill establishing an oil and gas corporate franchise tax.

The Department of Revenue, in its oil and gas tax study, found two basic deficiencies with the corporate income tax as it relates to oil and gas corporations. This bill would correct those deficiencies.

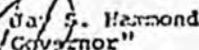
HB 322

The first problem is the eroded federal tax base. The department found that the federal corporate tax base which Alaska has adopted has been substantially eroded by special exemptions, deductions, credits and other accounting devices. The result has been that oil and gas corporations pay an effective tax rate much smaller than the statutory 48 percent. Accordingly, the bill would enact a separate franchise tax on a corporation's "book income." "Book income" is the net income which the corporation reports to its stockholders. This would eliminate all the special Congressional tax provisions.

In addition, the departm[illegible] found that the present apportionment formula does not fully represent the oil and gas corporate activity in the state. The present formula of property, payroll, and sales generally measures corporate business activity in the state. For natural resource companies, however, it does not. No reflection in the present formula is made for the scarcity value of the oil and gas produced. Accordingly, the bill will substitute for the present sales factor an extraction factor which will give weight specifically to oil and gas production activity.

One of the advantages of this franchise tax is that it will take into account elements of property, payroll, and extraction located on the Outer Continental Shelf which causes a resulting impact on the adjoining state. Thus property, payroll, and extraction not located in any state but which are located off the shores of an adjoining state which is impacted by the oil and gas production activity will be allocated to that state suffering the impact. Although this latter provision may raise some constitutional law questions, we believe that the proposal comes within the limits of the state's taxing powers given the impact on the coastal communities of our state of these OCS activities.

Sincerely,



Jay S. Hammond
Governor"

AGO 547957

HOUSE BILL NO. 328 by the Rules Committee by request of the Governor, entitled:

HB 328

"An Act amending the oil and gas reserves ad valorem tax; and providing for an effective date."

was introduced, read the first time and referred to the Committees on Resources and Finance.

"March 9, 1977

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

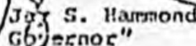
Dear Mr. Speaker:

Under the authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.50.060(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill amending the oil and gas reserves ad valorem tax.

Section 1 of this bill proposes that the reserve tax levy be reduced from 20 mills to 12 mills this year with the condition that an additional levy will be made if there is a delay in the start-up of the Trans-Alaska Pipeline.

This amendment is proposed because the state has a budget surplus for FY 1977. This surplus is somewhat illusory, however, since the reserve tax payments may be recouped by oil and gas producers by credits against future severance tax. Accordingly, the adoption of this measure would reduce the surplus for 1977 and also reduce the amount "borrowed" from future revenues.

Section 2 provides for a contingent 1978 assessment at a rate to be determined by that year's legislature.



Sincerely,

Jay S. Hammond
Governor"

AGO 547958

HOUSE BILL NO. 323 by the Rules Committee by request of the Governor, entitled:

"An Act relating to the oil and gas exploration, production, and pipeline and marine transportation property tax; and providing for an effective date."

was introduced, read the first time and referred to the Committees on Resources and Finance.

"March 8, 1977

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

Under the authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.30.050(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill relating to the oil and gas exploration, production, and pipeline and marine transportation property tax.

The Department of Revenue has recently completed its study of Alaska's oil and gas tax structure and has made several recommendations. One set of recommendations dealt with the state's 20-mill property tax imposed by AS 43.56. This bill would implement that set of recommendations.

The bill corrects four problem areas in the current property tax: the omission of certain important kinds of oil-and-gas-related properties from the definition of taxable property; present uncertainty about how pipelines should be valued; the static nature of the $1500 per-capita limitation on municipal taxation, and the extent to which municipal property tax payments should be allowed as credits against the state tax. The bill's features are described below:

Section 1 of the bill makes clear that taxes paid to municipalities which exceed the statutory limitations in AS 29.53.045 and 29.53.050 are not creditable against the state tax.

Section 3 of the bill removes the current uncertainty on pipeline valuation by ensuring that pipelines will be valued on the basis of their full and true value with due regard to their economic value. This will eliminate the possibility of pipelines being valued under the depressed valuation method of actual cost depreciated.

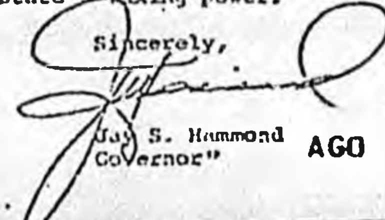
Section 4 of the bill defines full and true value of property used in refining or liquefying of gas or oil as replacement cost less depreciation. It also defines the value of taxable marine transportation property.

Section 7 adds new categories of taxable property including oil refineries, gas processing plants and liquefied natural gas facilities. This will mean greater revenues to the state from these important oil and gas properties.

Section 8 and 9 of the bill tie the $1500 per capita municipal limitation to the Anchorage cost-of-living index in order that the limitation would increase over time as inflation raises the cost to municipalities of providing services to its residents.

HB 323 In addition, Sections 2, 4, 5, 6, and 7 are aimed at amending the relevant provisions of AS 43.56 to provide for the taxation of marine transportation property (i.e. tankers) on an apportioned basis determined by the number of days spent on parts loading and unloading gas and unrefined oil divided by the total number of days-spent-in-ports everywhere. Although these provisions raise close and difficult questions of constitutional law regarding the ability of the state and municipalities to impose an ad valorem property tax on such vessels in light of the traditional application of the "home port" doctrine, it is the view of the Department of Law that these vessels have sufficent nexus with the state to bring them within the constitutional parameters of the state's taxing power.

Sincerely,



Jay S. Hammond
Governor"

AGO 547959

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TESTIMONY BEFORE THE
SENATE RESOURCES COMMITTEE
OF THE
ALASKA STATE LEGISLATURE

By

LEONARD E. KUST

February 10, 1978

Madame Chairman and members of the Committee:

I am LEONARD KUST, partner in the New York City law firm of Cadwalader, Wickersham & Taft. I have been retained by the Alaska Oil and Gas Association (AOGA) to study the present Alaska corporate income tax and the various proposals to change that tax pending before the Alaska Legislature. On December 9, 1977 I presented a 45 page paper to AOGA setting forth my views on these issues. This paper has, I understand, been made available to you and I offer a copy for inclusion in the record of these hearings.

Before I proceed further I think you are entitled to ask whether I have the credentials to presume to give you views which it is worth your time to listen to and consider. I have for this purpose prepared a resume of my past involvement in issues of state taxation of the income of multistate and multinational business. I would like to offer this

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resume for the record and hand copies to members of the committee for their perusal, if they wish.

I understand that your major concern and the concern which the various bills under consideration are intended to address is that the current Alaska income tax fails to reach and effectively tax income derived from oil and gas production and transportation activity in Alaska and your concern that oil and gas corporations operating in Alaska are paying to Alaska significantly less than the statutory 9.4% tax rate on their income.

Let me remind you at the outset of what I am sure you are all aware. Under the United States Constitution Alaska cannot impose its tax of 9.4% on the entire income of corporations engaged in business in Alaska and elsewhere. Such a tax would insure multiple taxation by the states in which the corporation does business and be an unconstitutional burden on interstate commerce.

This constitutional limitation conforms with internationally recognized fundamental principles of tax jurisprudence. Where the activities of a business extend over two or more countries or states, all of the income from such business cannot be taxed by each of the countries or states.

AGO 547961

Accordingly Alaska can impose a tax only on Alaska source income of corporations which operate in Alaska and elsewhere. Any tax which applies to income earned outside Alaska will not only result in multiple taxation but will also violate both the United States Constitution and the generally accepted principles of tax jurisprudence.

The problem, of course, is in determining the source of income. This is not a new problem. It is a problem which scholars, legislators, and tax administrators have struggled with over the years. In this modern era as corporations have expanded their interests throughout the country and in many cases the world the problem has become more acute. The states from the outset upon enacting corporation net income taxes beginning in 1911 strove to avoid imposing an unconstitutional burden on interstate commerce by taxing only a portion of the income of the interstate business. The development over the years has been in devising and refining the method by which to determine the portion of the total income of a multistate business which should be taxed by each state and the attainment of uniformity in the methods used by different states so as to subject to tax all, but not more than all, of the total income of multistate business.

The system which has developed has two elements:

AGO 547962

(i) a tax base measured by a company's worldwide income determined by reference to Federal taxable income and (ii) a method of dividing this base through use of an apportionment formula.

Why a formula approach? Well, the states initially sought to determine the source of income by means of "separate accounting", that is, by constructing an income or loss statement for the activities of the business in the state as if it constituted an independent business dealing at arm's-length with the remainder of the business and the outside world. It was soon evident, however, that separate accounting was not reasonably feasible within the limits of administrative practicability. As a consequence, the so-called "Massachusetts formula" gained early and general acceptance, commencing in the 1920's, among tax administrators and business taxpayers as a reasonable alternative to separate accounting for determining the portion of the total income of multistate business which is taxable in each of the states in which it has activities. The Massachusett's three-factor formula apportions the income of a business to the taxing state on the basis of the average of three fractions:

(1) property within the state over total property,

(2) payroll within the state over total payroll,

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and

(3) sales within the state over total sales.

It was recognized at the outset that multiple taxation of multistate business income arises not merely from failure to apportion reasonably but from disparity in methods of apportionment as well, even though each method by itself and applied universally might be reasonable. The National Tax Association began advocating uniformity in the method of apportionment as early as 1919. Ultimately, these and other efforts culminated in the Uniform Division of Income for Tax Purposes Act (UDITPA) adopted by the National Commissioners on Uniform State Laws in 1957. UDITPA incorporated the three-factor formula and, most notably, defined the numerator of the sales fraction, with respect to which the greatest divergence from uniformity had developed, as being sales having their destination, that is, delivered to customers, in the state.

The Multistate Tax Compact, of which Alaska is a member, inaugurated in 1966 to promote uniformity and thereby avert Federal legislation then under consideration to impose uniformity on the states, incorporates UDITPA.

The UDITPA formula is not without its flaws; clearly it is not perfect. Whether, in theory, a better formula can

AGO 547964

be developed, I do not know. This particular formula rests on common sense which has survived years of practical application. Most importantly, this formula has been accepted by both taxpayers and state tax administrators.

I want to emphasize the general acceptance of the three factor UDITPA formula. Out of my experience serving as co-chairman in 1969-71 of a committee of state administrators and business representatives seeking to formalize a country-wide uniform system for division of income of multistate and multinational business by a combination of the Multistate Tax Compact and Federal legislation, I can report that there was at no time any disagreement among the state tax administrators and business representatives as to the validity of the three factor formula. It was accepted by all as the bedrock on which any system of uniform division of income must rest.

Out of a total of 44 states and the District of Columbia which impose a corporate net income tax, 40 provide for the three-factor formula 25 by adoption of UDITPA or the Multistate Tax Compact and 15 by incorporation in their own tax statutes, four of the latter giving greater weight to the sales factor than to the property and payroll factors. Differences in the economies of the states as to whether primarily industrial, or commercial, or agricultural or extractive have not affected the general acceptance of the three-

AGO 547965

factor formula as essentially fair and reasonable.

The major concern raised by the proposals under consideration by this Committee , and I will discuss the proposals more specifically in a few moments, is that they would seriously disrupt the uniformity which over the years the states and business have labored to achieve, and which, I believe, is essential to fair and effective taxation by the states of the income of multistate businesses. A few other states have begun to tinker with the formula for their own parochial interests. I deplore such action. If you really believe that the UDITPA formula is not reasonable with respect to the oil and gas industry as a whole, the solution is to proceed under Section 18 of UDITPA on a case by case basis or to approach other states and seek a new uniform method for division of the income of the industry. Unilateral action by Alaska or by any other state would generate multiple taxation and would threaten the framework that has developed for division of income among the states.

But beyond the question of uniformity, I believe that both HB 322 and SCS CSHB 322 and the impetus behind them are based on a fundamental fallacy. They are based on the assumption--and I stress assumption--that the "fair" share of income to be taxed by Alaska is

AGO 547966

to be determined by changing the apportionment formula or by statutory "separate accounting" so as to approximate the income based on barrels of production in Alaska times the well-head price less costs and expenses incurred solely in Alaska. This is demonstrably not the "fair" share of income attributable to Alaska. Income is not merely the result of production. The creation of income requires both production and consumption. It is the demand created by the economies of the consumption states that converts the production into income. The consumption states have an undeniably legitimate claim to tax part of the income which is based on this price created by their demand. Would Alaska agree that only the states in which the goods are produced which are sold by Sears in Alaska can tax the income and Alaska cannot? Of course not. As the consumer state in this case it war [illegible] and is entitled to and it does tax a portion of the income from production outside Alaska.

Thus, having read some of the prior testimony, I would take sharp issue with the confident assertion that Alaska's fair share of the income of the oil and gas industry is the well-head price less costs and expenses incurred in Alaska.

I would like to challenge Mr. Lipton and Professor Zeifman to present their arguments to the Multistate Tax Commission or to a meeting of the National Association of Tax Administrators in support of their proposals as appropriate uniform methods to be accepted by all states for division of the income of the oil and gas industry. I think it is reasonable to predict that neither of the proposals would be judged to be a fair and reasonable basis for uniform division of income among the states.

AGO 547967

This committee and the Alaska legislature will ultimately decide what course to follow. It is your responsibility and your prerogative but I would like to suggest that your decision should be made against the broader framework which I have presented rather than the narrow perspective urged upon you in support of the proposals under consideration.

THE ZEIFMAN-AINSWORTH PROPOSALS

The proposals of Professors Zeifman and Ainsworth which are incorporated in H.B. 322 are based on these two premises: (i) that Alaska's tax base has been eroded through Federal tax subsidies and incentives which are unrelated to the definition of net income, and (ii) that the UDITPA apportionment formula unfairly reduces the amount of taxable income attributable to Alaska by corporations which export nonrenewable petroleum resources from the state. Zeifman and Ainsworth recommend:

1. Adoption of a tax base measured by the greater of book income or Federal taxable income, and
2. Replacement of the destination-oriented sales factor with an "extraction factor".

Furthermore, they propose that these changes apply only to corporations with ordinary gross receipts in excess of $250,000,000, more than 50% of which is derived from production, transportation, refining, manufacturing, processing, distribution or retail sale of oil or gas or products derived from oil and gas.

AGO 547968

I believe that Professors Zeifman and Ainsworth are mistaken both as to their premises and their recommended solutions.

The current Alaska income tax base is a corporation's Federal taxable income. That base includes the world-wide income of the corporation - not just United States source income. In determining Federal taxable income, Congress has allowed certain deductions which are not taken into account in determining the corporation's book income. These "tax subsidies", however, are for the most part available to all corporations, including corporations engaged in business solely in Alaska and multinational corporations engaged in various business activities in Alaska. It is unfair to single out the oil industry. If "tax subsidies" are to be eliminated they should be eliminated for all corporations.

Furthermore, with respect to the one Federal "tax subsidy" available solely to the oil and gas industry, a current deduction for intangible drilling costs, it is erroneous to charge that because drilling costs reduce Federal taxable income Alaska in using such income provides an incentive to drilling wells outside Alaska. Federal taxable income reflects not only deductions for the cost of wells drilled outside Alaska but also the income from such wells. It is not a one-way street. Alaska is no more providing an incentive for drilling outside Alaska than other states are providing an incentive for drilling in Alaska.

AGO 547969

The Department of Revenue has cited Congressional studies by Congressmen Vanik of Ohio to support the Department's claim that adoption of the Federal tax base by Alaska results in an effective tax rate significantly less than 9.4%. Vanik's study measures Federal income tax due as a percentage of worldwide income. Obviously this comparison will result in an effective U.S. tax rate of less than 48% for companies engaged in foreign operations because the United States provides a credit against its tax on worldwide income for taxes paid to other countries. This is the necessary alternative to taxing only the income earned in the United States. Similarly, measuring taxes due to Alaska as a percentage of a corporation's total worldwide income will result in an effective tax rate of less than 9.4%. Both comparisons are meaningless, since neither the United States nor the State of Alaska intends or reasonably can impose its tax on the worldwide income of taxpayers without a foreign tax credit or without apportionment. It is primarily because of the division of income (by means of a foreign tax credit at the Federal level and formula apportionment at the state level), not determination of the tax base, that the effective rate on worldwide income is significantly less than the statutory rate. If 25% of the worldwide income of a company is earned in Alaska, obviously the effective rate of Alaska tax on worldwide income will be 2.35%.

The suggestion of Professors Zeifman and Ainsworth, which is incorporated in H.B. 322, that book income be used as

AGO 547970

a tax base is unique. I am aware of no state with a tax base measured by book income, even as an alternative basis. Book income is an inappropriate tax base. Adoption of such a tax base would in effect delegate determination of income to the company's management and the accounting profession. If Alaska is not prepared to accept management's and their accountants' determination, it will have to develop an audit staff sufficient in size and skill to conduct its own audits. It will not be able to rely on the audit skills and extensive examinations of the Federal government or the Multistate Tax Compact.

Furthermore, book income not only reflects taxable income before tax subsidies but also many accounting and timing differences unrelated to Congressional tax policies, many of which reduce book income in comparision to taxable income. As an example, corporations are often entitled and even required for financial accounting purposes to set up reserves for certain estimated expenses or losses which are not deductible in determining Federal taxable income.

Finally, use of the higher of Federal taxable income or pre-tax book net income as a tax base, as is proposed in H.B. 322, will tax income without reduction for those expenses which are deducted in different years in determining book net income and Federal taxable income. For example, if book income

AGO 547971

exceeds Federal taxable income because of current deduction for intangible drilling costs which are deferred for book purposes, and then Federal taxable income in a succeeding year exceeds book income because the deferred intangible drilling costs are then expensed for book purposes, the tax base will be determined without deduction for such costs at any time.

As to substitution of the extraction factor for the sales factor in the apportionment formula, it is my view that the UDITPA formula provides for fair and equitable division of income of oil and gas corporations between Alaska and the rest of the world and fairly reflects the extent of their activity in Alaska as compared to the rest of the world.

The destination sales factor cannot be regarded as allocating Alaska's share of income to other states but more properly as assuring to the market states a fair share of the taxable income base. Without the purchasing power and demand provided by the market states, there would be little if any income of oil and gas companies for Alaska to tax. The sales factor quite properly gives recognition to the contribution by the market states to the creation of the income tax base. Substitution of the extraction factor for the sales factor would ignore the contribution of the market state to the creation of income, just as would an origin-oriented sales factor

AGO 547972

which was used for years by heavy manufacturing states for their parochial interest. Use of this factor was so short sighted that it drove business out of these states. States such as New York and Massachusetts have had to retreat so far that they have adopted double-weighted destination sales factors to attempt to convince businesses to stay or to return to their states.

Alaska may dismiss this experience as irrelevant since the oil is in Alaska and the oil business cannot go elsewhere. Only within limits is this so, but in any event Alaska cannot ignore applicable principles of fairness and of cooperative action among the states to avoid multiple taxation. Use of an extraction factor in Alaska when other states use a destination sales factor would obviously result in multiple taxation. Is it proper for Alaska to take deviant action and expect all the other states to conform their apportionment formulas to Alaska's in order to avoid multiple taxation? Is it appropriate for Alaska unilaterally to disrupt the progress the states have cooperatively been making toward uniformity in their apportionment formulas?

Professors Zeifman's and Ainsworth's proposal to replace the destination sales factor of the UDITPA formula with an origin-oriented extraction factor is based primarily on

AGO 547973

the ground that the extraction factor would generate more tax revenues than the sales factor. Apportionment formulas are not intended to be vehicles to generate tax revenues but are designed to divide income among the states fairly and uniformly so as to avoid multiple taxation.

Finally as to the proposed new tax base and apportionment formula in H.B. 322, the singling out of the oil and gas industry and of companies within the industry having receipts of more than $250,000,000 may well be unconstitutional.

SEPARATE ACCOUNTING -- SENATE CS FOR CS FOR HOUSE BILL 322

I understand that the other major proposal before this Committee is adoption of a tax based upon principles of separate accounting. The declared purpose of this bill is to tax oil and gas production and pipeline transportation income in Alaska by means of a statutory separate accounting, while retaining formula apportionment (as modified) to apportion all other income.

Conceptually, separate accounting constructs an income or loss statement for the activities of a corporation in the state as if it conducted an independent oil and gas production or transportation business solely within Alaska and assumes that all dealings by the business with other

AGO 547974

aspects of its business and with the outside world are at arm's-length. I am sure it is an attractive concept to try to isolate the Alaskan income by what purports to be a rational procedure rather than the fixed formula. But let me suggest, as your Department of Revenue has strongly argued, that this approach is doomed to failure. Perhaps with small localized businesses the concept is workable. But to apply this concept to large integrated multinational oil and gas corporations ignores the unitary nature of their operations. Each element of a corporation contributes to the overall net profit of the business. You simply cannot ignore the contribution of out-of-state activity to the creation of income in Alaska and how will separate accounting deal with this?

Separate accounting, in practice, is impossible to administer and determine. I fail to see how a concept which proved to be unworkable in the 1920's, when business was relatively simple, can be expected to work in today's era of complex multistate and multinational business of which the oil companies are a preeminent example. The apportionment formula was resorted to because separate accounting could not be administered.

The current proposal attempts to avoid some of the inherent problems of separate accounting by arbitrarily defining net income. Allocation of overhead expenses is "solved"

AGO 547975

by simply denying a deduction for such costs. Pricing differences are "solved" by using as gross income the value of the oil and gas produced as determined for purposes of the production tax. And inadvertently, I assume, the proposal results in a double allocation of production income to Alaska, first by allocating production income in Alaska under the statutory separate accounting formula and then allocating to Alaska a portion of the production income outside Alaska under the two-factor apportionment formula. This is clearly a duplication.

Such duplication can be eliminated only by determining production income by separate accounting both in Alaska and outside Alaska and eliminating both, not just Alaskan production income, from the base subjected to the two-factor apportionment formula.

Accordingly, the current proposal does not by definition even approach theoretical separate accounting, and is at least as arbitrary, if not more so, than formula apportionment. It is, indeed another kind of statutory formula.

The proposal has major infirmities. It purports to be an application of separate accounting but it is not and it incorporates a "double dip" allocation of production income to Alaska. It represents a sharp deviation from uniformity and as such would constitute a major disruption of the common consensus underlying the system of state taxation of interstate business income. Separate accounting defined by legislative fiat and applied by one state to a whole industry in order to increase the state's share of the total income

AGO 547976

over that resulting from the three-factor formula necessarily results in multiple taxation because income which is fully taxed by the one state is also apportioned by formula to other states. Such deviant action, particularly when it is directed at one industry, may well be unconstitutional.

Moreover, Alaska must ask itself again whether it is appropriate for it to take unilateral action which will disrupt the progress toward uniformity in the division of income among the states which is essential to avoidance of multiple taxation.

THE MULTISTATE TAX COMPACT

Alaska's continuing membership in the Multistate Tax Compact and the administrative benefits derived from such membership may not be tenable if either of the proposals under consideration are adopted. The courts may find such proposals to be in conflict with the Compact and as a result may hold that Alaska has in effect withdrawn from the Compact or that the Compact remains in effect but enactment of the proposals is ineffective to prevent taxpayers from applying the UDITPA formula under the provisions of the Compact. It will take years of litigation to clarify these issues which will cast doubt on what the applicable law is for taxing the income of the oil and gas industry.

CONCLUSION

The United States Supreme Court presently is considering the constitutionality of Iowa's single-factor sales formula. I cannot predict the Court's decision, nor can I

AGO 547977

predict to what extent a state may tamper with the uniform formula without violating constitutional principles. Perhaps the Court is ill suited to act as final arbiter as to whether one method of apportionment is fairer or more reasonable than another. But I suspect that with the nearly nationwide acceptance of UDITPA, the Court will show less tolerance of deviant formulas which result in multiple taxation. In any event years of litigation as to the constitutional validity of either of the proposals if enacted as well as their compatibility with the Multistate Tax Compact must be anticipated.

Great progress has been made in recent years in adopting uniform apportionment methods. Part of the drive for voluntary uniformity has obviously been the desire of both states and taxpayers to avoid Federal intervention. As long as states strive toward uniformity as a goal of fair taxation, Congress will be hesitant to act. If the drive for uniformity falters through unilateral action by states asserting their currently perceived self-interest without restraint and the Supreme Court declines to prescribe a uniform formula, Congress will be constrained to exercise its constitutional responsibility to protect interstate commerce by prescribing a Federal standard of uniformity in the division of multistate business income.

Alaska has been in the forefront of the drive for uniformity. By the collective judgment reflected in the

AGO 547978

development and general acceptance of the three-factor formula, Alaska's net income tax fairly and effectively reaches its proportionate share of the income of multinational oil and gas corporations doing business within the state. The proposed changes are designed to produce higher revenue, not a fairer division of multistate income, and they would be destructive of the cooperative effort among the states in developing a uniform approach to the division of multistate business income among them.

Madame Chairman and members of the Committee, I want to reemphasize in conclusion that changing the present formula for determining the portion of the worldwide income of oil and gas companies which is taxable in Alaska is not an appropriate way to increase revenues. If Alaska is to act responsibly it cannot ignore the interests of its sister states and in the long run its own interests in maintaining uniformity in the division of multistate business income among the states. If Alaska believes that the apportionment formula is not fair and reasonable as it applies to oil companies, the proper action to take is under Article 18 of UDITPA or through the Multistate Tax Compact or other cooperative state machinery to persuade other states of a different uniform approach, not unilateral legislation which is destructive of uniformity.

AGO 547979

CITIES SERVICE MINERALS CORPORATION
A SUBSIDIARY OF CITIES SERVICE COMPANY
1016 WEST [illegible]H AVENUE
ANCHORAG[illegible] [illegible]SKA 99501

DON STEVENS, PH.D.
DISTRICT GEOLOGIST

(907) 272-5 441

March 17, 1977

Mr. Bill Bishop
Bristol Bay Native Corp.
445 East 5th Avenue
Anchorage, AK 99501

Dear Bill:

Mr. Ranspot and I want to thank you and the Bristol Bay Native Corporation staff for the courtesies extended during our meeting last week. We found our review of the Bear Creek Mining Data to be most interesting and, in fact, these data exceeded our expectations. Bear Creek Mining has done an excellent job in its investigation of porphyry type targets.

As I mentioned on the phone, we have had to decline entering into an exploration agreement with Bristol Bay Native Corporation for a number of reasons in spite of the excellent mineral potential indicated by the data reviewed.

Certainly one important reason for being very hesitant to engage in new minerals exploration programs has been the Hammond administration's attitude toward mining taxes. Not only are attempts being made to adversely change the present mining license tax but several comments by the administration have indicated that an additional severance tax bill is going to be introduced in the next session of the legislature. One needs only to look at what has happened to taxes on oil and gas production in the last ten years to believe that the same thing will happen to the mining industry. With the high capital costs and the high infrastructure costs in mine development in Alaska a high tax burden will simply eliminate any chance for development of a mining industry.

The attractiveness of possible mining operations on native corporation land is being outweighed by the ever more burdensome tax policies generated in Juneau.

Sincerely,

Donald L. Stevens

DLS:bh

AGO 547980

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STATEMENT OF LARRY DINNEEN
ARCTIC SLOPE REGIONAL CORPORATION
BEFORE THE
SENATE RESOURCES COMMITTEE
STATE OF ALASKA
FEBRUARY 22, 1978

I am not here today to play the numbers game related to the corporate income tax legislation before your Committee. But I have a few points to make, based on my years of experience in developing business ventures in several states and working for the Arctic Slope Regional Corporation (ASRC) in Alaska.

The "bottom line" of my statement is this: the enactment of the separate accounting bill or the franchise bill -- or anything in between -- would be bad for Alaskans. Although the <u>intent</u> of both bills my be simply to extract more dollars out of the major oil corporations in Alaska, the <u>effect</u> will be damaging to ASRC, to some 70,000 Native Alaskans and to the future viability of the economy of the State of Alaska. First, I would like to call your attention to some of the specifics in the proposed legislation.

<u>JUST THE OIL COMPANIES?</u>

It is evident from some of the language in both bills that the intent is to exempt the Native Regional Corporations from the provisions of the bills. I believe that in either case, litigation could prove that Native Regional Corporations would not be exempt. This is especially true with regard to the separate accounting bill as the actual amending language in Section 2 relates directly to "income of any corporation derived in Alaska." Additionally, it appears

AGO 547981

deductible costs would not include the costs of the consultants that we have had to hire in Seattle, Washington, D.C. and elsewhere to deal with the myriad of government problems that are facing us . and to ensure that we are getting the most expert advice on our business matters. Since the Committee is addressing the separate accounting bill in particular, we felt that it was important to bring out these two points.

But the major point is that we do not feel that it is in Alaska's interest --and particularly with respect to ASRC and other Native Regional Corporations -- to change the corporate income tax laws affecting the major oil companies or anyone else, particularly at this time in Alaska's history. Even if we were exempted ultimately from the language of the corporate income tax legislation, the effects of raising taxes on the oil industry in Alaska would be directly damaging to ASRC and thousands of other Alaskans. Although I will develop this point further in my testimony, I want to mention now that ASRC and other corporations are engaged in a great deal of contract work for the major oil companies. And, while no one expects the Prudhoe Bay companies to leave the State altogether, there is no doubt but that the amount of exploratory work going on in Alaska could and should be much higher. And with exploratory and development work comes jobs for Native Alaskans in the form of contract work. Yet this is only one important aspect of the tax issue that I would like to call to your attention.

AGO 547982

THE BILLION BARREL OIL FIELDS PROBLEM

Last year, Revenue Commissioner Sterling Gallagher spoke about our problem to the Federal Energy Administration officials dealing with North Slope oil pricing in discussing the Lisburne and Kuparuk oil pools:

> "The Lisburne and Kuparuk pools are illustrative of the case for most-likely discoveries on Alaska Native lands selected under the Alaskan Native Claims Settlement Act. It is far more probable that any discoveries on Native lands will be in the 1 to 2 billion-barrel range like Lisburne-Kuparuk, than in the 8 to 10 billion-barrel range like the main Prudhoe pool." 1/

The problem for ASRC is that we need to raise capital in order to find these fields and we need oil company expertise both to find and develop them. But the future is not PRUDHOE-BAY SIZED FIELDS.

Costs in Alaska are extremely high, and there are many other places still left in the world -- including the North Sea -- where drilling operations are more profitable than they have been and especially will be in Alaska. The wellhead value, after subtracting transportation, etc, is only about $3 these days, and with smaller sized fields as the likely prospect for future discoveries, we can not afford to continue raising taxes on the oil industry without directly reducing the likelihood of finding and developing marginal fields. Needless to say, this is of some concern to ASRC in particular, but all 70,000 Natives are also directly affected...

1/ Statement of Commissioner Sterling Gallagher, Department of Revenue, State of Alaska to the Federal Energy Administraion Regarding Alaska North Slope Crude Oil Price and Entitlements Issues, Washington, D.C., March 21, 1977, p. 3.

AGO 547983

ALASKA NATIVES: THE LOWERING OF EXPECTATIONS

With the enactment of the Alaska Native Claims Settlement Act, it was hoped that the Alaskan Native might at last be able to have more of what some have called The American Dream. More choices in terms of employment and lifestyle. And a strong economic base from which to build for their children and grandchildren.

But problems with the Federal Government have multiplied, causing long delays in land transfer and incredible costs. The importance of the D2 issue cannot be overstated. The threat to village lifestyles and subsistence living is very great. Yet few seem to realize that the State government is another direct threat.

If either of the corporate income tax bills were to pass, there would be an immediate effect, not only on the oil companies but also on every Native in Alaska. There would be an immediate reduction in the value of Native land to the Natives who have made their selections in large measure for resource value. All Natives are affected because of Section 7(i) of the Act which provides that 70% of the revenues received by an Native Corporation for hard rock minerals or oil and gas discovered on the Corporation's land will be shared with the other Corporations.

Thus, if ASRC cannot get a billion barrel field developed or more fields found, every other Native Corporation and its stockholders will also be adversely affected. Not to mention the adverse affect on the State of Alaska itself over the long term.

AGO 547984

THE THIRD ALTERNATIVE

In conclusion, I would like to highlight a number of important points that Milton Lipton made in addressing this Committee on January 25th. First, despite any perceived "deficiency" in Alaska's corporate oil income tax laws, Lipton endorsed the Arthur Andersen study and stated that the figures are "revealing." Lipton also pointed out that the Legislature should note that "the deficiency in your corporate income tax receipts from the oil and gas producing industry is at least and probably more than made up by higher severance and ad valorem taxation which the Legislature has already imposed upon the industry."

Additionally, Lipton took a good bit of time expressing the importance of perceptions. He stated that the impression which the State of Alaska presents "may be even more important in discouraging investment than the fact of the tax burden per se." He spoke also about the dangers of giving the impression of having an "ad hoc taxing policy" which increases taxes year to year "dedicated to the budgetary needs, revenue deficiences, or whatever the case may be." As a businessman, not an economist, I have noted that the perception of Alaska as a good plce to invest is already poor.

And Lipton seriously presented what he called the Third Alternative: not to amend the income tax statute. It seems to me that the two corporate income tax bills may make more dollars and cents for the State in the near term but that it makes much more sense for Alaska at this point to stop changing the oil and gas tax laws.

AGO 547985

Prudhoe Bay production will begin to decline in about eight years. Once a new field is discovered in Alaska, it takes about eight years to get it into production. We need much more exploration now and many more discoveries in the future to replace the income from Prudhoe Bay. A tax hike now could mean the loss of far greater revenues in the future for the State from the development of the remaining smaller fields. And we must face the fact that there probably will not be any more Prudhoe Bays in Alaska.

The Native interest in this matter is clearly the value of our land, revenue and jobs. But the importance of the perception of Alaska is important to all Alaskans. With billions of dollars of surplus revenues projected by the State for the future, we do have time. The passage of these bills would not just reduce oil companies' profitability. Either one would be damaging to the economic aspirations of all Alaskans and particularly Alaskan Natives.

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AGO 547986